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Practical cross-border insights into investor-state arbitration law

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The Impact of EU Law on ISDS, Intra-EU BITs and the ECT

European Federation for Investment Law and Arbitration (EFILA)



Prof. Dr. Nikos Lavranos

The EU's Investment Law and Arbitration Policy Since the Lisbon Treaty

It is now more than 10 years ago that the Lisbon Treaty entered into force by which the European Union (EU) obtained exclusive competence regarding foreign direct investment (FDI) (Art. 207 Treaty on the Functioning of the European Union (TFEU)). As a consequence thereof, the EU has become an active player in international investment law and arbitration by affecting the investment law policy of the Member States, both internally and externally, by introducing modifications to substantive and procedural aspects of international investment law. The primary focus of the EU's effort has been to modify, or as it calls it, "reform" the existing investor-State dispute settlement (ISDS) system contained in practically all bilateral investment treaties (BITs) and free trade agreements (FTAs). In addition, the Court of Justice of the EU (CJEU) has become another central player by rendering decisions which increase the tension between EU law and international investment law.

In the following sections, the impact of EU law on ISDS, intra-EU BITs and the Energy Charter Treaty (ECT) will be reviewed by discussing the most important developments of the past year. This analysis starts with reviewing the situation post-*Achmea*, which culminated in the recently signed Termination Agreement that aims to terminate most, if not all, intra-EU BITs.

Subsequently, we will examine the recent developments regarding the ECT, in particular concerning its current modernisation process.

Finally, we will focus on the external dimension of the EU's efforts to modernise the ISDS by introducing the concept of an Investment Court System (ICS) in its recently concluded FTAs and on a global level within the United Nations Commission on International Trade Law (UNCITRAL), by pushing for the creation of a so-called Multilateral Investment Court (MIC).

The Termination Agreement Regarding Intra-EU BITs

Following the CJEU's *Achmea* judgment, delivered in March 2018, 23 Member States signed a Termination Agreement that would terminate all their intra-EU BITs. This Termination Agreement has now entered into force for all signatory Member States.

For obvious reasons, the UK did not sign this Termination Agreement, and neither did Austria, Finland, Ireland, and Sweden.

The Termination Agreement declares all intra-EU BITs and all disputes based on them to be incompatible with EU law, and thus moot. New intra-EU BIT arbitrations are declared to be no longer possible.

In addition, all sunset clauses are also declared inapplicable, meaning that investors cannot rely on the sunset clauses of those intra-EU BITs for investments made prior to their termination. In other words, whereas sunset clauses kick in when BITs are terminated in order to protect the vested rights of investors for investments made prior to termination, the Termination Agreement retroactively takes that right away from investors.

As an alternative to intra-EU BITs, the European Commission has proposed setting up an upgraded Solvit mechanism – so-called "Solvit-Invest" – which would be adapted to investment disputes. The Solvit-Invest procedure would aim to resolve individual cases amicably and prevent escalation into a formal legal dispute. The intention is to set up a Solvit branch that specialises in investment cases, equipped with specific independence safeguards.

Moreover, Solvit-Invest would allow reporting of issues of general concern in a Member State, such as recurring investment protection missteps. In that case, contact points would be set up within Solvit-Invest where stakeholders could provide structured feedback. This feedback would provide a better overview of structural issues at the national and EU level.

Obviously, the proposed Solvit-Invest mechanism cannot be considered an adequate replacement of the ISDS system contained in the intra-EU BITs. This means that European investors could only rely on domestic courts in Member States in order to seek protection against (in)direct expropriation and other unfair treatment, whereas the very same European Commission and the CJEU have repeatedly confirmed the existence of a significant backsliding of the Rule of Law level in several EU Member States – in particular, due to the political pressure and influence imposed on domestic court judges. Hence, the level of investment and investor protection within the EU is being significantly lowered. This could make it particularly attractive for European investors to restructure their investments via non-EU Member States, such as Switzerland or the post-Brexit UK.

The Compatibility of the ISDS Clause of the ECT With EU law Before the CJEU

Despite the fact that the *Achmea* judgment does not mention the ECT at all, several Member States are attempting to use it as an argument to annul or set aside intra-EU awards rendered against them under the ECT. In particular, Spain (but also Germany, Italy, Romania, and the Czech and Slovak Republics), which is facing more than 40 intra-EU ECT claims, has been attempting to use the *Achmea* judgment to vacate awards that have been rendered against it. However, so far, all ECT arbitral tribunals have rejected the *Achmea* objection and concluded that the *Achmea* judgment has no bearing on their jurisdiction under the ECT.

At the same time, the focus has now shifted towards the question of the compatibility of the ISDS clause of the ECT with EU law before the CJEU. Recently, several Advocate Generals have opined that the ISDS clause of the ECT is incompatible with EU law by essentially extending the *Achmea* judgment to the ECT. Thus, it seems very likely that the CJEU will follow these opinions, which would make the ISDS clause of the ECT inapplicable for European investors for claims against EU Member States. Such a decision of the CJEU would question the very *raison d'être* of the ECT.

Simultaneously, the EU and its Member States are pushing to conclude the modernisation process of the ECT, which was started a few years ago. Next to the main aim of excluding the application of the ECT for intra-EU investment disputes, the EU and its Member States want to replace the currently existing ISDS system with the ICS (see next section). However, there is some resistance against these proposals, in particular from Japan.

In addition, in the context of the increasing effort to fight climate change and to meet the Paris Agreement CO₂ emission targets, the “greening” of the ECT has become a new top priority for the EU and its Member States. Essentially, the idea is that all fossil fuels would be excluded from the scope of application of the ECT. Again, this would be another blow to the *raison d'être* of the ECT and could push the ECT into a fundamental identity crisis.

However, for the time being not all ECT members are yet fully convinced. As a result, the ultimate outcome of the ECT modernisation process remains to be seen.

The Investment Court System

In recent FTAs with Canada (CETA), Singapore and Vietnam, the EU and its Member States have replaced the ISDS system with the new so-called ICS.

Essentially, the ICS – largely inspired by the World Trade Organization (WTO) Dispute Settlement System – would create a semi-permanent, two-tier, court-like system, which significantly moves away from arbitration. The ICS would consist of a first instance tribunal with 15 members and an appellate tribunal of six members. The most important change is that the claimant would not have any say in the selection of the members of the tribunal. Instead, the Contracting Parties, including the Respondent in the respective dispute, would appoint all members by common agreement for several years.

Consequently, party autonomy, which is one of the hallmarks of arbitration, would be effectively eliminated. This obviously shifts the balance to the advantage of States.

In particular, it is not difficult to anticipate that States will appoint members whom they consider to be more pro-State biased rather than pro-investor biased. Indeed, the damaging effect of the politicisation of the appointment of members of international courts and tribunals is currently visible regarding the WTO Appellate Body, for which the US refuses to agree on the re-appointment of several of the Body's members; this has effectively paralysed the Appellate Body and prevents it from carrying out its functions. As a consequence thereof, the EU – rather ironically – has proposed arbitration as a solution to overcome the current paralysis of the WTO Appellate Body.

The other important feature, which strongly deviates from arbitration, is the possibility of lodging an appeal on both points of law and fact. This obviously will increase the costs of the parties and extend the length of the proceedings further. It also gives both parties a second bite of the apple, which is exactly what arbitration intends to avoid by offering only a one-shot procedure with a final binding award.

Despite the initial success of the EU in introducing the ICS in its FTAs, it ought to be noted that Japan did not accept the ICS

in its FTA with the EU, while the European Commission has not even put the ICS on the table in its FTA negotiations with Australia and New Zealand; nor is the ICS part of the recently concluded FTA between the EU and Mercosur.

Meanwhile, the ratification of CETA and the other EU FTAs is meeting significant opposition in many EU Member States because national parliaments are still not convinced that the ICS sufficiently addresses their concerns regarding the current ISDS system generally.

Therefore, if and when the ICS under the various EU FTAs will actually become operational remains questionable.

Towards a Multilateral Investment Court

In 2017, the European Commission, together with Canada and Mauritius, convinced UNCITRAL to set up a Working Group with a broadly formulated mandate to identify and examine any of the perceived shortcomings of the current ISDS system and to propose possible solutions. The discussions began in late 2017 and have since then made significant progress. In these discussions, the European Commission, Canada, Mauritius and several South American States have repeatedly referred to the MIC as the panacea that would solve most, if not all, of the perceived shortcomings of the current ISDS system.

The MIC would be based on the ICS as contained in the EU's recent FTAs. However, many States are not convinced that creating a new international court would be the appropriate solution. In particular, Chile, Israel, Japan, Russia, the US and some Asian States are not yet convinced and instead consider reforming or modifying the existing rules and institutions, such as, for instance, the International Centre for Settlement of Investment Disputes (ICSID) Convention or the Permanent Court of Arbitration (PCA), to be a more effective and realistic option. After all, in the past 50 years, more than 3,000 BITs and FTAs have been concluded and more than 1,000 ISDS disputes have been initiated, much to the general satisfaction of the users. Indeed, according to statistics provided by the United Nations Conference on Trade and Development (UNCTAD), States win more cases than claimants. Thus, States have little reason to complain about the current ISDS system, which is also confirmed by the fact that States continue to conclude BITs and FTAs with ISDS provisions. Meanwhile, the first results of the negotiations have been achieved.

First, as requested by UNCITRAL Working Group III, a draft Code of Conduct for Adjudicators has been jointly submitted by the Secretariats of ICSID and UNCITRAL. The second draft has been discussed and met with broad support, and its approval can be expected soon.

Second, the Working Group agreed that third-party funding (TPF) should be regulated more tightly, in particular by requiring users of TPF to be more transparent with regard to the identity and content of the TPF agreement.

Third, the Working Group agreed to establish an Advisory Centre for International Investment Law that mirrors the Advisory Centre at the WTO, which provides legal assistance to developing countries involved in WTO disputes.

The first round of discussions have taken place and the first contours of the Advisory Centre for International Investment Law have become visible. There is broad agreement that it should provide legal assistance to developing countries in investment disputes and that it should provide a forum for the avoidance of disputes by offering mediation and other Alternative Dispute Resolution (ADR) mechanisms. In addition, this Advisory Centre should also provide training and outreach activities for government lawyers of developing countries.

However, some details regarding the Advisory Centre still need to be worked out, for example: what is its institutional

relationship with the envisaged MIC; how and by whom will it be financed; and whether SMEs may be allowed to use the services of the Centre as well.

While the discussions and negotiations will be intensified in the next years, it is too early to say whether the MIC proposal will gain sufficient traction and support from all the major economies, investors and the arbitration community generally. Possibly, parties might agree to adopt an incremental and flexible approach by taking several intermediate steps rather than going immediately for a full-blown, two-tier permanent court, which would require many more years of negotiations. Thus, the parties could agree to first establish only an Appeal Court for disputes brought under specified investment treaties, which could later be further developed into an Appeal Court with universal jurisdiction for all investment disputes.

In any event, the UNCITRAL parties have agreed that the Working Group III on ISDS reform must conclude its work by the end of 2026. Accordingly, concrete results can be expected in the near future.

Outlook

Over the past decade, the EU has become an active driver in shaping international investment law and arbitration. The impact of EU law on ISDS is particularly noticeable regarding intra-EU BITs after the CJEU determined in *Achmea* that the relevant ISDS provision is incompatible with EU law. The recently

signed Termination Agreement will largely eliminate intra-EU BIT disputes. Besides, the impact of EU law is becoming increasingly visible regarding the use of the ISDS provisions of the ECT in intra-EU disputes. The CJEU is playing a decisive role in this context. Moreover, the currently ongoing modernisation process of the ECT provides an opportunity for the EU and its Member States to implement their reform agenda. All this will inevitably lower the level of investment and investor protection within the EU, which will force investors and their advisors to consider viable alternative solutions.

At the international level, while the ICS has been included in several EU FTAs, it has not yet become operational due to the resistance to the ratification process within EU Member States. However, if and when the ICS is put into operation, this could potentially have far-reaching consequences for investment treaty arbitration generally. This impact would be even more sweeping if the MIC proposal were to be embraced by a significant number of States around the world.

In any event, one thing is clear: EU law will continue to impact international investment law and arbitration over the coming years. Indeed, it seems that the EU and its Member States have artificially been creating a permanent conflict between EU law and international investment law, which was absent until recently.

Consequently, the arbitration community must think creatively of solutions that would effectively resolve or at least reduce the tension between EU law and international investment law in a mutually respectful way.



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Since the European Federation for Investment Law and Arbitration (EFILA) was established in Brussels in 2014, it has developed into a highly regarded think-tank which specifically focuses on the EU's investment law and arbitration policy.

EFILA is unique in that it brings together arbitration practitioners, academics and policymakers who have extensive first-hand experience and a deep understanding of the relevant investment law and arbitration issues. EFILA provides a platform for a fact- and merit-based discussion on the pros and cons of the EU's investment law and arbitration policy.

In recognition of its important role, EFILA has been granted Observer Status at the UNCITRAL Working Group III, which is working on the reforms of the ISDS system.

EFILA's regular events, such as its Annual Conference and Annual Lecture, have established themselves as key events of the investment arbitration community.

EFILA regularly submits its views to public consultations organised by the EU and ICSID, as well as to the UNCITRAL Working Group III. All its submissions are published on its website.

EFILA also publishes – together with Queen Mary University of London – the *European Investment Law and Arbitration Review*.

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