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Taking the 'MIC': Questioning the European Union Rationale for Establishing an Investment Treaties Court

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The European Union Commission (EC), after the 2009 entry into force of the Lisbon Treaty (available at https://bit.ly/34TUxpu) updating the European Union, acquired a new competence in the foreign investment field among other areas of law.

More recently, it has decided to persuade a large majority of the member states to adhere to a project aiming to replace the old ISDS (Investor-State Dispute Settlement) processes through ad hoc arbitration or, in many cases, arbitration administered by ICSID (the International Centre for Settlement of Investment Disputes), by a system based on a multilateral investment court, or MIC.

The result has been the signing of a multilateral agreement between those member states and the EU for the termination of all investment treaties entered bilaterally between and among those member states—so-called *intra* BITs, or *intra* bilateral investment treaties. The 2020 agreement is known as the Termination Agreement. The ground was that the intra BITs are incompatible with EU law.

The countries were: Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, and Slovakia. The United Kingdom did not sign due to the then-prospective Brexit.

Some EU member states—Germany, France, the Netherlands, Austria, and Finland—agree with the Termination Agreement, but have maintained that in parallel the EC also should afford European investors with a guarantee on substantive and procedural investment protection so as to maintain a level playing field vis-à-vis their foreign competitors.

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The Termination Agreement has created a vacuum in investment protection for intra-EU investors and done nothing to fill that vacuum. See Agreement for the Termination of Bilateral Investment Treaties between the Member States of the European Union (available at https://bit.ly/3iqsTn3).

The rationale for the moves was:

- Intra BITs benefit the bilateral parties in each BIT, but without similar protection for all the other member states which are not parties of each bilateral agreement, which is against the principle of equality provided for in the EU founding treaties; and
- Arbitration tribunals have no power to construe EU law or, contrarily to member state courts, have no power to request from the EU courts an opinion about any specific point of the EU law which has been raised in an arbitration process.

The Court of Justice of the European Union adjudicated a decision based on this second ground in the *Achmea* case (see below), which constituted a decisive and probably ultimate reason for the Commission to leave private arbitration out of the new ISDS system.

The EC has informed, in addition, that the ISDS provided for in the Energy Charter Treaty (or ECT) also will be reviewed similar to the intra BITs. The European Court has repeated the jurisprudence held in the *Achmea* case (*Slowakische Republik v Achmea BV. 9*, Document 62016CJ0284, Judgment of the Court (Grand Chamber) (March 6, 2018) (available at https://bit.ly/2Kf8OmM), but now related to energy disputes.

This was the jurisprudence adjudicated in the *Komstroy* case (C-741/19 *Republic of Moldova v Komstroy LLC*, ECLI:EU:C:2021:655 (Sept. 2, 2021) available at https://bit.ly/3sQXgbT)). In short, the Court also said that the Energy Charter Treaty-based intra EU arbitrations are contrary to EU law.

In addition to this reasoning, the EC has also firmly supported the need to set aside the old ISDS arbitration system based on other particular aspects that the EC holds are critical, such as a lack of transparency of the arbitration process, a lack of arbitrator impartiality, a lack of consistency of arbitrator's awards, and lack of predictability of their decisions.

Another concern is based on the fact that the EC has been a real champion in supporting the state's power to regulate certain activities affecting the public interest, which has been blocked by some constraints imposed by investment agreements or by the BITs themselves. This is generally referred as the states' *right to regulate*.

This issue is, consequently, a reason to ensure that the states must have the unlimited power to regulate such activities even if they interfere with the investors' rights either as provided for in investment agreements or in the BITs.

In this context, it's not difficult to conclude that the EC believes that arbitrators are less prepared than judges to understand, apply, or decide measures which have been taken by states' governments, likely including amending or disregarding the investment contract or the applicable BIT, in order to meet their public interests.

Current Prospects

It should be pointed out that, in parallel with the negotiation of the Termination Agreement through which intra BITs were terminated that the EC concluded, in the meantime, negotiations continued with third countries to sign comprehensive Free Trade Agreements.

The following free trade agreements have been signed in recent years: CETA (Comprehen-

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sive Economic and Trade Agreement) between EU and Canada; EU and Singapore; EU and Japan; EU and Vietnam, and EU and China.

In all these treaties except the one with Japan, the parties agreed on the submission of investment disputes to a unique multilateral investment court, instead of arbitration tribunals as was the case before the signing of the Termination Agreement. (As a matter of fact, these FTAs relate not only to investment protection, but also detailed collateral aspects concerning the topical matter on how to solve investment disputes). The EU and Japan FTA agreed to wait for the clarification of the system to be followed to solve investment disputes under the auspices of UNCITRAL (in Working Group III, Investor-State Dispute Settlement Reform (available at https://bit.ly/3wWL5xH).

Beyond the EU

The EU understood that a new investment disputes settlement system based on a multilateral investment court should not be confined to the member states that had entered into intra BITs with other EC members states, but should involve all other third states with which the EC representing all member states has entered investment treaties.

As a matter of fact, under the EC regulation about investment disputes after the Termination Agreement has entered into force only the EC is authorized to execute new investment treaties with third countries on behalf of the member states. The Commission will represent all member states in negotiating and signing new bilateral or multilateral treaties on investment with third countries.

With this in mind, the EC endorsed UNCITRAL carrying on the consulting process and discussions with stakeholders in order to get a consensus on the format and substance of a new ISDS system.

A final decision about this is still not predictable. Two main distinct positions are at stake:

- First, the setting-up of a multilateral court composed of a certain number of adjudicators appointed by the parties—that is, the states that are interested in participating, or
- Second, a hybrid system comprising arbitrators, as first-instance adjudicators, and an appellate body integrated—or not—into the EU judiciary system which would be entitled to review the arbitration award on errors in law or manifest errors in fact and serious procedural shortcomings.

The first alternative is clearly the one supported by the EC, even though, as noted, the EC is waiting for the efforts of UNCITRAL Working Group III. The U.N. Security Council adopted, on March 20, 2018, certain directives that will guide UNCITRAL in its Working Group III efforts, which are practically the ones proposed by the EC.

Arbitration, Set Aside

The territory & the ADR forum: The European Union, and the many bilateral investment treaties between members.

The process: Investor-State Dispute Settlement.

The 'improvement': The European Commission has terminated the BITs' dispute resolution process. It is being replaced with something, TBD. The author backs the existing bargained-for arbitration processes, and the fear here is that the new methods will be much worse.

Briefly, these directives are:

- A multilateral investment court will be open to the access of all interested states;
- The MIC will be a permanent international institution. This is the opposite position to the old arbitration tribunals which have been set-up on a case-by-case basis;
- The MIC's adjudicators should be preferentially high-qualified, not necessarily professional judges subject to a strict code of conduct, including on ethics and conflict of interests;
- A balance of regional and gender representation of adjudicators will be required, in addition to ensuring an efficient and effective court management;
- In view of safeguarding the guarantees of impartiality and independence, the adjudicators are expected to receive a permanent remuneration and they shall be appointed following an objective and transparent process for a fixed, long, and non-renewable period of time, enjoying security of tenure;
- The adjudicators should be appointed as court members.

The MIC may function both as a first-instance court, and an appeals court to review the judgments issued by the first-instance court, on the grounds of errors in law or manifest errors in fact, as well as serious procedural shortcomings.

As to costs, the MIC would be expected to allow for scale economies. Frivolous claims shall be under evaluated and dismissed.

As to transparency, the MIC shall publish online details of its activity and allow third parties (such as NGOs, trade unions, consumer groups, and business associations) to file submissions. It has been held that this will allow the MICs to address the criticism for an alleged lack of transparency in traditional arbitration tribunals.

The MIC is expected to place itself far from being similar to an arbitration tribunal.

At What Risk?

What is the risk and price of the nationalization of investor-state dispute settlement?

First, the EC has had only one view of the systemic reform of the ISDS through an MIC. To implement it, the EC has, indeed, used some heterodox powers to guarantee, via the Termination Agreement, the existence of an MIC and to let go the far-away arbitration tribunals and intra BITs.

This, however, was not the best decision. It is understandable the interest in reforming ISDS, but it appears that too many people are dealing with this matter with little preparation for it—impetuously motivated by a strong political focus against arbitration and disregarding serious consequences of this position.

The concept of an MIC is based on an idea instilled in courts of law to solve disputes, and

this has already proved that it is not the best way to proceed with international disputes. The envisioned system is exactly what the ISDS arbitration system adopted in view of eliminating partial decisions by the courts, a lack of preparation and inefficacy.

It's sure that the MIC will work in a different context. The old courts heard international investment disputes, but the basic pillars are the same—judges without enough preparation to hear complex and sometimes too technical matters.

The EC decided to terminate the intra BITs signed by the member states which adhered to the Termination Agreement in a quite strange manner. Here are the effects of the moves:

First, it persuaded the member states to accept the ISDS reform to eliminate arbitration from the scene, and to create a court which is still not clear how it will resolve international investment disputes. The EC has an idea, but it's unclear how it will operate and be favorable to the economy, particularly for countries needing to attract foreign investment.

The EC dismantled a system without having another to immediately replace the former one. This sounds quite strange. This is too serious and important a matter to be solved by a system which is absolutely unknown and without any clue about its potential success.

This appears to have just been an EC exercise either to ensure the observation of the right to regulate by the public authorities of the member states, or to build a good relationship with certain European Parliament parties and social movements, or other unknown purpose.

It's sure that the EC endorsed this task to UNCITRAL in order to get larger international support from non-EU member states. But the U.N. Security Council appeared laboriously to establish directives to limit UNCITRAL's function. That is, a perfect circle of governments agreed on a matter of common interest and pushing the economies and investors out of the business of reform.

Second, the EC has pursued its purpose of influencing third states, via the entering into of free trade agreements with them, and will attempt in this manner to bind the parties to solve investment disputes through an MIC.

Third, investors will move off the scene and will lose the right to participate in selecting the adjudicators, which may be, in many situations, crucial for a good decision in a case.

Fourth, who can guarantee that one judge selected at random from a number of people coming from different places around the world is better qualified to resolve disputes than a panel of three experts whose adjudicators' profile and capacities the parties know?

Fifth, the MIC judges will not be in long-term offices—nine years has been the speculation. The EC says it would assure impartiality and enough knowledge for a judge to address and resolve the global issues related to international investments. A long-term office either can offer a judge with a good long performance . . . or a long bad performance.

Sixth, the MIC capacity and efficiency, which may justify its creation instead of arbitrators, still hasn't been demonstrated or explained fully. Therefore, the Commission's criticism of ISDS based on arbitration noted at the outset (i.e., lack of transparency, impartiality, awards consistency, etc.) is still not tested in the context of an MIC's activity.

Seventh, we can accept that investment arbitration needs reform, but this should have been UNCITRAL's work, and not what is now happening, which is a pure political decision disguised by apparent negotiations that are directed exclusively toward a solitary option, the EC's idea of an MIC.

Transparency Criticism

Let's come back to the main criticism to the ISDS system based on ad hoc arbitration, which has been the proceedings' lack of transparency.

The EC has supported this criticism and designed a new scenario for the MIC project where, beyond the disputing parties, also NGOs, unions, groups of citizens and business associations would be admitted to intervene. Is this workable?

That is, this will be an investment dispute transfigured in a festive gathering, a kind of sub-"class action" dispute without any legitimate sense and purpose in an international investment courtroom.

In a number of situations, if not all, an investment dispute carries secrecy requirements for filings and data, which in particular for the investors is needed to preserve competition and their partners' security. The EC apparently either defends people implementing data protection on laws or forgets secret data allowing their public exposure.

Everything here appears oriented to meet the governments' interests before the voters, but not necessarily in the interest of the economy of the nations.

Arbitration is able to comply with this important goal. An MIC, as it has been conceived, will not be able to do so, because it is positioned, and its very structure seeks, to expose the most fundamental interests of the investors who are risking not only losing a more secure and transparent system of solving disputes, but also exposing too much their business secrets.

To be sure, the need to know, either by the public or the shareholders, as the case may be, have their rightful places for analysis and discussion in accordance with the local law and, surely, for the investor's shareholders and their bankers.

What Kind of Experts?

But as to other aspects of these issues, let's imagine that an MIC judge is not able to understand the dispute in part or in full or certain facts of a complex technical dispute, and unable to decide the case appropriately.

A logical solution is to get the help of experts. But what kind of experts? Resident experts of the court seat? If that expertise is contradictory, do the parties have power to intervene on the expert conclusions? What may be an ordinary expert-witness procedure in arbitration could become a real mess in an MIC.

And at what costs and length?

As to the text negotiated in the Transatlantic Trade and Investment Partnership, and known in the United States as TAFTA—the Transatlantic Free Trade Agreement—together the so-called TTIP/TAFTA draft treaty—and as discussed in Manuel P. Barrocas, "TTIP/TAFTA Dispute Resolution System: Why a Move to Judges From Arbitrators Raises Concerns about the Treaty," 35 *Alternatives* 35 (March 2017) (available at https://bit.ly/3gOhEoq)—it has been emphasized that judges who could compose a court like an MIC be civil servants nominated and paid by the states involved.

Or they may be—if not professional judges—academics or retired politicians who were probably trained in the public sector with

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the consequent tendency to understand public interest in a certain manner.

Of course, arbitrators also may face some of these same or similar pressures and biases, as well as their own issues emanating from the source of their placement on tribunals. Like professional judges, arbitrators have ethical and professional code responsibilities to uphold, depending on the jurisdiction and their professional status.

But it should be highlighted that there is a regime for setting aside arbitration awards in which a lack of independence may be scrutinized and awards declared null and void by courts of law—that is, state courts composed of professional judges.

Why would such a court be better than properly selected, installed, and supported arbitrators?

As stated above, it is true that the current ad hoc arbitration system needs some reform, including to accommodate, within the European Union, the *Achmea* judgment of the Court of Justice of the European Union, but for this there are several methods that might follow, including (1) the creation of an appellate court which could be, in some way, integrated into the EU judiciary system or, as an alternative, (2) an appellate court formed by adjudicators—judges or arbitrators—to hear exclusively matters that have to do with the interpretation and/or enforcement of the EU law.

States' right to regulate is a matter that does not concern arbitration or the judiciary. Once such rights are included in investment treaties, they must be respected by the arbitrators.

ICSID is a good example on how an official institution—the World Bank—has worked in a well-organized way where an appellate option is unavailable, instead offering a Supplementary Decision or Rectification. See ICSID's Post-Award Remedies—ICSID Convention Arbitration at https://bit.ly/3x1K4V5.

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To conclude, there is a paradox between the state's interest in assuring the right to regulate under certain conditions, and the contrary, which is the states' interest in attracting foreign investment and avoid hindrances to investors and their banks when deciding to make or support an investment.

The EC should avoid going too deep and radical in the matter of settling investment disputes. It should give a clear signal by adopting good policies to really protect foreign investments as a fundamental vehicle of growing the economy in the target country—and keep the politics and rhetorical speeches out of this matter.

In the meantime—and without about 130 intra BITs which have protected foreign investment within the EC—someone will benefit from this situation, but not the EC investors vis-à-vis their competitors from non-EU countries.

The EC's proposition to the EU member states that entered into the Termination Agreement of going to national courts of law to solve their pending investment disputes with another member state in any process initiated before the Termination Agreement entered into force doesn't make sense. Those disputes emerged under a valid intra BIT.

The investor has signed a contract with the EC member state and has performed a part of the investment, but suddenly the Termination Agreement has come into force to put an end to all intra BITs and investment contracts, including their "sunset clauses." The investors inevitably will believe that this is not lawful, and certainly creates a big mess.

The Termination Agreement is in force—fully and ferociously against valid BITs and negating any view of the non-retroactive effects of treaties.

Finally, the EC's arbitration animosity also doesn't make sense. Arbitration is a democratic institution where states and investors resolve their disputes. Arbitration is not a matter for discussion with extremist political ideas which usually are based on arguments that have nothing to do with the topic at stake, but instead are biased or rhetorical.

The EC and UNCITRAL still have time to avoid risks which may become irremediable problems. Investors and their banks surely will be cautious about the way the EC addresses their vulnerable position vis-à-vis the member states.

A final word to look into the way new cases involving EC member states have been treated by both state courts and arbitration tribunals, including ICSID, in the current and quite unruled context. As could be expected, there have been court or tribunal decisions contemplating both viewpoints. Here are some of those, via *Global Arbitration Review* News and Analysis (subscription required):

- An ICSID tribunal's refusal to throw out an Irish renewables group's Energy Charter Party claim against Germany in light of the European Court of Justice's ruling on intra-EU arbitration in the *Komstroy* case. Sebastian Perry, "Renewables claim against Germany clears early hurdle," *GAR News* (Jan. 20) (available at https://bit.ly/3qUI7pA);
- Another ICSID tribunal, whose award found Spain's renewables energy reforms violated the Energy Charter Treaty, has declined to revisit its conclusions in light of the European Court of Justice's *Komstroy* judgment, calling it "entirely irrelevant." Jack Ballantyne, "Another ICSID panel rejects *Komstroy* ruling," *GAR News* (Feb. 9) (available at https://bit.ly/3v4ppPc);
- On the other hand, the Lithuania Supreme Court has ruled that the country's energy ministry is not barred from pursuing a 240 million Euros suit against French group Veolia in local court due to a pending ICSID claim, citing the European Court of Justice case law on the invalidity of intra-EU BITs. Cosmo Sanderson, "Lithuanian suit against Veolia can proceed despite ICSID case," *GAR News* (Jan. 20) (available at https://bit.ly/3721EgN);
- The European Commission has launched infringement proceedings against the U.K. over a decision by its Supreme Court allowing enforcement of a 178 million Euros ICSID award against Romania. Jack Ballantyne, EU targets U.K. over *Micula* award, *GAR News* (Feb. 10) (available at https://bit.ly/3I0l9E0);
- The Court of Justice of the European Union has ruled that the European Commission did not lack competence to adjudicate a judgment that Romania's payment of a 178 million Euros award in favor of the Micula brothers would violate state aid rules—also finding that *Achmea* judgment is relevant to the case. Id.