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Back to sovereignty? Policy space in investor-State dispute settlement

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Abstract

The paper examines how investor-State dispute settlement mechanisms -included in international investment agreements- are able to condition national policy space, even when foreign investors question measures regarding human rights, public health, or environmental protection. It also intends to identify and explain the new trends in international investment agreements that illustrate different ways out the investor-State dispute settlement labyrinth. In order to achieve the objectives, a qualitative documentary research was conducted, based on secondary sources. The new trends in international investment agreements cartography show the emergence of a new concept of sovereignty rooted in the defense of policy space -“regulatory sovereignty”.

Keywords: Policy space; Right to regulate; Investor-State dispute settlement; Sovereignty.

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Introduction

The element that differentiates the State from any other subject of International Law or any other actor in international relations is sovereignty and, as a response, States recognize each other as legally equal. Although sovereignty remains “a ticket of general admission to the international arena” (Fowler and Bunck, 1995), its concept has evolved throughout history and has even come into tension with hyper-globalization (Rodrik, 2011). One of the areas that illustrates this tension is Investor-State Dispute Settlement (ISDS).

The golden age of hyper-globalization corresponds to ISDS proliferation era, a period that, according to United Nations Conference on Trade and Development (UNCTAD), goes from the 1990s to 2007 -Bolivia’s withdrawal from the Convention on the settlement of investment disputes between States and nationals

of other States (ICSID Convention). The Washington Consensus generated favorable conditions for the construction of a network of more than 3,000 International Investment Agreements (IIA), but also triggered a consistent rise in disputes registered¹.

After the proliferation era, the current phase is characterized by the backlash against the regime, particularly for its impact on the right to regulate –the heart of the policy space; in this phase, two elements stand out: regulatory chill -when policymakers refrain from regulating or change a regulation as a consequence of a lawsuit - and the fact that the investment courts operate as external control bodies of the legality of States' actions, even regarding human rights, public health or environmental protection.

Although the claim for the extension of policy space has a long history, and different nuances in the Global North and the Global South, climate change and energy transition concerns have intensified the discussion in the course of Energy Charter Treaty modernization. Furthermore, during the Covid-19 era, the role of the State in the economy is under scrutiny again. Are States going back to sovereignty, particularly regarding ISDS? Why? How?

In light of the above, the objectives of this paper are: 1) to examine the conditioning of the State's policy space by international investment agreements; 2) to identify and explain the new trends in international investment agreements that illustrate different ways out the ISDS labyrinth. Thus, from a qualitative approach, a document content analysis was conducted, based on unobtrusive methods (non-lexicographic data analysis).

To seek convergence and corroboration from multiple sources, in addition to literature review, this research drew upon multiple secondary sources that included IIA, investor-state published awards and resolutions², European Union (EU) and UNCTAD official documents about ISDS. Also, by using the explaining-outcome process tracing approach (Beach and Pedersen 2013), this research tried to link the new trends in IIA with a current return to sovereignty.

Theoretically, this piece seeks to broaden the strictly legal view, and it builds on the contributions of Krasner (1999) in "Sovereignty. Organized hypocrisy" regarding the four ways in which the term sovereignty has been used, according to the historical stage and the central elements in the analysis. This selection allows a deep and comprehensive understanding of the problem and its different dimensions through time. Moreover, by using this approach the study benefits from the knowledge created at the margins of International Relations with other fields, such as International Law or International Political Economy.

This paper is structured in four sections after this starting point. The first one revisits Krasner's approach to sovereignty -interdependence, Westphalian, internal and international legal sovereignty- by examining its interactions with IIA, particularly with Bilateral Investment Treaties (BITs). The second part is dedicated to explaining how ISDS mechanisms -contained in IIA- act

¹ According to data from UNCTAD's Investment Policy Hub, between 1987 - when the first request for arbitration was registered- and 2000, the number of disputes initiated was 57, while between 2001 and 2021, the figure increased more than 22 times, reaching 1,190 procedures.

² As access to information was a priority, finished disputes with unpublished awards were discarded.

as a filter that constrains national policy space by allowing foreign investor to question measures taken in exercise of the right to regulate (the heart of the policy space).

The following section deepens into possible pathways that States have to get out of the labyrinth of ISDS, identifying possibilities in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the EU proposal of investment court system, Morocco-Nigeria BIT and Brazilian Cooperation and Facilitation Investment Agreements (CFIAs). These four illustrate the new trends in IIA cartography. Lastly, the paper closes with some concluding remarks that reflect on the emergence of a new concept of sovereignty, which is rooted in the defense of policy space. As the right to regulate constitutes its heart, it can therefore be called regulatory sovereignty.

Sovereignty in International Relations: Krasner's approach

In "Sovereignty. Organized hypocrisy", Krasner (1999) introduces four ways in which the term sovereignty has been used, according to the historical stage and the central elements in the analysis. These are: 1) interdependence sovereignty, linked to state control of movements across national borders; 2) Westphalian sovereignty, which historically appears as a function of the fundamental notes of the Peace of Westphalia of 1648 and which consolidates a system of Law based on the principle of non-intervention in internal affairs; 3) internal sovereignty, related to the existence of domestic authority structures capable of exercising effective control within borders; and 4) international legal sovereignty, referring to mutual recognition between States.

The use of the typology would seem to indicate that throughout history, a State evolves from one type of sovereignty to another as a mechanism for adapting to new international challenges, but this does not necessarily need to be the case. In fact, at a given moment, a State may hold one type of sovereignty and not another, and it does not mean it is no longer considered a State or that it becomes a different entity for that reason (Krasner, 1999). Moreover, sovereignty projections may combine or extend to new areas of regulation. For instance, in the United Nations Convention on the Law of the Sea, Westphalian and international legal sovereignty were extended to the seas in order to define States' rights over the seas and prevent conflicts, as de Moraes (2019) argues.

Even in times of globalization where state authority is questioned, it is more likely that the latter is altered than a new form of organizing political life different from the state is created. The changes that may occur based on rules that emerge in the evolution of the international system coexist but do not take the place of sovereignty, which is resilient (Krasner, 2001). There is no accepted alternative to sovereignty (Krasner, 2009, 2011). The concept may mutate but it will continue to constitute the distinctive element of the State as the only way of organizing political life.

Likewise, the exercise of one of the sovereignties may condition or limit another. One such example are the commitments that the State voluntarily assumes internationally, in the exercise

of its international legal sovereignty, which condition or limit other projections of sovereignty. Krasner names these commitments “invitations” as the opposite of “intervention”, an act contrary to the will of the target State. In the specific subject of this piece, the conclusion of a BIT and its subsequent entry into force can condition the domestic sovereignty of the signatory, particularly concerning the authority to exercise the State’s acts. The conditioning can take different forms, from regulatory chill or paralysis to the review and control of the legality of State acts in the public sphere by external entities (international arbitration tribunals), even in cases of a valid exercise of the right to regulate in the field of human rights, public health, or environment protection.

Among the modalities of commitment, there are those of a voluntary nature, conventions, and contracts, as well as those of a non-voluntary nature, coercion, and imposition. Krasner (1999) proposes that in conventions, the rulers bound themselves to follow certain rules independently of the conduct of others. In contracts, a certain conduct is followed in exchange for a benefit. In coercion, the rulers are subdued so that their relative power is diminished; and finally, in imposition, the ruler has no capacity for resistance.

Although the author does not analyze it, similar reasoning can be made with BITs or other international instruments that provide for investment protection, in particular investor-State dispute settlement mechanisms. These are concluded in a valid exercise of international legal sovereignty -they do not contradict it- and impact on other sovereignties, particularly the authority to exercise State acts in public policy, partially approaching the concept of internal sovereignty.

Investment agreements are usually concluded between developed and developing States, in the case of international treaties, or between companies from developed States and developing States, in the case of investment contracts³. This is not a violation of the principle of non-intervention from a military perspective, nor is it carried out directly by another State, as Krasner suggests in the examples.

Policy space and investor-State dispute settlement

UNCTAD’s 2003 World Investment Report introduces the concept of *national policy space* for the first time in its analysis, highlighting the possible tension between market liberalization and the need for States to regulate in order to maximize the benefits and minimize the risks of openness (Ghiotto, 2017). In this sense, concerning the national policy space, the Report indicates that IIAs “are specifications of legal obligations that limit the sovereign autonomy of the parties” (United Nations Conference on Trade and Development 2003). UNCTAD’s statement recognizes the limitation that the conclusion of international agreements creates with regard to the interplay of international legal sovereignty and (partially) internal sovereignty.

³ From the point of view of the modalities of commitment proposed by Krasner, investment contracts are contracts. But not all contracts, in the Krasnerian sense, refer to this matter.

In terms of the relationship between the State and foreign investors, the conditioning of State sovereignty would have a direct effect on the possibility of initiating arbitration processes or fostering regulatory cooling-off situations. In addition to conditioning sovereignty from an internal point of view (authority to exercise State acts), agreements that leave out of their articles the protection of the right to regulate condition State autonomy by limiting its decision-making capacity.

Therefore, the defense of policy space is essential, especially with regard to ISDS, a regime in which the questioning of measures taken within its framework comes into play. At a lower level of abstraction, the right to regulate is the power of the State to limit private freedoms in order to protect a higher legal good: the public interest. In short, the two concepts in tension are stability - in terms of protecting foreign investment - and flexibility - in terms of protecting the State's policy space.

The right to regulate is precisely the one that sets the brake on international agreements or in terms of the State conditioning its own sovereignty. According to Titi (2014), the right to regulate “denotes the legal right exceptionally permitting the host State to regulate in derogation of international commitments it has undertaken by means of an investment agreement without incurring a duty to compensate”. Likewise, in *Parkerings Companiet AS v. Lituanien* (International Centre for Settlement of Investment Disputes [ICSID] case ARB/05/8), the tribunal concludes that, except for the existence of stabilization clauses, the investor must consider that the legal system in which it invests evolves as a consequence of the States' right to regulate. Therefore, it is expected that there will be regulatory modifications during the time in which an investment is developed. The limit operates in the exercise of this right in a discriminatory or unfair manner.

A more restrictive interpretation can be seen in *ADC v. Hungary* (ICSID case number ARB/03/16). The tribunal concluded that

when a State enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment protection obligations it undertook therein must be honored rather than be ignored by a later argument of the State's right to regulate (par. 423).

The restrictive view of the right to regulate comes into contradiction with considering State activity as a limit to it, so that the State itself would be the sole cause, for example, of its own regulatory chill. From an internationalist approach, according to Krasner, Westphalian sovereignty can be conditioned by the exercise of international legal sovereignty. Although the author does not address it, by making an extensive interpretation, internal sovereignty can also be limited by international legal sovereignty from the point of view of the authority to exercise State acts. The transition towards a new concept of sovereignty - regulatory sovereignty - must consider the risks of accepting “invitations”.

At this point, it is important to understand that regulatory powers are linked to internal sovereignty, since it implies the existence of an authority, legitimacy control within borders. However, internal sovereignty does not explain how a State has the power to regulate in certain areas without external interference (whether from States or other actors). The exercise of said power is embodied in the principle of self-determination: free choice of political status, and as a consequence, autonomous determination of economic, social, and cultural development policies. Self-determination is coherent without interference from another State - point of connection with Westphalian sovereignty -, or from any other non-state actor - for instance, transnational corporations.

In regards to international legal sovereignty, regulatory sovereignty could be presented as a domestic phase, as an antithetical concept: the “internal legal sovereignty”. However, it would be a limited reading, since regulatory sovereignty is not confined exclusively to the interior of the State. It seeks to reshape external structures through the creation, change or withdrawal of international institutions. Investment treaties design has evolved through States-driven transformation, as Alschner (2022) argues after analyzing a universe of almost 3,000 treaties with a computational science approach. The author emphasizes that the core problem is that the interpretation’s center of gravity is still in old treaties instead of new ones, therefore, new treaties have old outcomes⁴.

Alschner (2022) as well as Skovgaard Poulsen and Gertz (2021) focused the analysis on reforming the old problematic treaties rather than new ones. The old treaties do not include provisions regarding the right to regulate or exceptions to ISDS. In other words, treaties that still consider the risk of accepting “invitations” that constrain the national policy space. These studies propose a flexible and coherent alternative to current cartography, interpretative statements, which is also a plausible pathway out of the ISDS labyrinth.

Pathways out of the labyrinth

At the multilateral governance level, the roadmap for the reform of the international investment protection regime developed by UNCTAD sets out five areas of action: 1) reforming investment dispute settlement; 2) promoting and facilitating investment; 3) ensuring responsible investment; 4) enhancing systemic coherence; 5) safeguarding the right to regulate while providing investment protection (United Nations Conference on Trade and Development, 2015).

Concerning international rules, it is possible to see an evolution, not yet widespread, towards the inclusion of provisions in BITs or other agreements that enshrine the right to regulate in specific areas, such as security or the environment, as well as specific exclusions to the application

⁴ The role that the most favored nation clause plays in ISDS opens the door to old provisions resulting in “authorized” old interpretations. Nevertheless, the use of most favored nation clause is the decision of arbitrators. As Alschner (2022) points out, investment tribunals are a brake, not an engine, in ISDS reform.

of ISDS mechanisms - e.g., tobacco control measures in CPTPP. However, this is not a direct way out of the labyrinth that constricts policy space. This paper will not examine proposals for modifications at the level of specific clauses - for instance, fair and equitable treatment, minimum standard of protection, most favored nation clause, umbrella clause -, as their diversity can lead to different interpretative results.

Essentially procedural reforms at the level of regime governance - ICSID and the United Nations Commission on International Trade Law (UNCITRAL) - are also excluded from the analysis in this piece. In ICSID, the reform of the system refers exclusively to procedural mechanisms, and in UNCITRAL (Working Group III), the in-depth discussion on the policy space, linked to the substantive aspects of investment treaties, will take place once the debate on the reform of the dispute settlement regime is completed. Current advances in UNCITRAL focus on the creation of a multilateral advisory center, the appellate mechanism, full-time judges, a code of conduct for arbitrators and adjudicators, treaty interpretation, dispute prevention and mitigation, alternative dispute resolution methods (ombudsman, mediation), exhaustion of local remedies, counterclaims by respondent States, procedure costs and third-party funding, as well as the implementation of a Multilateral Investment Court, an EU proposal.

The focus of the analysis is on the direct enshrinement of policy space, visualizing four manifestations: 1) the express recognition of the right to regulate; 2) the incorporation of general exceptions in the treaties; 3) the withdrawal of the current regime by proposing an alternative; 4) the possibility of introducing binding interpretation statements for unbalanced treaties - the “old treaties”. Firstly, the right to regulate can be expressly recognized in a general or particular way in a sector or sectors of State activity. The most innovative BIT in recent times is the Morocco-Nigeria BIT, concluded on 3 December 2016 and not in force at the time of writing.

The recognition of the right to regulate is not an innovation in the system; in fact, one of the most common ways of incorporating it is its enunciation in the preambles of the treaties, seeking to balance the system with general references or in matters of non-economic interest (Mouyal, 2016). This is the case of the preambles of some of Brazilian CFIAs (Mozambique, Angola, Malawi, Ethiopia, Suriname, Guyana, United Arab Emirates, India), which recognize the autonomy of States and their power to implement public policies. However, these agreements exclude ISDS.

In Morocco-Nigeria BIT, the preamble reaffirms the right to regulate and adopt domestic measures concerning investments to achieve its public policy objectives. It also notes the particular need for developing States to exercise the right to regulate. Although the preamble is not part of the binding articles of the treaty, its analysis is relevant for the purpose of interpreting the text. Indeed, article 31 of the Vienna Convention on the Law of Treaties between States (1969), when regulating interpretation, refers to “the text including its preamble and annexes”. The importance of recognizing the State’s right to regulate is therefore undeniable.

Thus, following the recommendations of UNCTAD (2015) on strengthening the right to regulate, Article 13 of Morocco-Nigeria BIT - “investment and environment” - expressly recognizes

the right of States Parties to act with discretion in regards to regulation, compliance, investigation, prosecution, and decision-making regarding the allocation of resources on environmental issues, which the State considers having a higher priority (Article 13 paragraph 2). The importance of this provision lies in the recognition of a superior legal good to be protected (environment) over the protection of foreign investment. Therefore, the State has the right to regulate with a wide margin of discretion (Kendra et al., 2017).

Second, article 13, paragraph 4 emphasizes that nothing in the treaty prevents the parties from adopting, maintaining, or reinforcing measures that are consistent and non-discriminatory, which allow them to ensure that investments in their territory are made in an environmentally and socially sensitive manner. As Gazzini (2017) explains, this provision should be read with article 23, paragraphs 2 and 3, which state that the adoption of non-discriminatory measures in compliance with international standards other than the BIT does not imply a breach of the BIT. If similar provisions on the environment, public health, or human rights were to be universalized, this could neutralize one of the risks of the fragmentation of international law.

The last aspect of the Morocco-Nigeria BIT is that the parties undertake not to lower labor or human rights regulations to attract or promote investment (Article 15). An express provision of this type, which avoids a race to the bottom, is fundamental, although it does not establish the minimum level of protection in these areas, leaving ample room for interpretation to ad hoc arbitration tribunals. The practice derived from the implementation of the agreement will determine whether the path initiated by an innovative BIT permeates in a way that protects the right to regulate when clauses may be ambiguous (Nweke-Eze, 2017).

It is in this instance that one might question whether it is possible to protect policy space by giving the State a wide margin of discretion to regulate and exercise its *raison d'état*, as Sassen (2010) suggests, while at the same time applying a policy of flexibility, as advocated by UNCTAD (2003, 2015). Precisely, the risk of flexibility is to blur the limits of the protection of the right to regulate, and for them to be delineated diffusely and inconsistently by jurisprudence. Arbitrators can be a brake to rebalance ISDS and *Eco Oro v. Colombia* (ICSID case No. ARB/16/41) is a clear example of that.

Though the dispute was based on the Free Trade Agreement between Canada and the Republic of Colombia, a modern “balanced agreement” that protects the right to regulate, the tribunal concluded that Colombia was internationally responsible for protecting Páramo de Santurbán ecosystem. As Sierra (2021) points out, “some mechanisms supposedly conceived for the purpose of correcting the imbalances of this system, like the so-called ‘right to regulate’ remain ineffective and the tribunals do not seem interested in using them properly to correct the ISDS imbalances”. Thus, regulatory sovereignty needs a more solid ground.

The second path of vindication is presented by authors such as Wagner (2014), who propose the inclusion into future reforms of the investment protection regime of clauses similar to those existing in the multilateral trade regime with articles XX of the General Agreement on Tariffs and Trade (GATT) and XVI of the General Agreement on Trade in Services (GATS). In the first

case, it is generally stipulated that the rules of the agreement cannot be interpreted in a way that infringes measures adopted by States concerning the protection of public morals, health and life, the import of gold and silver, the observance of domestic rules that are not incompatible with the treaty, articles manufactured in prisons, national artistic, historical or archaeological heritage, the conservation of non-renewable resources, agreements on commodities, restrictions on the export of raw materials within the framework of stabilization plans, measures to alleviate shortages.

In the case of the GATS, although there is *mutatis mutandis* a parallel, the list of exceptions provided for in the text is considerably smaller. In short, the rule states that no provision may be interpreted in a way that violates State measures related to the protection of public morals and public order, health and life, the observance of domestic rules, rules designed to ensure equitable or effective taxation or collection, and domestic agreements or provisions to avoid double taxation. In all cases, the limit is the principle of non-discrimination, the cornerstone of the multilateral trading system.

In a globalized world, the role of States is fundamental to promote different actions that allow relevant transformations in the ISDS regime, especially in exceptional times as the Covid-19 syndemic. General exceptions can lead to a more balanced regime limiting future claims access. This reasoning is similar to that presented in academic and civil society proposals during 2020 (Columbia Center for Sustainable Investment, 2020; Gallagher and Kozul-Wright, 2020; Alianza Centroamericana frente a la Minería et al., 2020)⁵.

Lester and Mercurio (2017) follow Wagner's lead in analyzing the provisions of the CPTPP⁶ that restrict the recognition of the State's regulatory space to specific areas of regulation: public safety, environment, and health. The authors argue that there are better mechanisms to avoid infringing the right to regulate and limiting policy space, as the exclusions are unfair and unnecessary. They focus on a particular sector or sectors, with the risk of violating the principle of fair and equitable treatment, since the State has *carte blanche* to favor local industry over foreign investors, even leaving a foreign investor without recourse in situations of non-compliance with antitrust or anti-corruption rules.

Lester and Mercurio (2017) propose working on better drafting of international agreements and including general, not specific, exceptions for ISDS. General exceptions could be modeled on GATT Article XX and GATT Article XVI, as in the case of Article 22.1 (general exceptions) of the Australia-Korea Free Trade Agreement regarding measures to protect life, animals, plants, and health, ensure compliance with standards, protection of national artistic, historical or archaeological heritage, conservation of natural resources. The proposal is innovative, although more difficult to negotiate internationally, especially for developing States or those with less negotiating capacity

⁵ The first claim regarding COVID-19 measures was registered by ADP and Vinci against Chile in August 2021 (ICSID case number ARB/21/40). Moreover, according to UNCTAD's Investment Policy Hub, the total number of claims registered during 2020 increased in regard to 2019, a trend that repeats in 2021.

⁶ Previously the Trans-Pacific Partnership Agreement (TPP).

to protect their regulatory sovereignty. The risk is that a different system would present the same structural conditions.

The third possible way out of the labyrinth is to withdraw from the current ISDS regime by unilaterally withdrawing from IIA. Two examples may be illustrative. From the Global South, the most well-known cases are Bolivia (2007-present) and Ecuador (2009-2021)⁷ through the termination of the BITs in force and the denunciation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which constituted ICSID⁸. The aforementioned States are examples of dissidents from the regime, having left it after becoming members, following the new constitutional provisions limiting the jurisdiction to which the State can submit (Bas Vilizzio, 2016)⁹. Other States with varying degrees of dissidence include Venezuela, South Africa, India, Indonesia, and Pakistan.

The second example comes from the EU, a supranational process that was never characterized by the “excessive protection of national sovereignty”, as Nolte and Weiffen (2021) defined Latin American regionalism. After barely sixty years of European integration, the defense of the regional policy space¹⁰ in the UE is built after the Achmea case (C-284/16), in which the Court of Justice of the EU stated that investor-State arbitration mechanism in the BIT between Slovakia and the Netherlands is contrary to EU law.

Notwithstanding whether the judgment applies to the specific case, the Commission also concluded that BITs concluded between EU members “undermine the system of legal remedies provided for in the EU Treaties and thus jeopardize the autonomy, effectiveness, primacy and direct effect of Union law and the principle of mutual trust between the Member States” (European Commission, 2018). The arbitration and the award are therefore considered null and void, an aspect that triggers a domino effect in the future interpretation of the validity of the awards.

Another relevant dispute in the EU’s cartography is Vattenfall v. Germany (ICSID case number ARB/12/12) under the Energy Charter Treaty. As a consequence of the Fukushima nuclear disaster (2011), Germany passed the new Atomic energy act in order to phase out nuclear power by 2022. Amidst the Covid-19 emergency and after struggling in ICSID and local courts, the Swedish company won, and in March 2021, the Government agreed on a compensation of 2438 million euros. Therefore, the EU claim for policy space protection is a way to address negative externalities of investor-State arbitration (Morosini and Sanchez Badin, 2017).

⁷ Ecuador’s position changes in 2021 after accessing the Washington Convention once again. There is no other example of this practice in International Investment Law.

⁸ Venezuela also withdrew from the Convention in 2012, but did not terminate all the BITs in force, except for one of them on the basis of which most of the arbitrations against it had been registered (Venezuela-Netherlands BIT).

⁹ Survival clauses do not allow for immediate recovery of autonomy in matters of jurisdiction to resolve disputes. On the contrary, since the content of the treaty provisions remains in force for the period foreseen in the aforementioned clause, ad hoc international tribunals can continue to register claims by foreign investors, and thus act as institutions of external control of the legality of state conduct (Hernández González, 2017; Van Harten and Loughlin, 2006; Postiga 2013).

¹⁰ For further analysis of State sovereignty notion in the UE, see Jesus (2009).

As a consequence, on 5 May 2020, 23 EU members¹¹ signed the Agreement for the termination of Bilateral Investment Treaties between the Member States of the EU, an agreement terminating the BITs between them and rendering ineffective the survival clauses in the aforementioned agreements¹², and others that had been terminated earlier. These are the clauses that allow the substantive provisions of the treaties to continue to apply for five, ten, fifteen, or twenty years after the agreement is terminated. No new disputes will be initiated, and in pending arbitrations, States must remind the courts of the *Achmea* judgment; terminated disputes will not be reopened.

The termination treaty is a milestone in the international regime, despite its limitation: it only refers to BITs between members and there is no reference to the termination of the Energy Charter Treaty based on the largest number of intra-EU disputes developed. The EU is now in a position of contesting the regime on the international stage without crossing the threshold of dissent (Bas Vilizzio, 2019). According to Wiener (2014, 2017), contestation in International Relations refers to a wide spectrum of social practices that, from the discourse, disapproves of international norms. The author distinguishes four modes of contestation: 1) arbitration in courts, 2) deliberation in international regimes or organizations, 3) contention in protest movements, and 4) justification in epistemic communities.

Following Bas Vilizzio's typology regarding the position of the States in ISDS regime (2019), the EU contests the regime by the proposal of institutional changes and new legalities that criticize, or even break, the basic precepts of the regime, without withdrawing it and becoming a dissident. This position addresses two contrasting realities: relations between members versus relations with third States, without mentioning exit from the Energy Charter Treaty.

It also adds a proposal for an investment court system for bilateral agreements with third States, included in the Comprehensive Economic and Trade Agreement with Canada (2017), the Modernization of the Trade Agreement with Mexico (2020), as well as the Investment Protection Agreements with Singapore (2018) and Vietnam (2019). Furthermore, on 20 March 2018, the Council authorized the negotiation and approved negotiating directives for the negotiation of a Convention on the establishment of a multilateral court for the settlement of investment disputes (Council of the European Union, 2017). These actions can be considered part of the "Brussels effect", a term coined by Bradford (2020).

At this point it is crucial to mention that the implementation of a Multilateral Investment Court, which is nowadays under discussion at the UNCITRAL. The last report of Working Group III on the work of its forty-second session (New York, 14-18 February 2022) does not include any reference to the right to regulate or national policy space protection. Notwithstanding,

¹¹ Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Greece, Spain, France, Croatia, Cyprus, Italy, Latvia, Lithuania, Luxembourg, Hungary, Malta, Netherlands, Poland, Portugal, Romania, Slovenia and Slovakia.

¹² Nevertheless, some awards suggest that survival clauses cannot be consensually terminated by treaty parties; there is no solid argument to affirm that these provisions have a special nature in Law of Treaties. Thus, "just as any other treaty provision [survival clauses] may be terminated by consent of the treaty's parties" (Wackernagel, 2020).

the debate has significant advance in procedural draft provisions regarding jurisdiction, governance structure, tribunal members (diversity and selection)¹³. The next session (Vienna, 5-16 September 2022) will not address this topic¹⁴. It is not the objective of this piece to analyze the procedural reform.

Although the following examples do not turn the States into dissidents, they are disruptive pieces in investment regime. Firstly, the investment chapter in United Kingdom-Australia Free Trade Agreement (Agreement in principle, 2021) maintains investment protections but does not include investor-State arbitration provisions. Secondly, United States-Mexico-Canada Trade Agreement's mechanism only applies to Mexico-United States relations regarding national treatment, most favored nation, direct expropriation, or public contracts in specific economic sectors, such as oil and gas, power generation, telecommunications, transportation, and the ownership or management of infrastructure. Similar provisions regarding environmental, health, or other regulatory objectives and corporate social responsibility exceptions to investor-State arbitration can be found in Mexico-Hong Kong BIT, in force since 16 June 2021.

At this point, it is relevant to mention that, as Amorim et al. (2021) argue, "reactions in the developed countries were, in general, more restrained". The claim to expand the policy space presents different nuances in the Global South and the Global North. While in the North the debate seeks to correct negative externalities through health, public safety, and environmental exceptions, in some countries of the South, contestation and dissidence are rooted in constitutional provisions (Morosini and Sanchez Badin, 2017), such as rights of nature, protection of strategic resources - gas, oil, water - or local or regional courts competence based on Calvo doctrine.

Finally, interpretative statements are directly linked to the idea that States have a "dual role" as respondents in disputes and interpreters (Skovgaard Poulsen and Gertz, 2021). Although treaty renegotiation - for instance the United States-Mexico-Canada Agreements - or termination - for example the Agreement for the termination of Bilateral Investment Treaties between the Member States of the EU, and the proposal of investment court system - are possible options for States, they have costs in terms of time, resources, and politics. As the core problems for regulatory sovereignty are the unbalanced treaties, interpretative instruments can bring them to ISDS current debates and protect national policy space.

According to the Vienna Convention, together with the context, treaties should be interpreted regarding "any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions" (article 31.2.a). Interpretative statements are a reasonable tool to update old problematic treaties and find a pathway out of the labyrinth. In this context, regarding the North America Free Trade Agreement, the tribunal in *ADF Group v. United States*

¹³ A deep monitoring of the debates at the UNCITRAL can be found in Anthea Roberts's and Taylor St Jones's webpage dedicated to examining the evolution of the investment treaty system: <https://www.isdsreform.com/>

¹⁴ All documents can be accessed at the UNCITRAL Working Group III webpage: https://uncitral.un.org/es/working_groups/3/investor-state

(ICSID Case No. ARB (AF)/00/1) considered that the Free Trade Commission Interpretation – a binding instrument – illustrates the need

for a mechanism for correcting what the Parties themselves become convinced are interpretative errors but also for consistency and continuity of interpretation, which multiple ad hoc arbitral tribunals are not well suited to achieve and maintain (par. 177).

Skovgaard Poulsen and Gertz (2021) propose a multilateral interpretative mechanism under UNCITRAL's umbrella. The authors argue that it would be a flexible mechanism that can throw light from a political side and operates with economies of scale. Illuminating examples can be found in the United States-Mexico-Canada Agreement and Canada-EU Comprehensive Economic and Trade Agreement. Interpretative instruments limit arbitrators' influence to maintain the regime in the past, as in *Eco Oro v. Colombia*.

Conclusion

UNCTAD's concern about the conditioning of the right to regulate was belated, almost five decades after its creation. Notwithstanding the above, it marks a turning point by exposing the existence of the fallacy that BITs are always beneficial to States. It also marks a milestone in recognizing the shortcomings of the international regime and how these impact the regulatory powers of States.

However, is State sovereignty conditioned in the sense of any of the four projections proposed by Krasner? None of the projections proposed by Krasner has policy space at its core, responding to the call for States to regain regulatory powers, particularly in contexts of economic crisis, as Sornarajah (2015) points out. This idea is reinforced in the context of the Covid-19 syndemic and the construction of the day after: forecasts for global economic recovery show a trend towards deepening gaps (International Monetary Fund, 2021)¹⁵.

Furthermore, the antecedents indicate that policies related to public health have been contested by foreign investors. UNCTAD's report on international investment policies and public health details that at least 33 controversies related to health policies are known - tobacco control, access to drinking water and sanitation, intellectual property of medicines, among other regulatory areas (United Nations Conference on Trade and Development, 2021). Likewise, since there are no international treaties that regulate pandemics or syndemics¹⁶, the application of the state of

¹⁵ Even considering the prelude to COVID-19, in the case of Latin America and the Caribbean, States found themselves in a moment of economic slowdown that left them in a more fragile situation than the one they had before the global crisis of 2008 (Fleiss, 2021). A particular analysis of the impacts of COVID-19 on investor-State dispute settlement can be found in Bas Vilizzio (2020b) and United Nations Conference on Trade and Development (2020).

¹⁶ On 1 December 2021, the World Health Assembly's members agreed to start the negotiation of an international treaty on pandemic prevention and preparedness (World Health Organization, 2021).

necessity as an exemption from the international responsibility of the State (Article 25 of Resolution AG/56/83) becomes a decision of arbitrators.

The new concept of sovereignty is rooted in the defense of policy space, where the right to regulate is the heart and can therefore be called regulatory sovereignty (Bas Vilizzio, 2020b). As an initial approximation, regulatory sovereignty has notes of authority and legitimacy, like internal sovereignty, but no notes of control. It is also necessary to distinguish this concept from the choice of mechanisms that allow the State to develop as it sees fit, and thus exercise its sovereign status. This second concept is that of autonomy, a condition that makes it possible to define fairer and more balanced measures (Puig, 1986).

As the right to regulate is one of the areas of action of the UNCTAD-driven reform process of the investment protection regime, States may choose to exclude certain sectors or issues from ISDS as a way to protect it. However, this is not a direct path to protection, but presents a minor level of change from the current regime. Other paths can lead to direct enshrinement of the right to regulate, namely: its express recognition, as in the Morocco-Nigeria BIT, the introduction of general exceptions modeled on articles XX of the GATT and XVI of the GATS, or the exclusion of the current regime and the creation of a new institutional framework to protect it.

For this last point, two examples were examined: the South American dissidents and the Treaty for the termination of intra-EU BITs. It is possible to extend Puig's (1986) ideas in regards to solidarity-based integration in Latin American States: the strategic solidarity of EU members is presented as an overcoming force that strengthens autonomy and defends the EU's policy space as a mirror of its members' sovereignty.

Notwithstanding the above, the European institutions' criticism of intra-EU arbitration is nothing more than a reflection of an internal problem, whose catalysts are the economic crisis and the excessive increase in arbitration in the renewable energy sector. While his proposal for an investment court system (bilateral and multilateral phase, currently under debate at the UNCITRAL Working Group III) provides a realistic alternative, it does not necessarily supplant the current regime. It also shows a duality: intra-EU arbitrations are rejected, while extra-EU arbitrations are pushed forward either in the traditional regime (there is no proposal to terminate extra-EU BITs) or with the alternative proposal.

Furthermore, the introduction of interpretative statements - bilateral, regional, or multilateral - is the fourth pathway out of the ISDS labyrinth. The focus on the old unbalanced problematic agreements can help to protect the right to regulate in instruments where it was not. Although the options have different nuances, all constitute a demonstration of the construction of a new concept of sovereignty where the defense of policy space takes precedence, even if in the medium term it becomes a parallel regime to the current regime rather than a substitute for it. This construction begins within States and seeks to shape the international system, generating transformations in the international regime: principles, rules, and institutions. Sovereignty is back, but the question remains whether the proposals will be sufficient to address current challenges, such as Covid-19, climate change, or growing inequalities.

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