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Mackenzie-Stuart Lecture 2016: Investment Arbitration and EU Law – Juliane Kokott

Rachel Atkinson (University of Cambridge) · Friday, March 11th, 2016

Juliane Kokott, Advocate General to the Court of Justice of the European Union (CJEU), gave the 2016 Mackenzie-Stuart Lecture on 26 February 2016 at the University of Cambridge, Faculty of Law. In her lecture, Ms. Kokott explored the conflicts between investor state dispute settlement (ISDS) and European Union (EU) law, as regards (1) conflicts between arbitral awards rendered under bilateral investment treaties (BITs) and EU law, and (2) whether recourse to ISDS is compatible with the European legal order. In particular, Ms. Kokott discussed the effects of these conflicts on intra-EU BITs, extra-EU BITs, and future investment agreements concluded by the EU itself.

Illustration of the conflict

A fictitious case study was proposed based on the *Vattenfall* case (settled in 2010, ICSID Case no. ARB/09/6) to illustrate the conflicting obligations that can arise under EU law and BITs. This case concerned a Swedish energy company, Vattenfall, which filed a claim in 2009 with the International Centre for the Settlement of International Disputes (ICSID), whereby it claimed that Germany had violated the Energy Charter Treaty (ECT) by imposing strict environmental conditions on the investor in the operation of its coal-fired power plant. For the purposes of analysis, the following fictitious assumptions were made about the case: first, that the case was brought under a traditional pre-accession intra-EU BIT (a BIT concluded before one of the member states joined the EU); second, that an award in favour of Vattenfall was rendered; and third, that the general authorities had adapted the permit, and that the CJEU had subsequently found that these adaptations violated the Flora-Fauna Habitat Directive (FFHD).

A host state in this position faces two seemingly contrary primary obligations: one under the pre-accession intra-EU BIT, and one arising from its status as a member of the EU. A further source of tension arises from the fact that compensation for regulatory measures could be qualified as state aid under EU law. Thus, if the state in the case study modifies the permit, it risks violating the FFHD (EU law); if it pays out damages, it risks proceedings being taken against it by the European Commission (EC) for illegal state aid. This is in fact precisely the position Romania was found itself in in the *Micula* case (ICSID Case no. ARB/05/20). How can this conflict be resolved?

Intra EU-BITs

The main question in this context is whether EU law allows intra-EU BITs, most of which were

concluded with eastern European states before their accession to the EU, to remain in force, or if it requires a member state (MS) to terminate them.

Ms. Kokott pointed to the two opposing views to the validity of pre-accession BITs: that of the arbitration community, and that of the EC. The arbitration community views this issue through the lens of public international law and addresses the conflict by resorting to the conflict rules of the Vienna Convention on the Law of Treaties (VCLT), namely the *lex posterior* principle. Thus, in the case study, the accession treaty would have been concluded after the pre-accession BIT; thus the accession treaty and the obligations it imposes on the MS under EU law would trump the BIT.

However, this solution is not acceptable to the EC, which views the problem through the lens of primacy of EU law. From the EC's perspective, EU law should trump even a post-accession BIT. Thus, the EC does not adopt the arbitration community's view on the compatibility of pre-accession BITs and EU law, and considers that they should be terminated. It has two main arguments. First, the EC believes that BITs are inherently discriminatory. Investment arbitration provides an advantage to investors from an MS that concluded a BIT; but EU law prohibits discrimination on the grounds of nationality. Ms. Kokott explained that the principle of mutual trust, which prevents MSs from postulating the inadequateness of the judicial system of other MSs, and the notion that there should be equal access to justice in the union also militate against such discriminatory treatment being justified.

The second main objection by the Commission is that parallel systems of jurisprudence can produce outcomes that are incompatible with EU law, without the possibility for review of the award. For instance, there is an obvious tension between the duty of MSs to review decisions and ensure compliance with EU law, and, for example, the ICSID Convention that requires that the enforcement of awards is conducted without additional control. It also appears from the CJEU's Opinion relating to the creation of a unified patent litigation system (opinion 1/09) that the decision of an arbitral tribunal may in fact not be subject to infringement proceedings, unlike the decision of member state courts. Nevertheless, the MS itself may be subject to infringement proceedings if it pays the awarded damages, or the EC may issue a suspension injunction as it did in the *Micula* case. Doubts surrounding the ability of an arbitral tribunal to qualify as a court or tribunal of a MS for the purposes of making a preliminary reference to the CJEU under Article 267 of the Treaty on the Functioning of the European Union (TFEU) add further barriers to preserving the competence of the CJEU over EU law and its compatibility with arbitral awards.

The compatibility of intra-EU BITs with EU law is far from established, and we will have to wait for the CJEU to make a pronouncement. Ms. Kokott suggested that if arbitrators were to consider EU law in their decision-making, conflicts between the two legal orders could be avoided. One may wonder, however, to what extent the "consideration" of EU law by an arbitral tribunal really resolves this tension.

Extra-EU BITs

With regard to extra-EU BITs, most have been concluded after January 1958 and are not shielded by the provisions of Article 351(1) TFEU. Thus, MSs must eliminate incompatibilities between any post-accession treaties, which may require re-negotiation or even termination of BITs. The main example of such incompatible provisions are the free transfer of capital provisions found in most of these extra-EU agreements, which can be inconsistent with the EU law which, on the contrary, provides circumstances in which the European Council may impose restrictions on the

free movement of capital. Ms. Kokott noted that there seems to be an implicit political agreement to leave these agreements in place until they are replaced by a comprehensive EU agreement. One can, however, foresee the significant challenges in coming to one agreement to replace the plethora of extra-EU BITs.

EU BITs

With respect to EU BITs and multilateral investment treaties, the only EU treaty currently in force is the ECT. Since the exclusive competence in matters of investment for the union has been transferred to the EU, agreements have been negotiated with Canada, Singapore and Vietnam. The EC has requested opinion of the CJEU regarding whether it has exclusive competence in all investment matters, or if some questions remain the competence of MSs. In these recent agreements, the EU has assumed that future investment treaties will be concluded from the union level, and there are no objections in principle against the EU having the power to agree to ISDS. Because the EU is party to such agreements, the question of primacy will be partly resolved: an international agreement will take precedence over secondary EU legislation. For example, on the real facts of the case study, the ECT is an international agreement, thus trumping secondary European legislation such as the FFHB. This does not, however, resolve potential conflicts between BITs/MITs and primary EU law, such as the TFEU.

There also remains the question as to whether the CJEU will insist on the need to create a mechanism for the proper exhaustion of local remedies and to preserve the exclusive jurisdiction of the CJEU in matters of EU law, as it did in its Opinion regarding the EU's accession to the ECHR (opinion 2/13). It is apparent, however, that such a mechanism would be difficult to transpose to the investment tribunals because there is no requirement to exhaust local remedies and therefore no opportunity to refer a question to the CJEU. Indeed, the trend in these new agreements does not seem to be moving in this direction. Neither the ECT, nor the new agreements require local exhaustion of remedies, and arbitral tribunals have expressly rejected that the CJEU has sole jurisdiction to hear cases involving EU law, considering that the EU itself has agreed to submit matters arising under the ECT to arbitration.

Ms. Kokott concluded that the CJEU will soon have to grapple with these complex conflicts between ISDS and the structure of European law.

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