International Investment Law

Unpacking a Dynamic Regime

14 November 2024

Foreign direct investments (*FDI*) have faced greater scrutiny in recent years, as states increasingly subject investment transactions to screening procedures due to rising geopolitical tensions and national security concerns. The Russian invasion of Ukraine and the worsening climate crisis have prompted stronger and more frequent state actions. Regulatory measures and new security policies will likely impact existing and planned investments significantly. For instance, EU financial sanctions can directly affect the ability to control investments by investors subject to asset freezes and other restrictions. Russian "counter sanctions", on the other hand, have included threats of expropriation to Western companies, with one machine tool manufacturer already reporting that the Russian government nationalized one of its plants.

In this sensitive context, investors may not only have the opportunity to challenge state action in the domestic courts. International law also provides foreign investors with certain standards of protection and offers a way to avoid a potentially biased national court proceeding.

This briefing is the first of four on the international legal protection of investments that we will publish over the next few weeks. In this briefing, we will provide an overview of key features of international investment law (*IIL*) and its possible interplay with foreign trade law, including international sanctions, Russia's retaliatory actions, and investment screening procedures. We will highlight how IIL could offer potential remedies and enable foreign investors to assert their rights against states in front of arbitral tribunals through investor-state dispute settlement (*ISDS*) proceedings.

The Basics

IIL is a peculiar area of public international law. It combines aspects of domestic legal systems with rules of public international law. In a nutshell, it provides a legal framework for commercial activities of individual investors and multinational corporations in foreign states, granting substantial protection for economic activities through international legal commitments of the state hosting the investment.

One of its distinguishing features is its body of law, comprised largely of thousands of bilateral investment treaties (*BITs*). Through these, states mutually agree to guarantee certain standards of treatment for foreign investors on a reciprocal basis. These BITs are flanked by several plurilateral investment agreements, such as the Energy Charter

Treaty, and free trade agreements many of which contain rules on investment protection. Notably, the investment treaty concluded between Germany and Pakistan in 1959 is widely regarded as the first-ever BIT and a milestone in the development of IIL. Currently, Germany is party to 114 applicable BITs and a host of broader treaties containing investment provisions.

These international investment agreements protect investors' interests under international law for matters typically governed by the domestic laws of the host state. They also often grant access to distinct dispute resolution, thus permitting investors to avoid domestic courts which may be perceived to be biased in favour of the host state. An extensive body of case law has developed in recent decades, clarifying many broad BIT provisions and largely harmonizing key concepts. However, the lack of a formal doctrine of precedent and the fragmented nature of international agreements have led to contradictory decisions, provoking criticism and calls for reform of the regime.

The precise scope of protected FDI, particularly regarding the definition of covered "investments", depends on the applicable agreement. Many treaties provide vague definitions or none at all, prompting constant debate on various approaches to establish the existence of FDI. Nonetheless, most lasting commercial ventures involving substantial control or involvement by a foreign commercial entity are generally covered. Similarly, the scope of covered foreign investors varies depending on the specifics of the case, but generally includes everything from private individuals to multinational corporations to state-owned enterprises, if they are "sufficiently foreign" to the host state.

Protection Standards

International investment agreements typically place the same set of obligations on the states hosting the investment:

- Requirement of **non-discrimination** compared to national investors or other foreign investors in like circumstances.
- Requirement of **fair and equitable treatment** (*FET*), which seeks to establish a minimum standard of treatment for protected investors and their investments. Highly dependent on the individual circumstances of the case, this requirement can protect investors from a range of governmental actions, from harassment to the frustration of legitimate expectations investors may have had.
- Prohibition against **illegal expropriation**, often covering both direct and indirect forms of expropriation and stipulating a duty to provide compensation.
- Requirement of providing **full protection and security** to investments and investors from physical harm.

- Requirement to **observe undertakings**, ensuring that host states honour their contractual commitments regarding investments. Sometimes interpreted as elevating breaches of contractual obligations to violations at the treaty level through so-called "umbrella clauses."

- Requirement to allow the **free transfer of funds** related to investments in and out of the host economy.

Investors benefit from these protection standards usually without corresponding obligations of their own, aside from evident requirements such as respect for local laws and regulations. However, recently adopted and projected agreements attempt to rebalance investor protection and host states' regulatory powers by introducing (soft) obligations on investors and sometimes allowing for counterclaims by states.

Access to Investor-State Dispute Settlement

One of the most prominent features of IIL is the access to ISDS that most international investment agreements grant to investors. This enables them to assert direct claims against host states on the international level. This system was originally thought to attract greater FDI volume to host states while also de-politicizing international investment disputes. It provided an alternative forum compared to national courts, which were perceived as potentially biased and ill-equipped to handle such cases. While the validity of these original reasons appears, depending on the states involved, questionable today, the existing system, built upon several institutional arbitration institutions, remains highly active.

The International Centre for The Settlement of Investment Disputes (*ICSID*) is likely the most prominent investment arbitration institution. Many international investment agreements refer disputes arising within their scope to ICSID and its procedural rules. ICSID does not conduct arbitration proceedings itself but provides an institutional and procedural framework for ad hoc tribunals. In this context, the investor and host state, as parties to the dispute, select arbitrators to adjudicate their case. The host state's consent to arbitration (often interpreted as given through the adoption of the respective international investment agreement) often excludes other remedies such as domestic courts, which is notably the case under ICSID rules.

Avoiding the perceived inefficiency and delays of domestic court systems faced with international investment disputes is also often cited as an advantage of ISDS. However, in practice, investment arbitration proceedings can also stretch across many years and generate significant legal fees for both investor and responding state. One of the main advantages of asserting claims in front of a dedicated arbitration tribunal is the arbitrators' expertise regarding investment disputes and, perhaps above all, the international enforcement of arbitral awards against the host state.

Enforcement of Arbitral Awards

Obtaining a favourable arbitral award does not mean the end of an investor's journey. Enforcing the award brings up its own host of complex legal issues. The arbitral award must be recognised in the domestic legal system, for example, to recover against state property. Where awards are to be enforced against them, states may likely raise objections such as sovereign immunity. Therefore, international conventions, most prominently the ICSID Convention and the New York Convention, set out rules for the domestic recognition and enforcement of arbitral awards. These conventions require the national courts of contracting states to recognise and enforce awards as if they were final judgments of a domestic court. Moreover, refusals by domestic courts to recognise or enforce arbitral awards are restricted and permitted only in exceptional cases.

The specific geographic context of the sought enforcement forum can also heavily impact investors' chances of successfully enforcing their award. For instance, investors seeking to enforce intra-EU awards, i.e., awards rendered against one EU Member State in favour of an investor from another, are likely to face considerable opposition by domestic courts. This is because, in the *Achmea* judgment (Case C-284/16), the European Court of Justice (***ECJ***) found that an arbitration clause in a BIT between two EU Member States was inconsistent with EU law, as that clause undermined the autonomy of EU law and the judicial system of the EU. The *Komstroy* decision (Case C-741/19) extended these principles to the Energy Charter Treaty. Consequently, EU Member States' domestic courts are legally required to refuse enforcement of intra-EU arbitral awards. Investors seeking to enforce an intra-EU arbitral award are thus likely to be forced to seek enforcement against assets of EU Member States located outside of the EU.

Still, international investment law and arbitration is very much alive. ICSID alone reported 58 new ICSID and 17 new non-ICSID cases for the financial year 2024. BLOMSTEIN monitors developments in international investment law and is at your disposal to assist you with any matter in the area, in particular regarding the specific German and European context. If you have any questions or would like us to cover a specific topic, please do not hesitate to contact Roland Stein, Pia Hesse, Tobias Ackermann, and Sarah Beischau.

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