

How "new" EU Member States should approach investment claims by EU investors

by

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Investment arbitration against Central and Central-Eastern EU Member States is on the rise. A significant number of these claims are brought by EU investors despite the fact that the European Commission has opined that international arbitral tribunals established under these intra-EU BITs are not competent to decide these disputes with EU law relevance. In the wake of the Commission's relative inaction in respect of these intra-EU BITs, Member States have been tasked with responding to this increasing number of claims. To date, however, they have had limited success.

This brief policy paper outlines likely causes of this unsatisfactory situation in particular for new Member States. It identifies the structure of the legal arguments in these arbitrations and the lack of a comprehensive overall policy approach as likely main causes. To remedy these shortcomings, the paper suggests new Member States adopt a three pillar strategy, consisting of legal, policy and public awareness elements.

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A. Introduction

"New" EU Member States¹ in Central and Central Eastern Europe are facing an increasing number of claims by foreign investors under bilateral investment treaties ("BITs"). Recent statistics by the World Bank show that around one quarter of all investment claims are filed against countries in Eastern Europe and Central Asia.² Under most BITs investors may commence international arbitration before an international arbitral tribunal for alleged expropriation or "unfair and inequitable treatment" of their investments by the host state.

Such claims are frequently brought by EU investors (mostly, but not exclusively, from "old" EU Member States) against "new" EU Member States. In at least some of these cases, investors succeeded with their claims and international arbitral tribunals ordered the respondent EU Member State to pay significant amounts of compensation for alleged violations of the BIT concluded between two EU Member States (so-called "intra-EU BITs").³ This is notwithstanding the fact that the European Commission ("Commission") is of the unequivocal view that international arbitral tribunals should not exercise jurisdiction if and when they are established under intra-EU BITs and the dispute potentially touches upon EU law questions.⁴

While the Commission's view is clear, to date it has, likely for political reasons, refrained from starting formal infringement proceedings against Member States pursuant to Article 258 of the Treaty on the Functioning of the European Union ("TFEU") for upholding their intra-EU BITs.⁵ Similarly, with few exceptions, Member States have refrained from terminating their intra-EU BITs.⁶ As a result, it remains to be the case that there are more than 180 intra-EU BITs in force. On the basis of these BITs, Member States continue to be at risk of facing claims by foreign EU investors.

It would seem that to date "new" Member States have neither reacted to this – from their perspective – unsatisfactory situation with one voice, nor have they reacted effectively. A small number of Member States have sought to align their position with the Commission's position: they have argued that international arbitral tribunals established under intra-EU BITs ought to decline to exercise jurisdiction (although with arguments different to the ones advanced by the Commission, as we will show below). Other Member States have, deliberately or not, not pursued a similar defence strategy. Either way, it would appear that to date no Member State has succeeded in arguing that such arbitral tribunals are not competent to decide these disputes.

It is high time – not just for those entrusted by the EU Treaties with the task to preserve the unity and consistency of EU law – but for the "new" Member States to reverse this trend and to change this – from their perspective – unsatisfactory situation. This policy paper seeks to do this by providing some initial thoughts. It brings together a practitioner with a background in both government and academia⁷ and two academics with a practical background in EU law and international investment law.⁸

B. Taking stock: the challenges faced by "new" EU Member States

It is fair to say that Member States to date do not appear to have followed a successful, comprehensive and consistent strategy when it comes to intra-EU investment claims. It would appear that two Member States (the Czech and the Slovak Republic) have sought to challenge the jurisdiction of international arbitral tribunals established under intra-EU BITs.⁹ Judging from publicly available arbitral awards they would seem to have based their defenses on the argument that the pertinent intra-EU BIT is terminated by virtue of Article 59(1) of the Vienna Convention on the Law of Treaties ("VCLT"). In simple terms, according to this provision, a treaty (here: the intra-EU BIT) should be considered as terminated if "superseded" by a later treaty (here: the EU Treaties) relating to the same subject matter. Whereas we are of the view that intra-EU BITs are inconsistent with EU law (to the extent it applies), we are equally of the view that Article 59 VCLT inadequately describes the relationship between intra-EU BITs and EU law.¹⁰

Similarly, subsidiary arguments based on Article 30(3) VCLT have not succeeded so far. Again in simple terms, according to this provision if an earlier treaty is not terminated by virtue of Article 59(1) VCLT, the intra-EU BIT would apply only to the extent that its provisions are compatible with those of the EU Treaties. The main provision in intra-EU BITs that was targeted with this argument was understandably the investor-State arbitration clause. The argument is that this clause would not be compatible with the exclusive system of remedies under EU law. In particular, the argument goes, international arbitral tribunals may not request a preliminary ruling from the Court of Justice of the European Union ("CJEU") in accordance with Article 267 TFEU. While this argument would seem to be more convincing than the argument based on Article 59(1) VCLT, this strictly public international law perspective is still unlikely to succeed as it appears that the scope and effect of the EU Treaties have not always been comprehensively presented to and dealt with by arbitral tribunals.¹¹

In order to succeed in such intra-EU investment arbitrations it is paramount that respondent Member States put forward arguments strong on both points: international investment law *and* EU law. Experience in EU law, in addition to international investment law, is important in all steps of an intra-EU investment arbitration, including, crucially, when appointing the Member State's arbitrator: we are not aware of any intra-EU investment arbitration in which the respondent Member State has appointed an arbitrator with strong credentials in both international investment law *and* EU law (admittedly, a fairly rare species). It may thus come as no surprise that to date no international arbitral tribunal appears to have declined jurisdiction on the basis of EU law.

In at least some of the known intra-EU investment arbitrations, the Commission filed so-called *amicus curiae* submissions seeking to explain the scope of the EU Treaties to the

relevant arbitral tribunals. It is fair to say that over the last few years the Commission's view developed such that originally the Commission was less than clear as to whether arbitral tribunals would be competent to decide intra-EU investment claims. More recently, however, the Commission was clear in saying that arbitral tribunals established under intra-EU BITs are not competent to decide these disputes.¹²

Nevertheless, arbitral tribunals to date remain to be convinced. It is possible at least that one of the reasons why arbitrators have not been convinced of the arguments so far is that Member States' arguments would not appear to have been (fully) aligned with the Commission's arguments, leading to further confusion in an already complicated legal matter. We are also aware of at least one case in which the respondent Member State (in that case, Hungary) did not put forward the argument that the arbitral tribunal was not competent to decide the dispute, whereas the Commission, in an *amicus curiae* submission in the very same arbitration, adopted this view.¹³ Unsurprisingly, the arbitral tribunal in that case accepted jurisdiction over the dispute.

We consider that, if Member States want to succeed in intra-EU investment claims, they ought to adopt a more comprehensive strategy. Ideally, Member States would cooperate, but even in the absence of coordination there is a lot which individual Member States can and should do, as we outline below.

C. Overcoming the past: a made-to-measure three pillars strategy for the future

To remedy the shortcomings identified above, we recommend a strategy consisting of three pillars. Pillar 1 comprises legal actions; Pillar 2 contains policy and communication actions; and Pillar 3 aims at steering public debate on the issue of intra-EU investment protection. The three pillars are inextricably linked to each other and call for coordinated and synchronized actions across the pillars.

Central to success is to develop a coherent, sophisticated and credible line of reasoning on the incompatibility of intra-EU investment arbitration with EU law which can be presented vis-à-vis both, the EU institutions and other Member States. Currently, such a line of reasoning appears to be missing. At least we are not aware of any comprehensive strategy by Member States, setting certain ad hoc and case-by-case initiatives aside.

In our view respondent Member States currently focus too much on fending off individual investment claims. Instead, they would urgently need to put forward a proactive initiative on investment protection which accommodates the concerns of all Member States. Hence, respondent Member States should not only focus on pending arbitrations, but also aim at building consensus to replace the current system of intra-EU BIT arbitration with a state-of-the-art system of protection of foreign investment which suits all stakeholders and interests concerned.

Pillar 1 - Legal actions

We concur with the Commission's position such that intra-EU BITs and in particular investor-State arbitration clauses included in most of these BITs are inconsistent with EU law (to the extent it applies): For example, due to an incomplete network, differing standards, and limited personal scope of application intra-EU BITs discriminate against EU nationals and companies and thus violate EU fundamental freedoms. Further, fair and equitable treatment and umbrella clauses in intra-EU BITs are in a potential conflict with EU law as they might strike a different balance between substantive legality and the protection of legitimate expectations of an investor. Intra-EU BITs are also potentially capable of hindering or preventing the implementation of EU policies due to conflicting obligations to act and to desist. Finally, intra-EU investment tribunals are incompatible with the exclusive jurisdiction of the CJEU which is put in place in order to preserve the autonomy, unity, and consistency of EU law.¹⁴

However, intra-EU investment claims will most likely not end until either Member States jointly terminate their intra-EU BITs or the CJEU hands down a judgment on their incompatibility with EU law. While the first option is tainted with more difficulties, respondent Member States should primarily aim at referring the compatibility question of intra-EU BITs and EU law to the CJEU by way of commencing infringement proceedings pursuant to Article 259 TFEU or, probably more appropriately, by way of seeking to nudge competent courts to initiate preliminary rulings proceedings pursuant to Article 267 TFEU. In this respect, it is important to note that the CJEU – in contrast to international arbitral tribunals – applies a distinct EU law perspective which attributes specific weight to unity and consistency of EU law.

Hence, any legal effort of a respondent Member State in respect of ongoing and looming intra-EU investment claims needs to aim at utilizing a coherent, sophisticated and credible line of reasoning on the incompatibility of intra-EU BITs with EU law. This needs to take into account the views held by the Commission. Significantly, it needs to aim at both, succeeding in individual investment arbitrations and challenging intra-EU BITs before the CJEU.

Pillar 2 - Multi-stakeholder policy and communication actions

Respondent Member States are in need of presenting the issue of incompatibility of intra-EU BITs with EU law to all relevant European stakeholders in a way that intra-EU BITs are terminated by consensus and replaced by state-of-the-art, EU-law compatible mechanisms of investment protection. In the alternative, respondent Member States should either push for infringement proceedings initiated by the Commission with the aim of receiving a favorable CJEU ruling declaring intra-EU BITs incompatible with EU law or should initiate such proceedings on their own account.

It is, hence, essential to create and foster appreciation of the position of the defining Member States among European stakeholders. It appears that respondent Member States

do not engage with all crucial stakeholders on the European plain in a manner sufficiently coherent and persuasive in order to gain momentum and turn things in their favor. In particular, the EU Parliament should prove a crucial player.

Pillar 3 - Steering public debate

Creating and fostering public understanding of the EU law and policy related issues surrounding intra-EU investment claims and developing alternative routes to intra-EU BITs is vital in order to create leverage necessary for action at EU level. This means that we should acquire a broad range of views, build up our knowledge base, and test new ideas in an informed public involving legal practitioners, academics, and policy makers from the EU institutions and EU Member States in order to build consensus on the idea of terminating or replacing existing intra-EU BITs.

However, it is important to note that any policy action taken in one of the three pillars in respect of removing effects from intra-EU BITs can *only* be successful if the respondent Member State can ensure compliance with and acts with a *bona fide* attitude towards EU law when regulating foreign investment. If a Member State cannot prove to its partners that it is willing to comply with its EU law obligations in respect of foreign investment, any effort in respect of removing the effects of intra-EU BITs will most likely be fruitless.

D. Summary

It is high time for "new" EU Member States to come up with a sophisticated strategy in intra-EU investment claims. This strategy needs to be fully aligned with the Commission's position which to date it demonstrably has not been. This is surprising in circumstances in which it would seem that the interests of these Member States and the Commission are at the very least overlapping, if not identical.

This paper has outlined how Member States could approach this – from their perspective – unsatisfactory situation of an increasing number of intra-EU investment claims. Potentially, at least, (threatened) investment claims may limit a (Member) State's policy space. Assuming that they comply with all of their EU law obligations, Member States, if they chose to aim at replacing intra-EU BITs with an EU-law compatible investment protection regime, would also regain much needed policy space. This is of particular importance in times of economic difficulty. Needless to say, a successful implementation of any strategy needs to be tailored to a given Member State's needs.

In any event, it is about time to enter into a constructive debate on how to replace an investment protection scheme incompatible with EU Law with a regime in line with Member States' EU law obligations, and which is, or at least should be, in their common interest to create a healthy and stable investment environment.

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¹ “New” Member States within the meaning of this policy paper are all those which acceded to the European Union in 2004 or later; to all others it is referred to as “old” Member States.

² ICSID, The ICSID Case load – Statistics (Issue 2013-2), available at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics>. (19 September 2013).

³ Cf. Steffen Hindelang, *Circumventing Primacy of EU Law and the CJEU’s Judicial Monopoly by Resorting to Dispute Resolution Mechanisms Provided for in Inter-se Treaties? The Case of Intra-EU Investment Arbitration*, Legal Issues of Economic Integration, April 2012, vol. 39, no. 2, pp. 179 et seq.

⁴ “In particular, most Intra-EU BITs provide for the possibility of investor-to-State arbitration procedures of a binding character, which is not subject to review by the CJEU on issues of interpretation of EU law. This form of international arbitration is incompatible with the exclusive competence of EU courts to rule on the rights and obligations of Member States under EU law.” Cf. European Commission, COMMISSION STAFF WORKING DOCUMENT on the free movement of capital in the EU, SWD(2013) 146 final, Brussels, 15 April 2013.

⁵ Cf. http://ec.europa.eu/taxation_customs/common/infringements/infringement_cases/bycountry/ (19 September 2013).

⁶ Note, for example, the efforts of the Czech Republic to terminate its intra-EU BITs, cf. IA Reporter, Newsletter, vol. 4, no. 2 (1 February 2011), available at: http://www.iareporter.com/downloads!20110316_1 (19 September 2013).

⁷ Cf. profile Markus Burgstaller at the end of this policy paper. His publications on the subject matter of this policy paper include *European Law and Investment Treaties*, Journal of International Arbitration, April 2009, vol. 26, no. 2, pp. 181 – 216 and *European Law Challenges to Investment Arbitration*, in: Michael Waibel et al (eds.), *The Backlash against Investment Arbitration*, Kluwer, 2010, pp. 455 to 482.

⁸ Cf. profile Steffen Hindelang and Ingolf Pernice at the end of this policy paper.

⁹ Cf. endnote 3.

¹⁰ Steffen Hindelang, *Member State BITs - There's Still (Some) Life in the Old Dog Yet - Incompatibility of Existing Member State BITs with EU Law and Possible Remedies*, in: Karl P. Sauvant (ed.), *Yearbook on International Investment Law & Policy 2010-2011*, Oxford University Press, 2011, pp. 217 et seq.

¹¹ On this point cf. endnote iii.

¹² See above endnote 4.

¹³ *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability dated 30 November 2012.

¹⁴ Cf. endnote 10.