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

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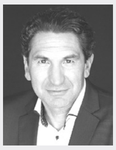


Prof. Dr. Nikos Lavranos

The EU's Efforts to "Reform" International Investment Law and Arbitration

Without doubt, in the past 12 months significant developments took place that highlight the increasing impact of EU law on international investment law and arbitration by affecting the investment law policy of the Member States, both internally and externally, and 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) – in conjunction with domestic courts of the EU Member States – have rendered several far-reaching 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 failure of the ECT "modernisation" process, which has resulted in the withdrawal of several EU Member States (France, Poland, Germany, Luxembourg), while Ireland, Slovenia, Portugal, the Netherlands, Denmark and Spain have publicly announced and/or notified their intention to withdraw from the ECT. In addition, the UK, now a non-EU Member State, also decided to denounce the ECT. Most recently, the EU has also formally adopted a decision to withdraw from the ECT.

Moreover, given the increasingly arbitration-unfriendly climate within the EU, we can observe a rising number of successful enforcements of intra-EU ISDS awards outside the EU, which we will review as well.

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, the first results of the United Nations Commission on International Trade Law (UNCITRAL) Working Group III on ISDS reforms, in particular regarding the proposed 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 in May 2020 that would terminate all their intra-EU BITs. This Termination Agreement has 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 or 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.

Recently, domestic courts, in particular in France and Sweden, have annulled intra-EU ISDS awards by reference to the CJEU's jurisprudence, which declared an incompatibility of intra-EU ISDS awards with EU law.

Significantly, the German Federal Supreme Court ruled that the Netherlands could rely on a provision of German Procedural Law to effectively stop the intra-EU ECT ICSID proceedings, which were initiated by RWE and Uniper against the Netherlands.

Most recently, the German Constitutional Court refused to consider the constitutional complaint of Achmea against the setting aside of its award following the CJEU's *Achmea* judgment.

Thus, the bottom line of these developments is that intra-EU ISDS arbitration is *de facto* impossible now within the EU, which means that European investors can only rely on domestic courts in the Member States in order to seek protection against (in)direct expropriation and other unfair treatment. This conclusion is particularly depressing given the fact that 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 and consistently lowered. Consequently, the only remaining option for European investors would be the European Court of Human Rights in Strasbourg, though it remains to be seen whether this route will actually be a viable option.

All this makes it particularly attractive for European investors to (re)structure their investments via non-EU Member States, such as Switzerland or the post-Brexit UK. Additionally, as will be discussed below, this will increasingly compel European investors to enforce their intra-EU ISDS awards outside the EU.

The Withdrawal 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 extended the ban of investment treaty arbitration to intra-EU ECT disputes.

In parallel, the ECT modernisation process, which resulted in a significant revision of the ECT text, and which was agreed "in principle" by all ECT Contracting Parties (including the EU and its Member States), failed because, instead of signing up to the revised ECT text, several EU Member States opted to withdraw from the ECT.

In addition, in June 2024, the EU also announced that it is formally withdrawing from the ECT.

This surprising and sudden *volte face* has thrown the ECT into an existential crisis. It remains unclear whether the other non-EU Contracting Parties of the ECT will ratify the modernised ECT text or whether more withdrawals will take place.

However, the (announced) withdrawals from the ECT have not prevented a UK-based investor (Klesch Group) from initiating ECT disputes against the EU, Germany and Denmark. Similarly, two ECT disputes have been initiated by European and a UK investor against Finland, while Croatia has also been hit by an ECT dispute initiated by a Hungarian investor.

The Enforcement of Intra-EU ISDS Awards Outside the EU

Meanwhile, the intra-EU ECT awards against in particular Spain, but also other EU Member States, continue to be issued by arbitral tribunals. Whilst enforcement of those intra-EU ECT awards appears to now be very difficult within the EU, the opposite is true for the enforcement outside the EU. Indeed, the UK High Court has granted the *Antin* award holders the right to seize Spanish property in London, while the *Eiser* award has been successfully enforced in Australia and several enforcement proceedings are pending before US courts.

More recently, the shares of Spanish state-owned operator Aena, which operates Luton Airport in the UK, were temporarily seized by award holders. Further, a US court has allowed the enforcement of an adverse ECT award against Spain. Similarly, the US Court of Appeals recently issued an important decision clarifying that Spain cannot rely on sovereign immunity to prevent the enforcement of ECT awards in the US.

Finally, the Swiss Supreme Court also pushed back against the EU's argument that intra-EU ISDS awards could not be enforced in Switzerland.

Hence, it is now clear that the enforcement of intra-EU ECT awards is significantly more successful outside the EU than within the EU.

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, at the time of writing, 17 out of 27 EU Member States have ratified the CETA investment chapter, there is still resistance; for example, in Ireland the Irish Supreme Court has rejected CETA by ruling that either changes to the Irish arbitration law or a referendum is needed for the ratification of CETA.

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 some progress, especially by drafting provisions for the creation of the Advisory Centre and by adopting the Code of Conduct for arbitrators and judges.

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. 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 1,300 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 UNCITRAL Working Group III negotiations continue at a steady pace.

The most recent discussions focus on the draft provisions for a "standing mechanism for the resolution of international investment disputes", i.e., the MIC.

The 40-plus draft provisions are already fairly detailed and indicate that the creation of the MIC is likely to happen. The MIC will consist of a Tribunal and an Appeals Tribunal, supported by a Secretariat. All members of both tribunals will be selected by the Contracting Parties for a non-renewable term. The members of the tribunals shall most likely serve on a full-time basis, meaning that they are not allowed to have any other jobs.

Compared with international arbitration, the MIC system will entirely cut out any influence of the investor/claimant regarding the selection of the members of the tribunals, the selection of the seat or the choice of the arbitration rules. Consequently, there is a clear danger that the MIC will become a pro-State biased institution.

In addition to drafting the provisions for the MIC, the UNCITRAL Working Group III has been discussing a whole range of so-called "cross cutting" issues, which aim to address mainly procedural issues, but which potentially could have far-reaching consequences. For example, the facilitation of counterclaims by Respondent States, the restrictions on Third Party Funding, the elimination of shareholders' claims and restrictions on the calculation of damages. If adopted, these "reforms" will create further hurdles for claimants to successfully obtain adequate compensation, while at the same time, increasingly shielding States from ISDS claims, which appears to be the ultimate goal of "reforming" "crossing cutting issues".

Since the UNCITRAL parties have agreed that the Working Group III on ISDS reform must conclude its work by the end of 2026, it remains to be seen whether all these reform proposals will gain sufficient traction and support from all the major economies, the investors and the arbitration community generally to be adopted.

In any event, the draft provisions of the MIC foresee an "opt-in" system, thereby allowing each State to decide whether or not to join the MIC and for which Investment Treaties it shall be applicable. This will arguably make the multilateral treaty, which will contain the MIC, more acceptable as an optional protocol for a large number of States.

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, by effectively banning intra-EU ISDS arbitrations based on intra-EU BITs and the ECT. Moreover, recognition and enforcement of intra-EU BITs/ECT awards within the EU is becoming very difficult, if not impossible. Consequently, the enforcement of awards is now clearly shifting towards jurisdictions outside the EU, in particular, the US, UK, Australia and Switzerland.

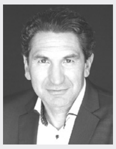
All this will inevitably lower the level of investment and investor protection within the EU. Therefore, it remains to be seen whether the European Court of Human Rights could compensate for this loss of investment and investor protection.

At the international level, it is notable that even after a decade of finalising the negotiations, none of the EU's so-called "new generation" investment agreements have entered into force. Meanwhile, the EU has signed a new type of "Sustainable Investment Facilitation Agreement" with Angola, which, however, lacks any ISDS provisions and provides for a very basic level of investment protection.

Despite the EU's limited success to get its investment treaties ratified, it has been making significant progress in UNCITRAL Working III regarding the potential creation of the MIC and the reforms of the "cross-cutting" issues.

In sum, 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. Meanwhile, arbitral tribunals continue to push back against *Achmea* and *Komstroy* and continue to exercise their jurisdiction. However, most recently, two ICSID arbitral tribunals have declined jurisdiction in two intra-EU ECT disputes by accepting the EU law objections of Spain. Further, domestic courts in jurisdictions outside the EU do not feel bound by EU law and thus continue to recognise and enforce intra-EU ISDS awards on the basis of their international treaty law obligations – stemming in particular from the ICSID Convention and New York Convention.

Consequently, the arbitration community must accept the lasting impact of EU law on international investment law, and deal with it by finding creative solutions for investors and their investments.



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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 that 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 for the investment arbitration community.
Recently, Young EFILA was established in order to provide another forum for the new generation of arbitration specialists.

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