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

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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 that increase the tension between EU law and international investment law.

The following sections will review the impact of EU law on ISDS, intra-EU BITs and the Energy Charter Treaty (ECT) by discussing the most important developments of the past year. This analysis starts with the situation post-*Achmea*, which culminated in the Termination Agreement, which is now fully in force for all 23 Member States that have ratified it.

Subsequently, we will examine the recent developments regarding the ECT, in particular following the *Komstroy* judgment of the CJEU and the conclusion of the ECT "modernisation" process, which has resulted in the *de facto* disconnection of the EU and its Member States from the ECT.

Finally, we will focus on the external dimension of the EU's efforts to modernise the ISDS by reviewing the state of play regarding the Comprehensive Economic and Trade Agreement (CETA) and the other EU investment agreements and, on a global level, within the United Nations Commission on International Trade Law (UNCITRAL) Working Group III on ISDS reforms.

The Termination Agreement Regarding Intra-EU BITs

Following the CJEU's *Achmea* judgment, delivered in March 2018, 23 Member States signed a Termination Agreement in May 2020 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.

Indeed, following the *Achmea* judgment as confirmed by the Termination Agreement, domestic courts have started to reject the admissibility of intra-EU BIT disputes, as was the case by German courts in the *Raiffeisen Bank v. Croatia* dispute.

Nonetheless, new intra-EU BITs cases continue to be filed; for example, the *Addiko Bank AG v. Slovenia* case in March 2022 and the *JCDecaux SA v. Czech Republic* in September 2020 were registered by ICSID.

It remains to be seen how these cases will proceed and whether any awards will be enforceable within the EU.

Meanwhile, 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 the 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 *De Facto* Disconnection from the ECT by the EU and Its Member States

After the intra-EU BITs and arbitration based on those treaties were terminated, attention shifted towards the ECT. Again, the CJEU took the lead in rendering its *Komstroy* judgment, which essentially extends the ban of investment treaty arbitration to intra-EU ECT disputes.

Indeed, the ban has already been applied by domestic courts, such as in the recent decision of the German courts, which granted the Netherlands' request for a declaration that the ECT claims against it initiated by *RWE* and *Uniper* were inadmissible.

In parallel, the outcome of the modernisation process, which resulted in a significant revision of the ECT text, has confirmed the ISDS ban for intra-EU ECT disputes, once it enters into force. This means that EU and its Member States are effectively disconnecting from the ECT.

In addition, in an effort to align the ECT with the Paris Agreement obligations, fossil fuels will be phased out from the scope of the ECT at least as far as the EU, its Member States and the UK are concerned.

All these revisions raise the question: what is still the *raison d'être* of the ECT?

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 investment court system (ICS).

Essentially, the ICS would create a semi-permanent, two-tiered, 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 World Trade Organization (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 will obviously increase the costs of the parties and further extend the length of the proceedings. 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. The ICS has also not been included in either the recently signed FTA between the EU and New Zealand and the FTA between the EU and Mercosur, nor is it on the table in the EU's FTA negotiations with Australia.

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. While recently, the Netherlands' Upper Chamber narrowly voted for the ratification of CETA and the German government reached a political agreement to support the ratification of CETA if additional conditions are met, in other EU Member States there is resistance; for example in Ireland, CETA is pending before the Irish Supreme Court.

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 Multilateral Investment Court (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. In fact, revised ICSID Arbitration Rules entered into force in July 2022.

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 UNCITRAL negotiations have been achieved.

First, a draft Code of Conduct for Adjudicators, has been jointly submitted by the Secretariats of ICSID and UNCITRAL. The latest 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 supports the establishment of 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 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 such discussions and negotiations will intensify in the years to come, 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 may agree to adopt an incremental and flexible approach by taking several intermediate steps rather than going immediately for a full-blown, two-tiered permanent court, which would require significant financial resources. 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 a MIC 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. Indeed, the number and length of the negotiations have been increased, and so 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.

The ban on ISDS has now also been expanded to intra-EU ECT disputes. Again, the CJEU played a decisive role in this context, which has been followed through by the results of the ECT modernisation process.

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. The artificially created and unnecessary conflict between EU law and international investment law seems to have been decided in favour of EU law – at least within the EU and its Member States.

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 respective way for the benefit of investors and their investments.

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In 2017, he set up NL-Investmentconsulting, a high-quality, boutique consultancy firm, which advises on all issues of investment law and arbitration.

He is listed as an arbitrator and mediator at the Vienna International Arbitration Centre (VIAC), arbitrator at the China International Economic and Trade Arbitration Commission (CIETAC), mediator at the Asian International Arbitration Centre (AIAC) and mediator for the Energy Community. Recently, he has also been added to the EU roster of arbitrators.

Prof. Dr. Nikos Lavranos acts as an independent external legal advisor and legal expert for several international law firms and sits as an arbitrator and mediator in investment treaty arbitrations.

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