THE CURRENT EUROPEAN UNION INVESTOR STATE DISPUTE SETTLEMENT REFORM: A DESIRABLE OUTCOME FOR INVESTMENT ARBITRATION?

Pierre Collet*

I. INTRODUCTION .................................. 689
II. INVESTOR STATE DISPUTE SETTLEMENT (ISDS) .... 690
III. THE E.U. POSITION TOWARDS ISDS .............. 691
   A. Internal Pressure: Compatibility with the E.U. Legal Order .......................... 694
   B. External Pressure: Global Political Contexts Fostering Excessive Criticism .......... 695
IV. THE EUROPEAN UNION’S ONGOING REFORM OF ISDS ........................................... 696
V. E.U. ISDS REFORM: A STEP BACKWARD ........... 698
VI. CONCLUSION .................................... 700

I. INTRODUCTION

On May 5, 2020, the majority of European Union member states signed a termination agreement to effectively bring an end to all bilateral investment treaties (BITs) concluded between two E.U. member states.¹ This agreement is a turning point in the European Union’s efforts to reform its own Investor State Dispute Settlement (ISDS) system. This reform is meant to replace the current ISDS system with a new framework that would eliminate investor-State arbitration. The European Union has advanced several revolutionary propositions, such as the creation of a Multilateral Investment Court (MIC) and an appeal mechanism, which can be observed in the latest

* LL.M. Candidate in International Business Regulation, Litigation and Arbitration, New York University School of Law; Master’s Degree in International Law, University of Paris 1 Panthéon-Sorbonne. I am very grateful to Clara Correa and Pauline Morgan for comments and suggestions on my earlier drafts.

E.U. free trade agreements (FTAs). The current reform effort finds its roots in strong criticisms leveled against the existing ISDS system, including a bias towards investors, a lack of transparency and consistency, and the infringement on states’ right to regulate in the pursuit of public interest. In the context of general distrust towards free markets and liberalism, it remains unclear whether these criticisms are well-founded.

The inherent conflict between the ISDS system and principles arising from the E.U. legal order forged the European Union’s position towards ISDS. In Achmea, the Court of Justice of the European Union (CJEU) declared that E.U. law prohibits investor-State arbitration because it is contrary to E.U. principles. The content of E.U. ISDS reform provides useful insight into the potential future of ISDS and whether it constitutes a step backward. This article discusses and addresses the pros and cons of E.U. ISDS reform. It begins by presenting the background of the ISDS system, followed by an overview of the European Union’s position and an analysis of its potential motivations for attempting a reform. The article considers the reform a step backward and concludes by identifying the new problems created by the reform and the vacuum left by the potential end of investor-State arbitration.

II. INVESTOR STATE DISPUTE SETTLEMENT (ISDS)

Investor-State arbitration emerged as the default ISDS mechanism in the nineteenth century as a peaceful alternative to the classical means of dispute settlement between states: war. Modern investment arbitration arose from the dramatic acceleration of international exchanges in the last sixty years, the institutionalization of arbitration with the creation of the

---

International Centre for Settlement of Investment Disputes (ICSID) in 1966, and the conclusion of BITs between states.\(^8\)

BITs provide substantive protections for investments made by investors from one of the two contracting states in the territory of the other contracting state, including a guaranteed level of legal protection and compensation for expropriation.\(^9\) Within this framework, foreign investors have direct claims against states which interfere with their investments.\(^10\) Arbitration became the primary international investment dispute settlement mechanism, largely because it offered an impartial forum, expertise to handle complex business matters, flexibility, and efficiency.\(^11\) Although the European Union is a major investment hub, for the past decade it has taken an offensive position against the current ISDS system.

### III. The E.U. Position Towards ISDS

The European Union takes a critical position of the ISDS system, grounded in the main criticisms coming from states, scholars,\(^12\) and NGOs.\(^13\) Among the most vocal states, South American countries were the first to distance themselves from the ISDS system by terminating BITs with ISDS clauses or withdrawing from the ICSID Convention.\(^14\)

---

8. More than 3,000 BITs have been concluded in the past sixty years.
12. Franck, *supra* note 3, at 1558; See generally Louis T. Wells, *Backlash to Investment Arbitration: Three Causes*, in *The Backlash Against Investment Arbitration: Perceptions and Reality* 341 (Michael Waibel et al. eds., 2010) (identifying some of the systemic concerns, such as limitations on domestic policy space, a lack of democratic accountability, a systemic pro-investor bias, and the inability of treaties to respond to changes in economic circumstances).
14. During the last decades, Bolivia, Ecuador, India, Indonesia, and South Africa have terminated BITs with ISDS clauses. *Termination of Bilateral
The ISDS system is often often perceived as favoring investors because of the imbalanced protections between investors and states in BITs. The system if replete with potential conflicts of interest, as the small group of people involved in investment arbitration can be arbitrators in one case and counsel in another. Accordingly, arbitrators might face incentives to rule in favor of the parties who appointed them to assure their appointment in future cases. However, there are rules allowing arbitrators to be challenged or removed when they are not impartial. Moreover, professional credibility and recognition play a significant role in both the appointment and reappointment of arbitrators. From 1987–2007, among the 548 ISDS cases concluded, thirty-seven percent were resolved in favor of states whereas twenty-eight percent were resolved in favor of investors.

The lack of transparency is one of the main criticisms toward the ISDS system. Confidentiality and secrecy characterize arbitration. Although parties appreciate these characteristics, they can become a problem when issues involved are of a pub-


16. E.g., ARR. INST. OF THE STOCKHOLM CHAMBER OF COM., 2017 ARBITRA-
TION RULES, art. 19 (2017), https://sccinstitute.com/media/1407444/arbi-
pute_Resolution_Services/lcia-arbitration-rules-2020.aspx#Article%2010
[https://perma.cc/52RL-BWLC].

17. Franck, supra note 3, at 1596–98.

lic nature, which is often the case in investment arbitration. It is increasingly problematic that decisions which can lead to national laws being revoked and justice systems challenged need not be disclosed.19

This lack of transparency has been addressed at both the national and international level.20 At the international level, the ICSID Arbitration Rules encourage parties to allow awards to be published.21 Additionally, the UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration give the tribunal authority to make all documents, testimony, and proceedings transparent, unless the information is found to be confidential or protected, and provide for publication of documents in a central repository.22

Investment arbitration has also been considered an infringement on state sovereignty. This criticism comes from provisions in BITs that protect investors from sudden changes of law in the countries of their investment. These provisions are seen as an infringement upon states’ right to regulate in pursuit of legitimate public interests. Finally, investment arbitration is inconsistent in its decisions. Different arbitral tribunals faced with the same facts or questions of law have reached different conclusions.23 However, inconsistency constitutes a minority of cases that are not representative of the system.24 In

20. See, e.g., SING. INT’L ARB. CENTRE, SIAC RULES, art. 32.12 (2016) (allowing arbitration awards to be published with consent of the parties).
21. ICSID Arbitration Rules, supra note 16, art. 48(5).
addition to these criticisms of the ISDS system, internal and external pressures are influencing the E.U. position.

A. Internal Pressure: Compatibility with the E.U. Legal Order

The E.U. legal system is based on a fundamental principle of autonomy affirmed by the CJEU. The internal dimension of this principle provides that the powers of E.U. institutions cannot be eroded by national authorities and that E.U. norms cannot be outlawed by national legal systems. The external dimension ensures that international courts do not question those powers and that international law does not supersede E.U. law within the E.U. legal order. The exclusive jurisdiction of the CJEU over the application and interpretation of E.U. law guarantees the principle of autonomy. As a result, E.U. member states are prohibited from submitting to any dispute settlement which would interpret E.U. law through any mechanism other than those provided by E.U. law.

But investment arbitration, due to its very nature, was destined to collide with this principle of autonomy. Arbitration disputes involving E.U. member states could potentially involve the application or interpretation of E.U. law. With two landmark decisions, the CJEU underlined the incompatibility of E.U. law and the investor-State arbitration system. The first decision, Achmea, deals with investor-state arbitration between E.U. member states. The court’s reasoning was based on two principles: the autonomy of the E.U. legal order and the principle of mutual trust between E.U. member states. In regard to the first principle, the court noted that as a jurisdictional matter, an arbitral tribunal applying or interpreting E.U. law

27. Id.
would not be subject to the control of the CJEU. In regard to the second principle the court determined that E.U. member states enjoy an equal legal level of protection. If impartiality and legal protections are no longer an issue between E.U. member states, investor-State arbitrations become useless in disputes involving Member States. The second decision, Opinion 1/17, deals with the concerns raised by investor-state arbitration provisions in agreements between the European Union and other countries. In Opinion 1/17, the CJEU laid down the conditions for making such arbitral mechanisms compliant with E.U. law. In this case, the CJEU ruled that the Comprehensive Economic and Trade Act (CETA) between the European Union and Canada was compatible with E.U law because the MIC established by that agreement could only consider domestic law as a matter of fact. As a result, the tribunal would never have to interpret or apply E.U. law. Arbitration is permissible as long as it does not approach the perimeter of E.U. law. E.U. reform arises mainly from internal constraints, such as the need to protect the E.U. legal order and avoid jurisdictional conflicts.

B. **External Pressure: Global Political Contexts Fostering Excessive Criticism**

The backlash against globalization and liberalism distinguishes the current global political context. The expansion of FTAs has been temporarily put on hold and public opinions have shifted to praise nationalist positions. Claims brought by multinational companies against states have been seen as a way to protect corporate profits over individual human rights. As the primary dispute settlement mechanism in international investment, investment arbitration has been the symbol of broken globalization and excessive liberalism.

---


34. Id. ¶ 123–24.
In the current “post-truth” era, emotional arguments are more powerful than objective fact in changing public opinion. A tiny fraction of arbitration has been used to sully arbitration mechanisms. For example, when tobacco and chemical companies brought actions before arbitral tribunals to challenge state legislation on health and environmental interests, public opinion and governments became convinced that the system was inherently unfair and biased. But this contention is misleading given that the majority of decisions are rendered in favor of states.

IV. THE EUROPEAN UNION’S ONGOING REFORM OF ISDS

The European Union’s reform attempt has been extensively laid out in European Commission communications but has not yet been fully implemented at a large scale. However, recent FTAs include principles of this reform and give a general idea of what the European Union envisions at a global level.

The first reform measure is the creation of permanent courts of arbitration. The first part of this measure is the establishment of an investment court system pertaining to single investment treaties. The European Union has already applied this measure in several FTAs. In the CETA, the ad hoc arbit-

35. Stern, supra note 4, at 15–16.
36. The most infamous example is perhaps when Philip Morris, a tobacco company, challenged Australia’s ability to promulgate measures to reduce smoking in the interest of health. Philip Morris Asia Ltd. v. Commonwealth of Austl., PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (Perm Ct. Arb. 2015).
38. UNCTAD, supra note 18, at 5–6.
The tribunal was replaced by a tribunal of fifteen members and an appellate tribunal previously appointed by the CETA Joint Committee. This measure is part of a more ambitious proposal, not yet realized, to create a MIC open to all states. The long-term objective of both the CETA and European Union-Vietnam tribunals is to convert this bilateral system into a multilateral one that would incorporate all investment courts. A permanent court of arbitration could address the issue of inconsistency, as all disputes would be heard by the same court. This court could provide a degree of predictability in terms of regulatory stability, as well as enforceability of investor’s rights or obligations. It could also address the issues of independence, impartiality, and transparency as judges would be appointed by states. Member states would also be able to refer questions for preliminary rulings to the CJEU, which would result in more legitimacy for the MIC. Finally, it would be a way to address the issue of competition. In a globalized world, E.U. investors are not only competing against investors within the European Union, so the MIC would correct the asymmetries facing all E.U. investors vis-à-vis non-E.U. competitors.

The second proposal, already implemented in several FTAs, is the establishment of an Appellate Body. The new body would oversee appeals for errors of law and fact contained in awards issued by arbitral tribunals. An appeal process and permanent investment court would address the issue

41. CETA, supra note 2, art. 8.27, 8.28.
43. CETA, supra note 2, art. 8.29.
44. Free Trade Agreement Between the European Union and the Socialist Republic of Viet Nam, art. 15.7, 2020 O.J. (L 186) 3, 145.
47. E.g. CETA, supra note 2, art. 8.29.
48. Zarra, supra note 42, at 144.
of inconsistency within awards, as the appellate tribunal would be able to correct decisions inconsistent with previous dispute resolutions and therefore uphold a consistent jurisprudence. An appeal process would also normalize arbitration by making it seem more like a classic adjudicative process rather than a private, biased justice system for wealthy companies.

V. E.U. ISDS Reform: A Step Backward

The ongoing E.U. reform of ISDS seems to be a step backward as it will do away with the core benefits of arbitration: flexibility, expert decision-making, speed, and enforceability.

The end of BITs will result in less protections for investors, who will be deprived of one of the most efficient ways to access justice. Big enterprises will still be able to require arbitration in their contracts or use letterbox entities, but small and medium-sized enterprises may be shut out. There is also a fear that E.U. investors will be discriminated against in their access to dispute resolution mechanisms. Moreover, the end of intra-European Union arbitration could make the European Union less attractive, as big companies and investors particularly appreciate this mechanism.

There are questions concerning the equivalence of protection between BITs and E.U. law. The principle of mutual trust creates a legal fiction that the legal protections in every E.U. member states are equivalent, but in reality this is far from the case. The European Union’s recent communications and resolutions raising concerns over the impartiality of Poland and Hungary’s legal systems are significant. Reliance on national courts may raise a bias in favor of states, and different legislatures in the E.U. member states could promulgate different investor protections.

The appellate mechanism goes against one of the foundational principles of arbitration: efficiency. An appellate mecha-

nism would require more resources, time, and funds. In cases involving complex transactions, these issues of time would be critical. Arbitration is already criticized for being costly.\footnote{E.g., Steven Seidenberg, \textit{International Arbitration Loses Its Grip}, ABA J. (Apr. 1, 2010), https://www.abajournal.com/magazine/article/international_arbitration_loses_its_grip [https://perma.cc/J8RX-YMWR].} By creating an appeal mechanism, the European Union is increasing the cost and thereby restricting access to arbitration to a group of wealthy entities. Resolution would also take longer, as an appeal would delay states in recognizing and executing arbitration awards. The WTO Appellate Body offers a glimpse into the potential future: From 2011–2018, appeals were initiated with respect to sixty-seven percent of panel reports.\footnote{Appellate Body, \textit{Appellate Body Annual Report for 2018}, at 13, WTO Doc. WT/AB/29 (May 28, 2019).} Therefore, there is a high probability that the E.U. appeal mechanism would be used in a similar pattern.

The creation of permanent arbitration courts goes against another principle of arbitration: fairness. A court composed of judges exclusively nominated by states may create a new bias in favor of states to the detriment of investors and raise an issue of impartiality. There are serious concerns about states appointing judges with particular views or backgrounds that would favor state interests.\footnote{Brower & Ahmad, \textit{supra} note 51, at 1179.} Arbitration was meant to be an equal system where each party has the right to appoint a judge to the dispute. In this new system, the investor would lose this right and the appointment of judges would be entirely controlled by the states. A permanent court of arbitration would also seriously hinder the diversity of arbitrators. The current body of arbitrators is already considered problematic.\footnote{See ICC Releases 2019 Dispute Resolution Statistics, Int’l Chamber Com. (July 15, 2020), https://iccwbo.org/media-wall/news-speeches/icc-releases-2019-dispute-resolution-statistics/ [https://perma.cc/ZN23-Q96U] (nothing that 71.7\% of arbitrators in 2019 came from Europe, the United States, or Canada, and only twenty-one percent of all arbitrators were women).} A body of fifteen appointed judges, like in the CETA,\footnote{CETA, \textit{supra} note 2, art. 8.27.} could lead to a dramatic decrease in diversity as well as a decrease in competence. The ability to choose judges allowed the parties to appoint experts in their field. Parties and counsel placed high value on this ability to vet the relevant experience of arbitrators in a given industry, especially in complex business dis-
putes. Finally, the other danger is the risk of politicization of the court. As judges will be appointed by states, states may be able to disrupt the judicial process. One need not look further than the current crisis in the WTO Appellate Body for a warning example: U.S. refusal to appoint judges to the Appellate Body has completely blocked the judicial mechanism of the WTO.

In conclusion, the creation of a MIC seems unrealistic given the current political context. In a world dominated by distrust of multilateralism, new initiatives such as a MIC are less welcome now than before.

VI. CONCLUSION

The current ISDS system is far from perfect and needs to change, but the E.U. ISDS reform is likely to create more problems than solutions. Losing the possibility of arbitrating to obtain justice would cause great harm to investors and states. The misguided reform is based on criticisms that are not representative of the overall ISDS system and, problematically, the European Union could have a global impact on the future of the ISDS system. Since the Treaty of Lisbon, the European Union has enjoyed exclusive competence over commercial policy, including investment policy, allowing it to present a coherent position for twenty-seven countries. Moreover, the E.U. proposal to create an MIC is not limited to the European Union and is meant to include as many states as possible. Finally, concrete implementations of E.U. policy can be seen in its latest FTAs. The European Union thus has a significant impact on ISDS reform.

Although investment arbitration reforms are needed, the European Union should favor incremental reforms over radical changes. Step-by-step improvements have already started

57. Bahrain UNCITRAL Submission, supra note 45, ¶¶ 27–34.
with new BITs providing a more balanced framework for dispute settlement;\textsuperscript{61} emphasizing health, safety, and environment and sustainable development; and including new transparency instruments. There is no need for a revolution: the reform is already underway.\textsuperscript{62}

