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SUMMARY

1. General outline of the research

The purpose of the dissertation is to take a horizontal look at the main characteristics of the Investor-State Dispute Settlement (ISDS) mechanism and identify its deficiencies, if any. Indeed, the research undertaken for the sake of this study show that the essential features of ISDS were not adapted to the needs of investors and, thus, they posed some risks for countries hosting foreign investment.

Two areas where the systemic deficiencies appear were identified. The first one is the operational principles and procedural issues of the ISDS; the second one is the substantive legal standards of investment protection. The most significant need for a detailed discussion of these areas arises from systemic imbalances and constraints which emerge within either of the so defined areas. These include the imbalance of investors' and states' rights, the constraints of pro-social policy-making, and the high costs which, in reality, exclude small and medium-sized enterprises from the ISDS mechanism. The deficiencies include also the emergence of significant level of legal uncertainty and relative dilution of doctrine of ISDS rules application and enforcement, both being consequences of vaguely formulated investor protection standards.

This dissertation consists of five chapters. Chapter one presents the institutional environment of foreign direct investment from the perspective of the European Union, followed by the stages of the Communitisation of FDI in EU trade policy and the sources of legal international protection of FDI. Chapter one also "sets the (analytical) scene" as it presents key actors in the foreign investment environment and the most important fora through which investor-state disputes are settled. At the end of the Chapter, the CETA dispute settlement model, found in the Comprehensive Economic and Trade Agreement between the EU and Canada, is presented as the most innovative model for investor-state protection and investment dispute settlement likely to set standards for any future arrangements of similar character.

Chapter two concerns the impact of existing investment treaties and the ISDS on foreign investment flows. Its analytical objectives are to consider whether companies' decisions to establish foreign branches or subsidiaries are dictated by the presence of foreign investment protection legislation, and by the type of forums in which potential conflicts with the host state will take place. From here, the cost-benefit structure, from the perspective of the investor and the state, is presented. Available academic research on the subject was also reviewed in this Chapter.

Chapter three examines the cost structure of the main dispute resolution 'fora': UNCITRAL, ICSID and the Stockholm Chamber of Commerce. The analysis begins with transaction cost theory which is then compared with the typical cost structure in investment arbitrations. Then follows a thorough analysis of the cost drivers, taking into account the data for the relevant forums. The Chapter presents an analysis of the impact of dissenting opinions and bifurcations on the duration of arbitrations.

The fourth Chapter discusses the most common investor protection standards in investment disputes, i.e. the standard of fair and equitable treatment and the prohibition of expropriation (direct and indirect). In particular, the formulation of these standards and the consequences of the semantic ambiguity they involve for the disputing parties are analysed. In view of the need for arbitral tribunals to continuously refine the standards, the Chapter also addresses the discretionary powers of arbitrators in formulating successive interpretations of the meaning of these standards.

The fifth Chapter discusses the impact of the pivotal (at lest for the EU) *Achmea* judgment on the intra- and extra-EU application of the ISDS mechanism. The course of the proceedings and the CJEU judgment itself are analysed. The problems that the *Achmea* judgment solved are diagnosed, followed by the discussion of problems that the judgment has created in the foreign investment protection regime. The general consent of EU states to terminate intra-EU BITs as a consequence of the *Achmea* judgment is also discussed. This is followed by a discussion of the key steps in the planned reform of the ISDS mechanism and the main features of the Multilateral Investment Court (MIC). The Chapter concludes with a presentation of the key changes to the dispute settlement model resulting from *Achmea* judgment.

2. Key findings

2. 1. The impact of international investment treaties and foreign investment protection provisions on foreign investment flows

Whether ISDS clauses depoliticise investment treaty disputes still remains to be verified. What can be said based on the analysis undertaken for the sake of this study is that treaties with ISDS clauses either moderately increase certain types of foreign investments in developing countries or have no significant effect. They may restrain the freedom to enact pro-social policies resulting in the social unrest observed in the public debate. In juxtaposing the

benefits and costs of investment treaties, it can be seen that there is insufficient evidence to draw any general conclusion about the net effect of investment treaties with ISDS provisions on the economic health of the state parties to these treaties.

2. 2. Costs, including the cost-driving role of the duration of state-investor disputes

The objective of the research presented in this study was to test the veracity of the thesis of investment arbitration as a quick method of dispute resolution. Data obtained was inconclusive. The average duration of arbitration proceedings, both *ad hoc* and non-*ad hoc*, is 3.58 years. Neither an intuitive assessment, nor the more disciplined comparative method demonstrate that arbitration is a fast method of dispute resolution. Moreover, against the background of other tribunals or the expectations of its clients, investment arbitration compares rather poorly.

It is also impossible to conclude that arbitration cases take less time in comparison to court settlements or in absolute terms – when their life-span is measured historically. The average arbitration time fluctuates, though some studies show that the duration is, in fact, increasing. This phenomenon is attributable to the fact that the management of investment disputes is becoming increasingly nuanced. As such, they require increasingly complex legal or technical analysis as a result of more extensive and varied case law applicable to them. The research shows that the most time-consuming elements of the arbitration pathway include: the appointment of the tribunal; the production of evidence; the drafting of the award, including the deliberations of the tribunal; and the enforcement of the award. Overall duration is also affected by delays caused by excessive arbitrator workload, separate opinions and bifurcation.

Despite the dispersed nature of foreign (direct) investment, the costs arising during its life cycle should be analysed within the theoretical framework of transaction costs. The costs of settling investment disputes in this logic should be classified as *ex post* costs, as they arise after the conclusion of the contract. It is important to analyse by party to the obligation (state and investor), as studies have shown that the amounts of costs for the two parties to disputes differ, with investors usually bearing the greater costs. Arbitration costs should be considered by the parties to the proceedings (investor and state) and by their type, in simple terms: tribunal costs and the parties' legal costs. Tribunal and administrative costs are in the range of one million dollars. The costs of the parties, which include the costs of legal representation and experts, are incomparably higher. For investors, the average total costs of a single investment arbitration are USD 7.12 million. These are almost 11 times higher than the turnover of the

average Polish SME company. For the average EU SME firm, these costs are 5 times higher than turnover. It must therefore be concluded that investment arbitrage for SMEs is hardly achievable unless it is financed through third party funding.

According to the data analysed for countries, the average total cost of a single investment arbitration is USD 6.02 million. The average cost of a single investment arbitration represents between 0.33% and 15.24% of annual judicial expenditure in selected EU countries. For Poland, the Czech Republic, Slovakia and Hungary, the share varies between 1-2%, for Lithuania and Latvia between 8% and 10%, and the highest Estonia, where it exceeds 15% of annual judicial expenditure.

The average annual increase in arbitration costs is also quite relevant for the assessment of arbitration as a means of trade conflict-solving. The annual increase in administrative costs for cases for both rules of procedure (ICSID and UNCITRAL) is in the range of 12%. In the case of party costs, they increased by 35% between 2013 and 2017 for investors, while they increased by 7% for the states' variant. In addition to quantifiable costs, there are also non-quantifiable or difficult to quantify costs. These include social costs, political costs or costs of the legal system's readiness to handle disputes, such as the organisation of the Polish Attorney General's Office in the case of Poland.

2. 3. Winners of investment arbitration and the amount of claims and damages

Any review of research findings on the demographics of winners in investment arbitration leaves no illusion - usually states win, dispelling the myth of investor supremacy in investment arbitration. However, between 2012 and 2021 the percentage of cases decreased by 6%, which may indicate that investors are increasingly willing to choose conciliation methods of dispute resolution, such as mediation.

2. 4. Amount of claims and damages

The results of the studies regarding the number of claims and damages vary considerably, explained by the differences in the definition of the essential elements under study, such as, the meaning of the terms win and lose for the investor or the state. Another problem detrimental to the credibility of the survey results is the practice of excluding from the core sample of cases surveyed the outlier observations that have the greatest impact on changing the results.

2. 5. Ambiguity of treaty wording, including in particular investor protection standards

There are divergences among arbitral tribunals regarding where to draw the line between state and investor rights, which in turn fosters a degree of jurisprudential discretion in interpreting investor protection standards. This gap makes international investment law highly unpredictable. Thus, criteria should also be introduced to distinguish indirect expropriation from the right to regulate, which does not give rise to compensation effects. Literature research shows that also the standard of fair and equitable treatment is an ambiguous standard. Interpreting it leads to numerous disputes and, hence, to a blurring of the doctrine.

2. 6. The Achmea judgment and its implications for the application of the ISDS mechanism

Extra-EU investment treaties and the arbitration clauses contained therein have not been affected by the *Achmea* judgment and remain in force for now. It should be noted that, with the European Commission assuming exclusive competence over foreign investment under the Lisbon Treaty, they will gradually disappear and be replaced by EU treaties. Conversely, the consequence of the *Achmea* judgment is that the Intra-EU application of the ISDS mechanism will cease. By questioning the compatibility of arbitration clauses with EU law, the CJEU also undermined the very essence of the existence of intra-EU BITs, i.e. a reference to arbitration. For European Community countries, the *Achmea* judgment and the BIT Termination Agreement have many benefits. In addition to increasing legal certainty and reducing the risks brought by investors exploiting the vaguely worded provisions of international investment law, there are also the benefits of the costly servicing of the investment dispute resolution system. In the case of Poland, these are the costs of servicing the Polish Attorney General's Office and also its European counterparts. Savings can be expected for the time being in the intra-EU dimension, since, as already stated, the extra-EU model of the ISDS mechanism remains unchanged until its reformed variant is implemented.

As the comparison reveals, the model of foreign investment protection in external trade and investment policy did not change after the *Achmea* judgment. Instead, a new model (variant) of the mechanism in CETA emerged. A significant change in the external investment policy was the start of work on the Multilateral Investment Court, which, over time, according to current assumptions, will take over the competence to settle disputes to which either EU countries or the European Union will be a party.

The regulation of investment protection in internal trade and investment policy changed profoundly after the *Achmea* judgment. Bilateral investment treaties were replaced by provisions of the TFEU and, from then on, the protection of foreign investments has to be understood through the prism of the four freedoms expressed in the TFEU. The model of dispute settlement before and after the *Achmea* judgment has, therefore, changed. From a single, monolithic model for the mechanism, two models emerged: one involving the extra-EU application of the mechanism and one involving the intra-EU application of the mechanism, with the intra-EU application of the mechanism based on investment arbitration ceasing to exist with the conclusion of the Agreement to Extinguish Intra-EU-BIT. The competence of the investment tribunals was instead taken over by the EU judicial system.

2. 7. CETA – a pioneering approach to foreign investor protection

According to the research, the CETA arbitration mechanism is a pioneering tool for the protection of foreign investment. Among the tools it establishes, of particular note are:

(a) enhancing predictability of the law and consistency of jurisprudence, including the establishment of an appellate tribunal and guaranteeing legal consistency,
(b) guaranteeing the independence and impartiality of arbitrators,
(c) preventing a chilling effect on public policies,
(d) preventing multiple arbitration proceedings from being initiated in parallel,
(e) transparency of proceedings,
(f) the inclusiveness of the mechanism for small and medium-sized enterprises.

The CETA mechanism also counters the phenomenon of inconsistency in case law by introducing two tools: the possibility of examining an award for compatibility with treaty provisions and the possibility of reviewing the conclusion of an award by an appellate tribunal. In order to increase the consistency of investment jurisprudence in the CETA mechanism, it was decided to create an appellate body for the purpose of reviewing decisions made in the first instance.

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Although it may seem remote to the ordinary citizen, from the societal perspective, the ISDS mechanism is of utmost importance. It is also important from the perspective of foreign capital flows, the interests of foreign investors, in particular SMEs, and the interests of the

countries hosting these investors, the vast majority of which are developing countries. Considering ever-increasing foreign investment flows, these considerations should be taken into account in the broader international discussion on the ISDS and its desired reforms.

A legal-economic, theoretical and empirical analysis of the Investor-State Dispute Settlement mechanism is presented from an *ex-post* perspective and from the viewpoint of the European Union.