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Investment Arbitration and EU Law

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Abstract
Investment arbitration is based on international agreements and operates in parallel to the EU legal and judicial system. Therefore conflicts between EU law and investment protection are possible. These may result from the substantial investment protection standards, but also from the operation of a parallel system of judicial protection. The EU law position on such conflicts will depend on whether the investment agreement was concluded between Member States, between Member States and other countries, or between the EU and other countries.

Keywords: International law, investment protection, arbitration, Member State agreements, EU agreements

I. INTRODUCTION

Investment arbitration is a topic that has recently begun to attract a lot of interest in the public debate though it has been around for some time. We will discuss some specific issues that exist in relation to EU law.

Investment arbitration is based on international treaties on investor protection. States have concluded such treaties since the 1960s.[1] Their objective is the promotion and protection of foreign direct investment. To this end, treaties define investor protection standards. These apply to private investors coming from one of the treaty states and investing in another treaty state, the so-called host state. These investors can initiate international arbitration proceedings against the host state to claim damages for breaches of the investor protection standards. Mostly these are bilateral investment treaties (BITs), but there are also some multilateral agreements, such as the European Energy Charter Treaty where the EU is one of the parties. The protection standards

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[1] According to, eg C Tietje, 'EU-Investitionsschutz und -förderung zwischen Übergangsregelungen und umfassender europäischer Auslandsinvestitionspolitik' (2010) 21 (17) *Europäische Zeitschrift für Wirtschaftsrecht* 647, note 36, the first treaty providing for investment arbitration was the Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments, concluded at Bonn on 25 November 1959, Bundesgesetzblatt 1961, Teil II, p 794 ff.

usually include for example National Treatment and Most Favoured Nation Treatment, as well as Fair and Equitable Treatment, Full Protection and Security, Non-Expropriation and the free transfer of payments relating to the investments.

The public debate often focuses on the right of investors to bring actions against states under these standards. However, lawyers familiar with EU law won't consider this right to be exceptional. On the contrary, EU law provides for very similar standards under the fundamental freedoms, especially the free movement of capital and the freedom of establishment. For example, the free movement of capital explicitly includes the free movement of payments (Article 63 (2) TFEU) and many regulatory issues are covered by the freedom of establishment.[2] What isn't ordinary is the procedural setting, namely international arbitration. Under EU law, investor protection primarily relies on the judiciary of the Member States and on the European Court of Justice. Both are linked by the preliminary ruling procedure that enables the Court of Justice to give a binding and definitive interpretation of EU law. In addition, the European Commission may enforce EU law and in particular the fundamental freedoms by pursuing infringement procedures against Member States in the Court.

In contrast, investor-state dispute settlement may take place under different arbitration regimes, for example under ICSID,[3] UNCITRAL,[4] SCC[5] or ICC[6] arbitration rules. All these arbitration regimes have in common that they are structured as one-tier systems without the possibility of substantive review of the tribunal's decisions.[7] Moreover, arbitrators are generally experts in the field of international investment law. That's why the investment arbitration proceedings are considered to be particularly efficient. These characteristics, which are in general beneficial to the investor-claimant, distinguish it considerably from national court proceedings. Being under the protective shield of a BIT, they find themselves in the advantageous position of having recourse to 'fast track' investment arbitration. This allows investors to avoid ordinary judicial proceedings that are often more time-consuming. In addition, the judiciary in the host state is normally not specialised in international investment law and in some countries may be more sympathetic to policy considerations of the government than to investors' claims.

In the following, we will discuss some issues that are raised by investment arbitration in the context of EU law. First of all, the most obvious concern lies in

[2] Cf *CaixaBank France*, C-442/02, EU:C:2004:586, concerning a prohibition on banks to pay interests on certain deposits.

[3] International Centre for Settlement of Investment Disputes.

[4] United Nations Commission on International Trade Law.

[5] Stockholm Chamber of Commerce.

[6] International Chamber of Commerce.

[7] For example, in ICSID cases, the ICSID annulment mechanism under Art 52 ICSID Convention is limited to procedural issues and does not include a review on the merits. Under other arbitration regimes, eg UNCITRAL, the review of awards in set-aside proceedings or in enforcement proceedings before ordinary courts may allow for a control based on the 'public policy' exception of Art V(2)(b) New York Convention.

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potential conflicts between, on the one hand, arbitral awards rendered under BITs and, on the other hand, EU law. Secondly, from a more abstract perspective the question arises of whether the existence of investor-state arbitration as a legal recourse alongside the existing judicial architecture in Europe is compatible with the EU legal order. Both topics will be analysed on three levels, namely with regard to intra-EU BITs which are agreements between EU Member States, with regard to extra-EU BITs between Member States and third countries, and finally with regard to (future) BITs concluded between the EU and third countries. To exemplify the problems we will use a case study that can be adapted to each of these categories.

II. EXISTING INTRA-EU BITS AND THEIR RELATIONSHIP WITH EU LAW

There are currently approximately 190 intra-EU BITs between EU Member States.[8] Most of the intra-EU BITs were concluded between old Member States – the EU 15 – and between Central or Eastern European countries – the EU 13 – before their accession to the EU.

In the first part of this section we will present the case study. Then we will address the rules on the resolution of possible conflicts between investment arbitration under intra-EU BITs and EU law. The third part will deal with the question whether EU law allows intra-EU BITs or whether they must be terminated as the Commission believes.

A. Case study

Our case study concerns two old Member States. It is fictitious, but based on a real arbitration case that was brought by Swedish energy company Vattenfall against Germany. There is a well-known arbitration case between these two parties on nuclear energy,[9] but the case study is inspired by an earlier case about a coal-powered plant project at Moorburg, near Hamburg. The original permit for this project included very strict environmental conditions. The regional authorities argued that these conditions were necessary to comply with the EU Habitats Directive.[10] Vattenfall challenged the conditions in the German administrative courts and, at the same time, initiated an arbitration procedure under the European Energy Charter. Both proceedings were settled because the parties agreed to modify the permit.[11] Subsequently, the European Commission started infringement proceedings against Germany arguing that the project did not comply with the Habitats Directive. In 2015 the Commission decided to refer the case to the Court of Justice.[12]

[8] *Investor-State-Dispute Settlement: An Information Note on the United States and the European Union* (UNCTAD, June 2014), Issues Note 2, p 3.

[9] *Vattenfall AB and others v Germany*, ICSID Case No ARB/12/12.

[10] Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora [1992] OJ L206/7.

[11] *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v Germany*, ICSID Case No ARB/09/6, Award of 11 March 2011.

[12] Press release IP-15-4669 of 26 March 2015. Case C-142/16, application lodged at the Court [2016] OJ C165/13.

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For the purpose of this analysis we will adapt this case by adding some fictitious assumptions, namely that:

- The case was brought under a traditional pre-accession intra-EU BIT
- There actually had been an award in favour of Vattenfall
- As a consequence of the award, the German authorities, with the agreement of Vattenfall, had not paid damages, but adapted the permit
- The Court of Justice had found that these adaptations infringed the Habitats Directive.

As a result, the host State is facing two seemingly contradictory substantive obligations, one resulting from its obligations under the BIT and the other arising in its status as a Member State of the EU. Therefore, it may be subject to legal actions taken under different mechanisms to sanction any breach of these obligations. What can be done to solve this apparent dilemma?

We are not convinced by the formal argument that there is no real conflict because arbitration only awards damages, but does not affect a Member State's duty to implement EU law.[13] It can hardly be denied that the practical effect of EU law will be weakened if Member States are obliged to compensate investors for implementing EU measures. Moreover, it could even be argued that a compensation for EU regulatory measures that is selectively paid to investors from other Member States has to be qualified as an illegal state aid.[14] This is particularly relevant if damages are awarded to compensate for the claw-back of such subsidies.[15]

B. Resolving open conflicts

The arbitration community tends to look at this situation from the perspective of public international law. This approach considers the EU Treaties to be regional international law.[16] As a result, the relationship between successive treaties, namely the earlier concluded intra-EU BITs and the later concluded Accession Treaties, is governed by the rules of conflict set out in the Vienna Convention of the Law of the Treaties.

Under the Vienna Convention, one could regard the entire intra-EU BIT as terminated pursuant to Article 59.[17] One could also apply the BIT 'to the extent that

[13] T Eilmansberger, 'Bilateral Investment Treaties and EU Law' (2009) 46 (2) *Common Market Law Review* 383, p 410.

[14] But see C Tietje and C Wackernagel, 'Outlawing Compliance? – The Enforcement of Intra-EU Investment Awards and EU State Aid Law' (2014) 41 *Policy Papers on Transnational Economic Law*.

[15] Cf *Micula v Romania*, ICSID Case No ARB/05/20 and subsequently in the General Court Cases *Micula v Commission*, T-694/15, application [2016] OJ C38/69 and *Micula and Others v Commission*, T-704/15, application [2016] OJ C68/30; see also Tietje and Wackernagel, note 14 above, p 7 ff.

[16] See eg *Electrabel SA v Republic of Hungary,* ICSID Case No ARB/07/19 (ECT Belgium – Hungary) of 30 November 2012, 4.112.

[17] Further elaborations in H Wehland, 'Intra-EU Investment Agreements and Arbitration: Is European Community Law an Obstacle?' (2009) 58 (2) *International and Comparative Law Quarterly* 297, p 303 ff.

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its provisions are *compatible* with those of the later treaty' as set out in Article 30. Both provisions are expressions of the principle of *lex posterior*. Because the Accession Treaty was concluded after the BIT it can modify the earlier treaty. Consequently, no conflict with EU law can exist.

If one recalls the real-life origin of our case study, it will be apparent that there is a problem with this approach: The European Energy Charter was ratified by Sweden and Germany in 1997, after the Swedish accession to the EU. The Energy Charter is the later treaty and would modify the EU treaties concluded earlier. The EU treaties were subsequently reaffirmed by the Treaties of Nice and Lisbon, but at some point the Energy Charter may also be amended. From the perspective of EU law this approach is less than perfect.

Under EU law the solution is simpler because it enjoys primacy over Member State law. This principle is consistently applied by the Court of Justice when dealing with the question of how to handle conflicts between EU law and *inter se* treaties of Member States. In early cases the Court affirmed that the EEC Treaty takes precedence over agreements that were concluded between Member States before this treaty entered into force.[18] Later the Court confirmed this precedence also with regard to agreements that were concluded at a time when the states in question were already Member States of the European Community.[19] This approach is consistent with the general concept of precedence or primacy in EU law. Just as unilateral Member State legislation is subject to the primacy of EU law, Member State law that results from bilateral or multilateral agreements with other Member States must be subject to this primacy. As a consequence, international agreements between Member States can only be applied as far as they comply with EU law. Our fictitious case study with the pre-accession BIT and the original arbitration case with the post-accession Energy Charter appear to be affected in the same way. Therefore, irrespective of the international agreement in question, the respective Member State would be bound by EU law, in particular by the Habitats Directive.

However, the real life origin of our case study adds another element that complicates matters even more. The European Energy Charter is not only a treaty between Sweden and Germany, but a multilateral treaty that has also been ratified by the EU.[20] Therefore, it forms an integral part of the EU legal order and even enjoys primacy over secondary EU legislation, such as the Habitats Directive.[21] For this reason, it is questionable whether the Commission could obtain a finding of the Court of Justice that there has been an infringement of EU law if the original environmental conditions of the permit were not allowed under the Energy Charter.

To avoid this outcome, the Commission appears to have submitted in the arbitration procedure *Electrabel v Hungary* that the Member States implicitly agreed

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[18] See *Commission v Italy*, 10/61, EU:C:1962:2 and *Matteucci v Communauté française de Belgique,* 235/87, EU:C:1988:460, para 22.

[19] See *Ravil*, C-469-00, EU:C:2003:295, para 37.

[20] Council and Commission Decision 98/181/EC, ECSC, Euratom of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects, [1998] OJ L69/1.

[21] *Intertanko and Others*, C-308/06, EU:C:2008:312, paras 42, 53.

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not to apply the arbitration clause of the Energy Charter between themselves.[22] The panel has not upheld this position.[23] We would, however, argue that it is up to the Court of Justice to decide on the intra-EU effects of the Energy Charter. In our opinion, at the very least, in intra-EU cases the Energy Charter and EU law have to be interpreted – as far as possible – in a way to avoid conflicts.[24] It cannot be assumed that Member States or the EU intended to derogate from either the EU Treaties or the Energy Charter when they concluded the respective agreements. With regard to our case study this means that the arbitrators should have taken account of the obligations resulting from the Habitats Directive. If they had done this correctly the Commission would not have been able to obtain a judgment from the Court finding an infringement. Such a practice would help to avoid most open conflicts between arbitration under the Charter and general EU law.

We also believe that, apart from a purely legal perspective, there is one important practical incentive for arbitrators to avoid open conflicts between intra-EU BITs and EU law. Such collisions would demonstrate that both systems can't co-exist. Therefore, they would increase the risk that the Court of Justice would consider intra-EU BITs incompatible with EU law.

This incentive is comparable to the incentives of the Court of Justice with regard to the jurisprudence of the European Court of Human Rights in Strasbourg and, to a lesser degree, with regard to jurisprudence of Member State constitutional courts. Open conflicts would risk the viability of the judicial architecture of the EU and therefore they should be avoided if possible. We would therefore expect that investor state dispute settlement under intra-EU BITs will in practice only rarely lead to open conflicts with EU law.

C. Compatibility of intra-EU BITs as such with EU law

Can we therefore conclude that intra-EU BITs are allowed under EU law as long as their outcomes are not in conflict with substantial EU law? The EU Commission does not think so and demands that intra-EU BITs are terminated. In 2015 it initiated infringement proceedings against five Member States and proceedings against other Member States have been prepared.[25] Although these cases have not yet reached the Court of Justice, two main complaints can already be identified.

When the Commission announced these cases it argued that bilateral treaties provide selective protection. They only cover investment from the respective BIT states and not from all EU Member States. The Commission considers this to be discrimination on grounds of nationality. The second complaint can be derived from other sources. It appears that the Commission is critical of BITs providing for parallel jurisdiction through arbitration procedures.[26]

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[22] See note 16 above, 4.109, 4.110.

[23] Ibid, 4.112.

[24] Cf ibid, 4.130 ff.

[25] Commission Press Release IP 15/5198 of 18 June 2015.

[26] Cf the presentation of the Commission's position in *Eastern Sugar BV (Netherlands) v The Czech Republic*, UNCITRAL, SCC Case No 088/2004, Partial Award of 27 March 2007, para 126, and

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1. *On discrimination*

The first issue, relating to discrimination, seems quite obvious. If investment arbitration is important then it provides an advantage to investors from the Member States that concluded the BIT. However, the fundamental freedoms prohibit discrimination on grounds of nationality. Therefore the question arises of whether investment arbitration needs to be available to all investors from other Member States.[27] If this is the case it could be argued that rules providing for such arbitration for investors from some Member State, but not explicitly extending it to all investors from other Member States, would already infringe the fundamental freedoms.

However, a parallel could be drawn with intra-EU bilateral double taxation conventions. The Court of Justice has decided that the benefits of these conventions don't need to be extended to persons from other Member States. In particular, specific rules on the allocation of taxation powers cannot be regarded as a benefit separable from the remainder of the convention. They are integral parts thereof and contribute to their overall balance.[28] In principle, a similar reasoning could be applied to BITs between Member States. Their specific benefits form part of an overall balance and therefore cannot be granted separately.

However, it should also be considered that before the Treaty of Lisbon, when the Court ruled on double taxation conventions between Member States, these were explicitly welcomed, perhaps even required by Article 293 of the EC Treaty. Moreover, in the absence of specific EU rules to prevent double taxation, such conventions are essential to prevent substantial barriers to cross-border economic activities, the reason being that, in principle, the fundamental freedoms do not prevent double taxation.[29]

In contrast, intra-EU BITs have never been explicitly welcomed by the Treaties. They certainly promote cross-border investments, and therefore the exercise of fundamental freedoms. But it can hardly be argued that they are indispensable to achieve this objective. On the contrary, EU law already provides for a certain degree of investment protection. This protection can be claimed in the ordinary judicial system of the Member States. Within the EU, the principle of mutual trust prevents Member States from (systematically) doubting the effective judicial protection guaranteed by the judiciary of other Member States.[30] Where the judicial practices of Member States do not meet minimum standards, recourse to the ECtHR is possible and it could even be argued that they infringe fundamental freedoms of EU law in combination with the principle of effectiveness. These could, and should, be

(F'note continued)
subsequently European Commission, Staff Working Document on the Free Movement of Capital in the EU of 15 April 2013 (SWD (2013) 146 final, p 11 [Council Document ST 13023 2013 INIT]) as well as Staff Working Document on the Free Movement of Capital and the Freedom of Payments of 30 March 2016 (SWD (2016) 105 final, pp 29, 30 [Council Document ST 8123 2016 INIT]).

[27] This is the position of Eilmansberger (see note 13 above), pp 402, 403.

[28] *D*, C-376/03, EU:C:2005:424, para 62.

[29] *Damseaux*, C-128/08, EU:C:2009:471, paras 26 and 27 with further references.

[30] Cf Opinion 2/13 (Accession to the European Convention on Human Rights), EU:C:2014:2454, paras 168, 191–194; and *Allianz*, C-185/07, EU:C:2009:69, para 30.

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enforced by the EU Commission or, in principle, by other Member States. As a consequence, it is difficult to justify the difference in treatment between investors from different Member States that results from intra-EU BITs.

To a certain degree the European Energy Charter has resolved the problem of discrimination because all Member States are party to this treaty. Therefore, within the EU, all cross-border investments associated with an economic activity in the energy sector should enjoy similar protection under the Charter.[31]

2. *Parallel administration of justice*

The concept of mutual trust in the Member States' judiciary leads us to the second complaint of the Commission, namely that recourse to international arbitration will bypass the ordinary administration of justice in the Member States.

As far as disputes between private parties are concerned, EU law is not opposed to arbitration.[32] There may be excellent reasons why private parties choose to avoid the Member States' judiciary and take recourse to arbitration. However, it is difficult to reconcile mutual respect between Member States with regard to their judiciary and agreements between the same states providing for investment arbitration. If Member States trust each other sufficiently to support the free movement of judgments or arrest warrants, why do they need a special system of legal protection for investors?

But the European Energy Charter again provides us with a counterpoint in this regard. With the accession to the Charter, the EU legislator apparently has accepted this parallel system of legal protection between Member States. Perhaps this is the reason why the Commission doesn't mention parallel systems of justice in the announcement of the infringement cases. However, even the legislator cannot validly allow such a parallel system if it is contrary to fundamental principles of EU law. Therefore, we need to look more closely at this issue.

The most direct problem of arbitration as a parallel system of judicial redress has already been illustrated; it can arrive at outcomes that are not compatible with EU law. While we have already seen that in this case EU law would prevail in principle, it seems difficult to guarantee primacy as a practical outcome.

Where arbitration awards are subject to potential control by a Member State court before execution, the question arises whether this court could even examine compliance with EU law. With regard to private arbitration, the Court of Justice has allowed that review of arbitration awards should be limited in scope and that annulment of, or refusal to recognise, an award should be possible only in exceptional circumstances.[33] Therefore, certain conflicts with EU law would not necessarily justify a refusal to recognise an award resulting from private arbitration. Conversely, it is not clear that this restriction could be transposed to investment arbitration. Private parties are not obliged by EU loyalty, but Member States are. It would be surprising if they could agree to be bound by arbitration awards that infringe EU law. However, in

[31] See Art 1(6) Energy Charter Treaty, para 3.

[32] *Nordsee v Reederei Mond*, C-102/81, EU:C:1982:107 and *Eco Swiss*, C-126/97, EU:C:1999:269.

[33] *Eco Swiss*, ibid, para 35.

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practice it may be difficult to avoid this effect. In particular awards under the ICSID Convention are supposed to be executed without any additional control.[34]

In the arbitration award *Electrabel v Hungary* it was argued that the possibility of infringement proceedings against the Member State in question was a sufficient safeguard.[35] However, the Court of Justice, in its Opinion on the Patent Court, found that decisions of the Patent Court, as proposed at the time, could not be the subject of infringement proceedings because it would not be a court of a Member State.[36] The same could be argued with regard to decisions of arbitration panels. Moreover, even if Member States could be held accountable for their participation in the proceedings, we do not see how an infringement procedure could prevent the execution of an award that infringes EU law. That is why we need to ask ourselves whether an effective mechanism to prevent the execution of awards that infringe EU law is a precondition for the compliance of intra-EU investment arbitration with EU law.

But even if arbitrators aim to comply with EU law, they are confronted with another problem. Member State courts can, or in some cases must, refer questions on EU law to the Court of Justice. This mechanism helps to prevent errors in the interpretation of EU law. However, it is dubious whether such a reference can be made out of investment arbitration proceedings. So far no panel has even tried.

These doubts are based on the *Nordsee* case where the Court considered itself incompetent to rule on a reference from a private arbitration tribunal.[37] We would not exclude that some of the objections expressed by the Court in that case could be overcome with regard to investment arbitration.[38] The Court has accepted compulsory arbitration provided for by Member State law as courts under the preliminary reference procedure.[39] However, at least one problem specific to *international* arbitration is harder to resolve. If the originally proposed Patent Court was not considered a court of the Member States, it would be even more difficult to consider an arbitration panel such a court, in particular if this panel was seated outside the EU. These doubts with regard to the power to refer make a mechanism to prevent the execution of awards that infringe EU law even more important. If such a mechanism relied on Member State courts they could make a reference if there were doubts about the compliance of the award with EU law.[40]

A final issue of parallel systems concerns what we would like to call, for lack of a better term, a tension between judicial principles and investment arbitration.

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[34] Art 54(1) ICSID Convention. Cf Eilmansberger, see note 13 above, p 427.

[35] See note 16 above, 4.162. See also Eilmansberger, note 13 above, p 406.

[36] Opinion, C-1/09, EU:C:2011:123, para 88.

[37] *Nordsee*, see note 32 above; see also *Denuit and Cordenier*, C-125/04, EU:C:2005:69.

[38] Cf J Basedow, 'EU Law in International Arbitration: Referrals to the European Court of Justice' (2015) 32 (4) *Journal of International Arbitration* 367.

[39] *Handels- og Kontorfunktionærernes Forbund i Danmark v Dansk Arbejdsgiverforening*, 109/88, EU:C:1989:383, paras 7–9; and *Ascendi Beiras Litoral e Alta, Auto Estradas das Beiras Litoral e Alta*, C-377/13, EU:C:2014:1754, paras 22–35; as well as order in *Merck Canada*, C-555/13, EU:C:2014:92, paras 15–25.

[40] Judgments in *Nordsee*, see note 32 above, paras 14, 15; and in *Eco Swiss*, see note 32 above, paras 32, 33, 40.

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Philippe Sands recently made a sweeping blow to all kinds of international judicial arrangements.[41] He didn't spare the Court of Justice, but also addressed issues with investment arbitration, mentioning enormous legal fees as well as arbitrators sitting in one case and acting as counsel in other, possibly related, cases.

We can only guess that the issue of fees was relevant to the Vattenfall case that inspired our case study. Obviously, this problem must be serious, if it is acknowledged by a UK law professor and arbitrator like Philippe Sands. But for other legal systems the fees issue will be even more important. In German courts, authorities defending a decision face a very limited risk with regard to costs. They can represent themselves and court fees are low. Even if they lose the case, the fees of the opposing counsel that they must cover are capped quite low in comparison to the UK. In contrast, the fees that may accrue under an arbitration procedure are outrageous from a German perspective. If the dispute is about environmental conditions it would not come as a surprise if such fees had to be met out of the extremely limited budget of the environmental authorities concerned. It is therefore not surprising that the case that inspired our case study was settled very quickly. Consequently, the increased risk with regard to costs under arbitration can have a practical effect on the application of EU law by Member State authorities. They may be more reluctant to enforce EU law if arbitration is threatened. In doubtful cases it may even be more attractive to risk infringement proceedings than to risk arbitration. The cost issue can be even more important in cases where rich international companies confront poor developing countries. However, the appreciation of intra-EU BITs is not affected by this problem and even for extra-EU BITs it is doubtful whether it would be an obstacle under EU law.

The Vattenfall case demonstrated another issue that appears particularly striking to us. The investor not only initiated arbitration proceedings, but at the same time challenged the environmental conditions in German courts. Ordinarily, dual jurisdiction over the same matter is something we try to avoid. In this case investment protection allowed it. One could insist on a formal distinction between the challenge to the decision and the claim for damages. Strictly speaking, these are two different matters. But parallel proceedings are still vexing. Under German law, such procedures could only be introduced one after the other. In other words, a final court decision on the challenge against the decision would normally be a precondition of the claim for damages, because there is an obligation on claimants to minimise damages by challenging harmful decisions first. In a similar vein, traditional international law requires the exhaustion of local remedies. In contrast, the rules on investment arbitration in most instances explicitly exclude any obligation to turn to the courts of the host state.

In this context, the issue of discrimination should also be remembered. It is not only relevant for persons from other Member States, but also for persons from the Member State concerned. Under the rule of law everybody should have equal access to justice. However, some investors can choose between judicial and arbitration

[41] P Sands, 'Developments in Geopolitics – The End(s) of Judicialization?', 2015 ESIL Annual Conference Final Lecture, http://www.ejiltalk.org/2015-esil-annual-conference-final-lecture-developments-in-geopolitics-the-ends-of-judicialization/.

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proceedings or even combine the two while others, local ones, only have access to ordinary courts. It is not obvious that such privileges can be justified within a Union of Law, which is characterised by mutual respect between the different legal systems and already provides a certain degree of investment protection.

In principle, many of these issues have been identified as problematic and there have been attempts to address them. For example, transparency of arbitration, another point of contention, seems to have been enhanced significantly by recent reforms though the new rules may not be applicable to all existing agreements. Recent proposals of the EU in the context of negotiations of extra-EU agreements, spearheaded by Commissioner Malmström, build on these developments and aim to add further improvements, for example by creating permanent arbitration bodies that could help to reduce possible conflicts of interest among arbitrators and increase coherence in the jurisprudence.[42] However, it will be very difficult to satisfy all critics and maintain the advantages of investment arbitration at the same time.

D. Interim conclusion and outlook

There is some doubt that intra-EU BITs are compatible with EU law, however nothing has been decided yet. Some cases are in the pipeline that may provide clarification. In addition to the infringement proceedings initiated by the Commission last year, a case is pending in the German court system that has generated a reference to the Court of Justice. The case is based on the award in *Achmea* (formerly *Eureko*) *v Slovak Republic*.[43] It concerns legislative changes to the Slovak health insurance sector that affected the investments of a Dutch company. The panel awarded EUR 22 million to the investor. The Slovak Republic applied to the German courts to set aside the final award. After the application had been rejected in a lower court,[44] an appeal was made to the German Federal Court of Justice, the Bundesgerichtshof. By a decision on 3 March 2016, this court has referred questions on the compliance of investment arbitration clauses in intra-EU BITs with EU law to the Court of Justice of the European Union.[45] These questions cover in particular the issues of discrimination and the missing competence of arbitration panels to refer questions to the Court of Justice. Furthermore, one question raises the possibility of a conflict with Article 344 TFEU, requiring Member States to abstain from submitting a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein.

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[42] See Art 8.18 et seq of the *Comprehensive Economic and Trade Agreement between Canada and the EU*, http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf, and Ch 13 of the EU-Vietnam Free Trade Agreement, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1437; for earlier discussions within the Commission see F Hoffmeister and G Alexandru, 'A first glimpse of light on the emerging invisible EU Model BIT' (2014) 15 (3–4) *The Journal of World Investment & Trade* 379; on inconsistency in investment arbitration see K Diel-Gligor, *Towards Consistency in International Investment Jurisprudence: A Preliminary Rulings System for ICSID Arbitration* (Nomos, forthcoming), ch 2.

[43] *Achmea BV* (formerly *Eureko) v Slovak Republic*, UNCITRAL, PCA Case No 2008-13, Award of 7 December 2012.

[44] OLG Frankfurt, 26 Sch 3/13, Order of 18 December 2014.

[45] BGH, I ZB 2/15, registered as case C-284/16 *Achmea*.

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In addition, two direct actions in the General Court challenge a state aid decision by the Commission that was issued as a consequence of arbitration proceedings.[46] An investor had obtained an award against Romania because this Member State had terminated some subsidies to comply with the EU state aid rules when it acceded to the EU.[47] The Commission considers Romania's disbursal of the awarded sum another illegal state aid.[48] This case appears to require a discussion of the conflict between the Commission's appreciation of the situation and the award.

III. EXISTING EXTRA-EU BITS OF MEMBER STATES

The next section will address extra-EU BITs of the Member States. In this regard we will discuss the first and the second paragraph of Article 351 TFEU, namely the protection of pre-accession treaties from EU law and the obligation of Member States to eliminate conflicts between pre-accession treaties and EU law. Finally, we will comment on the so-called Grandfathering Regulation that allows Member States to maintain extra-EU BITs under certain conditions.

To illustrate the issues of this section we will adapt the case study a little. We will assume an investor from a third state, such as China, complains about environmental conditions. Germany has concluded a BIT providing for investment arbitration with China in 2005.[49]

A. Article 351(1) TFEU

If the BIT had been concluded before accession to the EU, the rights and obligations it creates would be protected from the precedence of EU law by virtue of Article 351(1) TFEU. The Court has recognised this in a case concerning privileged access of a Swiss company to energy infrastructure in Slovakia.[50] If our case study was based on such a pre-EU BIT, there would be no conflict even if the award did not comply with EU law. The Commission should not be able to obtain a judgment of the Court finding an infringement.

However, for Germany as a founding Member State, the deadline under Article 351(1) is 1 January 1958, and Germany concluded the first BIT providing for investment arbitration only in 1959. Member States that joined the EU later will probably also have BITs that do not fall under Article 351(1), for example the UK doesn't appear to have pre-accession BITs that are still in force.[51]

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[46] *Micula v Commission* and *Micula and Others v Commission*, see note 15 above.

[47] *Micula v Romania*, see note 15 above.

[48] Commission Decision (EU) 2015/1470 of 30 March 2015 on State aid SA.38517 (2014/C) (ex 2014/NN) implemented by Romania — Arbitral award Micula v Romania of 11 December 2013, [2015] OJ L232/43.

[49] Bundesgesetzblatt 2005 Teil II, 733 ff.

[50] *Commission v Slovakia*, C-264/09, EU:C:2011:580.

[51] See the List of the bilateral investment agreements referred to in Art 4 (1) of Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries, OJ 2015 C135, p 1.

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In the Opinion in *Commune de Mesquer* one of the authors envisaged the possibility of applying Article 351(1) by way of analogy to post-accession agreements if at the time of their conclusion there was no conflict between the agreement and EU law.[52] However, our case highlights the difficulties of this idea. How should anybody foresee that a BIT of 2005 would come into conflict with the application of the Habitats Directive of 1992? In addition, it should be noted that up to now, the Court has never even considered the possibility of such an analogy.

Because our case study is based on a post-accession BIT with a third state, the Commission in all likelihood could therefore obtain a judgment finding an infringement.

B. Article 351(2) TFEU

Even if a pre-EU BIT is privileged under Article 351(1) TFEU, the second paragraph of this article requires Member States to eliminate incompatibilities between EU law and privileged pre-EU agreements. An open conflict as laid out in our case study would trigger this obligation. The Member State would at least have to negotiate modifications to the BIT to avoid a repetition. If that's not possible it might become necessary to denounce the BIT.[53]

A real life example of a conflict can be found in the Court's jurisprudence. Most BITs contain unqualified clauses guaranteeing the free transfer of payments relating to the investments of foreign investors. In contrast, the free movement of capital and payments between the EU and third states can be restricted by the EU. Therefore, the Court of Justice has found in cases concerning Austria, Sweden and Finland that the unqualified guarantees set out in BITs are incompatible with EU law.[54] At first glance, this may appear to be a rather far-fetched problem,[55] but remember Mr Kadi whose assets the EU had frozen because the UN Security Council suspected him of supporting Al-Qaida.[56] Just imagine that he had initiated arbitration proceedings under the BITs the EU Member States have concluded with Saudi-Arabia.[57]

There are probably additional substantial conflicts to be found between the typical standards of investment protection and EU law.[58] Moreover, some of the other issues discussed with regard to intra-EU BITs could trigger the obligation to eliminate

[52] See the Opinion of Advocate General Kokott in *Commune de Mesquer*, C-188/07, EU:C:2008:174, para 95.

[53] *Commission v Austria*, C-203/03, EU:C:2005:76, para 61.

[54] *Commission v Austria*, C-205/06, EU:C:2009:118; *Commission v Sweden I*, C-249/06, EU:C:2009:119; *Commission v Finland I*, C-118/07, EU:C:2009:715.

[55] Cf the submissions by certain Member States, reproduced in *Commission v Sweden I*, EU:C:2009:119, para 23.

[56] Joined judgments *Kadi v Council and Commission*, C-402/05 P and *Al Barakaat International Foundation v Council and Commission*, C-415/05 P, EU:C:2008:461.

[57] Cf A van Aaken, 'International Investment Law and Targeted Sanctions: An Uneasy Relationship' (2015) 9 (1) *Bucerius Law Journal* 1.

[58] J Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of the Energy Charter Treaty' (2012) 15 (1) *Journal of International Economic Law* 85, pp 89–91, mentions performance requirements, that is quotas for intra-EU production, and, less convincingly, the public policy exceptions of the fundamental freedoms.

incompatibilities. In particular, the parallel administration of justice also appears to be relevant for the assessment of extra-EU BITs of Member States.

In contrast, the general prohibition of discrimination on grounds of nationality, and most specific fundamental freedoms, do not apply with regard to persons from third states and therefore do not pose problems.[59] However, one fundamental freedom, the free movement of capital under Article 63 TFEU, has been extended to third states. This freedom applies to purely financial investment whereas investments aiming to influence the management and control of the undertaking are covered by the freedom of establishment that has not been extended to persons from third states.[60] For financial investments, differences between the treatment of investors from other Member States and from third states therefore appear to require justification. It remains to be seen whether, in principle, the objective to protect investments in the third state is sufficient in this regard and, eventually, whether distinctions between third states are called for. Though EU law does not impose trust in the legal system of third states, there could be specific third states where the legal system already provides sufficient investor protection and, therefore, does not justify special privileges for investors.

It therefore seems that there is a substantial potential for disruption in this area.

C. The Grandfathering Regulation

One might be tempted to believe that this situation has been defused by the so-called Grandfathering Regulation of 2012.[61] In principle, it allows Member States to maintain existing extra-EU BITs until they are replaced by agreements between the EU and the respective third states. However, this authorisation comes with the reservation that it applies without prejudice to other obligations of the Member States under EU law.[62] A recital clarifies that Member States continue to be required to eliminate incompatibilities with Union law. Moreover, the Commission's right to bring infringement procedures is explicitly recognised.[63] Therefore, this regulation primarily addresses the consequences of additional competences that the EU acquired with the Treaty of Lisbon, but does nothing to resolve conflicts or tensions between other provisions of EU law and extra-EU BITs of Member States.

Despite the unclear situation, neither the Commission nor the Member States seem inclined to pursue the possible issues illustrated above. Therefore it is difficult to imagine cases that would require the Court of Justice to decide on them.

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[59] See *Faust v Commission*, 52/81, EU:C:1982:369, para 25; *Germany v Council*, C-122/95, EU:C:1998:94, para 56; as well as *Vatsouras and Koupatantze*, C-22/08 and C-23/08, EU:C:2009:344, para 52.

[60] *Haribo Lakritzen Hans Riegel*, C-436/08 and C-437/08, EU:C:2011:61, para 35.

[61] Regulation (EU) No 1219/2012 of the European Parliament and the Council establishing Transitional Arrangements for Bilateral Investment Agreements between Member States and Third Countries [2012] OJ L351/40.

[62] Art 3 Regulation (EU) No 1219/2012.

[63] Ibid, Rec 11.

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D. *Interim conclusion*

As a consequence, not only intra-EU BITs, but also extra-EU BITs may pose problems under EU law. However, for the time being there seems to be a tacit political agreement to maintain existing extra-EU BITs until they are replaced by comprehensive agreements of the EU. Therefore, we will conclude with a short look at EU investment agreements.

IV. EU INVESTMENT TREATIES

A. *EU competence*

We have already mentioned the only EU investment treaty that is currently in force, the European Energy Charter Treaty. At the time, in the 1990s, it was concluded as a so-called mixed agreement by the European Community, Euratom, and by all Member States as well as by third states. Apparently it was considered that some parts of the Charter came within EU competence while others remained Member State competence. Since then, the exclusive competences of the EU with regard to the common commercial policy have been extended. Now they cover foreign direct investment. Based on this power, the Commission has negotiated agreements that include investor protection with Singapore, Canada and Vietnam. Negotiations with other states, in particular with the US and China, are ongoing.

On the occasion of the Singapore agreement, the Commission requested an Opinion of the Court on whether the EU has exclusive competence or whether parts of the agreement still fall within Member State competences.[64] Therefore, it is not possible to comment on the question of whether investment arbitration is completely covered by the competence for foreign direct investment or not. However, it seems that the EU legislator, when it adopted the Grandfathering Regulation, at least assumed that future investment protection treaties will be concluded at the level of the EU. This could happen either in the form of mixed agreements or in the form of agreements concluded by the EU without Member State participation.

B. *Possible obstacles to investment arbitration in EU agreements*

If agreements including investment arbitration are concluded at the level of the EU, the next question is whether there are principles of EU law that would oppose the introduction of such arbitration. The obvious question in this regard concerns the submission of the EU to an international dispute settlement body. The Court has recognised that this is part of the treaty making powers of the EU. It can submit to the decisions of another court which is created or designated by such agreements for the purpose of the interpretation and application of their provisions.[65]

Though arbitration is not the same as a court we would assume that it is sufficiently similar to be covered by this jurisprudence. Furthermore, it should be noted that the Court of Justice did not object to the possibility of an individual complaint to the European Court of Human Rights when it assessed the accession to the Convention.

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[64] Application for Opinion 2/15, [2015] OJ C363/18.

[65] Opinion 1/91 (European Economic Area I), EU:C:1991:490, paras 40, 70; Opinion 1/09 (European Patent Court), EU:C:2011:123, para 74; and Opinion 2/13, see note 30 above, para 182.

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As a consequence, the right of individual investors as such to initiate investment arbitration doesn't appear problematic.

We have also already indicated in relation to the European Energy Charter that the primacy of EU secondary law over Member State law should not pose an obstacle to investment arbitration agreements of the EU. In fact, within EU law, international agreements enjoy precedence over secondary legislation such as the Habitats Directive. Moreover, the risk of conflicts could be minimised by way of interpretation.

As far as the prohibition of discrimination on grounds of nationality is concerned, we have already mentioned that the free movement of capital deserves special attention. Under this freedom a distinction between intra-EU investors and extra-EU investors would need to be justified. The necessity to protect European investors in other legal systems should be relevant in this regard. But it is not obvious that European investors do need the full spectrum of investment protection in all third states, such as, for example, Canada, Singapore or the US. This necessity should also be balanced against tensions with judicial principles, as mentioned earlier, at least as far as these are not sufficiently addressed by reforms of arbitration.

In addition, the Opinion of the Court of Justice on the accession of the EU to the European Convention on Human Rights raises many issues that may also be relevant for investment arbitration.[66] We will focus on one that might be more difficult than others to resolve, namely prior involvement of the Court of Justice in investment arbitration.[67]

The draft accession agreement to the Convention provides for a procedure ensuring the prior involvement of the Court of Justice in cases before the European Court of Human Rights that raise issues of EU law. From the perspective of the Convention, this procedure is designed as an expression of the subsidiary nature of the human rights complaint. In other words, it aims to guarantee the proper exhaustion of local remedies before a decision of the Strasbourg Court is made. From this perspective, prior involvement is not required in relation to most investment arbitration agreements because they do not require this exhaustion. In fact, neither the Energy Charter nor the new agreements of the EU appear to provide for such requirements.

However, the Court of Justice highlighted the fact that the procedure of prior involvement is also necessary for the purpose of ensuring the proper functioning of the judicial system of the EU.[68] In particular, the Court's exclusive jurisdiction over the definitive interpretation of EU law is relevant in this regard. To protect this exclusive competence, the Court wants to prevent the European Court of Human Rights, in considering whether a provision of EU law is consistent with the Convention, itself choosing a particular interpretation from among the plausible options. In the Court's opinion this would breach its exclusive jurisdiction.[69]

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[66] Opinion 2/13, see note 30 above.

[67] Cf S Hindelang, 'Repellent Forces: The CJEU and Investor-State Dispute Settlement' (2015) 53 (1) *Archiv des Völkerrechts* 68, p 84 ff.

[68] Opinion 2/13, see note 30 above, para 236.

[69] Ibid, para 246.

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Investment arbitration poses a similar risk, and in contrast to the Convention system investment arbitration normally does not require prior exhaustion of local remedies. Investors relying on investment protection therefore do not have to complete proceedings in European courts that could make a reference to the Court of Justice, before they initiate investment arbitration. Under these circumstances, a procedure for the prior involvement of the Court of Justice would appear to be even more urgent than under the ECHR system. But neither prior involvement nor references from investment arbitration to the Court of Justice are envisaged in the EU agreements that provide for investment arbitration.

Nevertheless, the differences between investment arbitration and the ECHR should not be forgotten. While the ECHR provides protection to everybody in the EU, the benefits of investment arbitration within the EU are limited to foreign investors. Moreover, in contrast to the human rights enshrined in the Convention, investment protection standards are not building blocks of the foundations of EU law.[70] These standards can rather be regarded as different expressions of some of these building blocks and because of this difference they have less influence on EU law than the Convention. As a consequence, an interpretation of EU law in the context of investment arbitration could be considered less sensitive than such an interpretation by the Human Rights Court. Therefore, it is possible that the Court of Justice would not insist on a procedure of prior involvement in investment disputes under EU agreements.

The issue of prior involvement is part of the broader topic of the autonomy of EU law that the Court discussed intensively in the Opinion on accession to the European Convention on Human Rights. This topic leads to more questions about EU agreements on investment arbitration that, however, cannot be discussed in the present submission.

V. CONCLUSION

We have seen that from the perspective of EU law, intra-EU and extra-EU bilateral investment treaties of Member States pose problems. Whether these problems can be resolved in order to allow such agreements by Member States has in many instances not yet been clarified by the Court of Justice. With regard to arrangements with third states, some of these problems can be overcome if the Member State agreements are replaced by EU agreements. Careful design of investment arbitration in such EU agreements could alleviate other problems. However, it may still be necessary to seek further clarification from the Court.

[70] Cf Opinion 2/13, see note 30 above, para 169 as well as Art 6(3) TEU and Art 52(3) of the EU Charter of Fundamental Rights.

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