Bilateral Investment Treaties and the European Union. Recent Developments in Arbitration and Before the ECJ

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Abstract
The issue of the relationship between Bilateral Investment Treaties (BITs) and the EU legal order has recently attracted attention amongst scholars and practitioners in the field of international investment arbitration. Under a first perspective of the problem, the Arbitral Tribunal in Eastern Sugar B.V. v. The Czech Republic was confronted with the question of whether there was any room left for BITs between EU Member States. The Tribunal discussed the legal arguments advanced for and against the applicability of such “intra-EU BITs” between Member States. The issue, which is particularly relevant considering that there are currently more than 190 BITs concluded between EU Member States, will be analysed in the first part of this article. Under a second point of view of the problem, the European Court of Justice (ECJ) handed down two judgments on 3 March 2009 addressing incompatibilities with EC Law resulting from certain BITs entered into by Sweden and Austria with third countries. The second part of this article will deal with the consequences arising out of the Court’s rulings with regard to existing and future BITs entered into by Member States with third countries.

Keywords
investment arbitration; Bilateral Investment Treaties; (BITs); intra-EU BITs; EU law

I. Introduction
A somewhat neglected topic has been attracting increasing attention amongst scholars and practitioners in the field of international investment arbitration. The nature of the relationship between investment agreements and the European Union (EU) legal order lay long forgotten until the issue was debated, rather unexpectedly, in recent arbitral proceedings and argued, from a different angle, before the European Court of Justice (ECJ).

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Under a first perspective of the problem, the Arbitral Tribunal in the *Eastern Sugar B.V. v. The Czech Republic* case rendered an award on 27 March 2007 dealing with the issue of intra-EU Bilateral investment treaties (BITs). The key question put to the Tribunal centred on whether there was any room left for BITs between States that were both members of the EU. The Respondent State in that arbitration argued that the BIT was superseded as a consequence of Respondent's recent accession to the EU, and that private investors were barred from resorting to investor-State arbitration after the host State attained EU membership. Addressing the debate in this area requires examination of the ultimate functions and purposes of BITs in the particular context of a highly integrated economic and political area such as the EU. It may be wondered if the European legal order requires a global approach to investment which is averse to the purely bilateral dynamics underlying the conclusion of BITs. BITs have traditionally been seen by capital exporting States as tools for safeguarding their investors abroad, and by developing countries as a means to attract foreign investment to boost their economies. A question therefore arises as to whether the generally investor-friendly climate in the EU makes intra-EU BITs redundant instruments. Sections II and III of this article will analyse the background of intra-EU BITs and the legal arguments advanced both for and against their possible applicability between Member States in the future. This section of the article will also explore whether the EU order provides investors with an equivalent protection to the one they would enjoy under a BIT.

The relationship between investment agreements and EC Law is also relevant under a second, different perspective, which is the one addressed by the ECJ in two recent judgments. The Court was presented with alleged incompatibilities with EC Law arising in BITs concluded by certain Member States with a number of third countries. Member States stood in a certain sense accused by the European Commission of having safeguarded the freedom of movement of capital too zealously, by not providing in their BITs for the possibility of restrictions to be imposed by the Community in certain circumstances. The second part of this article, section IV, deals with the two judgments of the Court that eventually found incompatibilities between such third-country BITs and EC Law. While from now on Member States negotiating new BITs with their partners (or revising their current Model BITs) will obviously need to incorporate provi-
sions in line with the ECJ’s rulings in their treaties, it is less clear what steps
will be taken in the immediate future with regard to the large number of
existing BITs that present the kind of incompatibilities identified by the
Court.

II. The Eastern Sugar Case

The award rendered on 27 March 2007 by an Arbitral Tribunal in the dis-
pute between the Dutch company Eastern Sugar B.V. and the Czech
Republic addressed, for the first time, the issue of whether the investment
regime which a foreign investor enjoys under a BIT should be deemed to
be inapplicable where both State Parties to the investment treaty are mem-
ers of the EU.¹

The answer provided by the Tribunal deserves attention, considering the
remarkable number of existing BITs between Member States of the EU.
The issue discussed in Eastern Sugar could, therefore, be advanced in simi-
lar terms in other occasions, in view of the growing tendency by foreign
investors to resort to international arbitration mechanisms under BITs.

The dispute between the sugar producer Eastern Sugar B.V. and the
Czech Republic was submitted to an ad hoc UNCITRAL Arbitral Tribunal
under Article 8 of the BIT concluded between the Netherlands and the
then Czech and Slovak Federal Republic.² The investor claimed to have
suffered discrimination by the Czech authorities by way of certain decrees
designed to specifically target the company. On the merits, the Tribunal

¹ Eastern Sugar B.V. (Netherlands) v. The Czech Republic, SCC no. 088/2004, Partial Award,
27 March 2007 (Pierre Karrer (Chair), Robert Volterra and Emmanuel Gaillard), available at:
Chalker, “Case Note: Eastern Sugar B.V. v. The Czech Republic”, 6 Transnational Dispute
Management (March 2009), available at: www.transnational-dispute-management.com; Michele
Potestà, “Il caso Eastern Sugar: accordi bilaterali sugli investimenti, Unione europea e diritto
comunitario”, 44 Rivista di diritto internazionale privato e processuale (2008) 1055. There is sup-
posedly (at least) another case (R.J. Binder v. The Czech Republic, not yet made available to the
public), where the issue of intra-EU BITs has been debated. See Markus Burgstaller, “European
Law and Investment Treaties”, 26 Journal of International Arbitration (2009) 181, 193; Christer
Söderlund, “Intra-EU BIT Investment Protection and the EC Treaty”, 24 Journal of International

² Agreement on encouragement and reciprocal protection of investments between the Kingdom of the
Netherlands and the Czech and Slovak Federal Republic, signed in Prague on 29 April 1991, 2242
UNTS 205.
agreed (in part) with the investor, and found a violation by the host State of the fair and equitable treatment standard set out in Article 3(1) of the BIT. The Tribunal awarded Eastern Sugar damages in the amount of more than 25 million Euros.

The most interesting aspect of the award relates to the findings made by the Tribunal on its own jurisdiction, where the issue of intra-EU BITs is discussed.

The Czech Republic objected to the Tribunal’s jurisdiction, claiming that its accession to the EU in 2004 had the effect of implicitly terminating or limiting the application of the BIT previously concluded with the Netherlands. By making the point that no BIT has been concluded between EU Member States since their accession to the EU, the Respondent argued that the European legal order leaves essentially no room for BITs between Member States. In particular, according to the Czech Republic, BITs and EU rules are “competing legal frameworks addressing the same subject-matter (i.e. the faculty of a party to invest assets on the territory of another state, and to freely dispose of the revenues)”.

EU Law, Respondent claimed, provides the investor with “equivalent rights” to those under the BIT, which is therefore to be considered as “superseded” by the European regime and not applicable in a possible dispute.

In dealing with this issue, the Arbitral Tribunal discussed two documents, the contents of which have been reprinted to a significant extent in the award. According to the Czech Republic, both documents endorse the argument that BITs between EU Member States should be deemed to have been terminated.

The first quoted document is a letter sent in January 2006 by the then Director General of the Directorate General (DG) Internal Market and

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3) In particular, the investor claimed to have suffered damages as a result of three decrees issued by the Czech Republic in 2000, 2001, and 2003, respectively. The Arbitral Tribunal found that the first and the second decree, although flawed and politically motivated, did not amount to a violation of the BIT (see Eastern Sugar v. Czech Republic, paras. 274 and 287). On the contrary, the third decree, which had unduly “targeted” Eastern Sugar, was deemed by the Tribunal to be a “discriminatory and unreasonable measure in the sense of Art. 3(1) of the BIT” (ibid., paras. 335–338). See also the Partial Dissenting Opinion by Mr. Volterra, available at: http://ita.law.uvic.ca (last visited 15 April 2009).

4) Eastern Sugar v. Czech Republic, paras. 91–190.

5) Ibid., para. 117.

6) Ibid., para. 98.

7) Ibid., para. 101.

8) Ibid., para. 104.
Services of the European Commission, Mr. Alexander Schaub, to a member of the Czech Republic’s government.⁹ In reply to a request for clarification sought by the Czech Republic on the question of the effect of BITs between Member States, the Commission opined that “intra-EU BITs should be terminated in so far as the matters under the agreements fall under Community competence”.¹⁰ Through a series of arguments, which do not appear to be entirely clear and consistent, the Commission came to the conclusion that, with regard to facts occurring after accession to the EU, a BIT was not applicable to issues falling under Community competence. The letter pointed out that the application of intra-EU BITs could lead to a more favourable treatment of investors and investments between the States parties to the BITs and consequently discriminate against other Member States (or their citizens), thus creating a situation that would not be in accordance with the founding treaties.

The second document quoted in the award is a brief excerpt from a note sent by the European Commission to the Economic and Financial Committee, an advisory body that regularly reports to the Commission and to the Council.¹¹ On that occasion, the Commission argued that most of the provisions included in BITs had been “replaced” by Community law upon accession of the respective Member State to the EU. The Commission underlined the “legal uncertainties” created by the presence of such intra-EU BITs and strongly recommended “that Member States exchange notes to the effect that such BITs are no longer applicable, and also formally rescind such agreements”.¹²

In contrast, the Tribunal appeared to be convinced that BITs between Member States were not automatically superseded by EU Law. As a first remark, the arbitrators noted that the relationship between the BIT and the Rome Treaty was neither expressly addressed by the treaties which had marked the Czech Republic’s entrance into the EU nor by the BIT at issue;¹³ secondly, the Tribunal examined the issue of possible conflict between the two treaties pursuant to the Vienna Convention on the Law
of Treaties (VCLT), with particular reference to its Article 59 on implied termination of treaties. The Arbitral Tribunal analysed the conditions which according to Article 59 VCLT have to be satisfied in order for a treaty to be impliedly terminated by the conclusion of a later treaty. First, the arbitrators pointed out that the BIT and the EC Treaty did not concern the “same subject-matter”. In the Tribunal’s interpretation, while the EC Treaty does deal with cross-border investment, through the free movement of capital and the freedom of establishment, it does not cover issues such as fair and equitable treatment, protection against expropriation and investor-State arbitration, which are all pivotal provisions included in most BITs. Further, according to the Tribunal, the Czech Republic was unable to prove the common intention of the parties that the subject-matter should be governed solely by the EC Treaty, nor did the BIT appear to be “incompatible” with the EC Treaty. The two treaties could be considered “complementary” instruments. For these reasons, the Arbitral Tribunal, refusing to be bound by any of the European Commission’s statements, affirmed its jurisdiction over the case pursuant to the BIT between the Netherlands and the Czech Republic.

III. Bilateral Investment Treaties between Member States of the European Union

The number of BITs concluded between EU Member States grew considerably following the EU’s enlargement to twenty-five States in 2004 and to twenty-seven in 2007. While prior to 2004 there were only two BITs con-

14) Art. 59 VCLT, entitled “Termination or suspension of the operation of a treaty implied by conclusion of a later treaty”, sets forth that: “1. A treaty shall be considered as terminated if all the parties to it conclude a later treaty relating to the same subject matter and: (a) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty; or (b) the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time.”


16) Ibid., para. 181. The Czech Republic had also requested the Arbitral Tribunal to stay the proceedings and to file a request for preliminary ruling to the ECJ on the issue of the termination of the BIT between the two Member States following the Czech Republic’s accession to the EU. The Tribunal, recalling the case law of the ECJ on the impossibility for an arbitral tribunal to ask the Court for a preliminary ruling pursuant to Art. 234 EC Treaty, rejected such request and refused to stay the proceedings (see ibid., paras. 130 ff.).
cluded between Member States,\(^\text{17}\) today – after the last enlargement – the number of these BITs totals approximately 190, according to data provided by the United Nations Conference on Trade and Development (UNCTAD).\(^\text{18}\) In fact, in the first half of the 1990s, each of the former socialist States entered into a number of BITs with first-generation EU Member States, in order to attract foreign investments in the context of their newly opened market economies.\(^\text{19}\)

Considering the high number of intra-EU BITs, the importance of the issue discussed in the *Eastern Sugar* case certainly goes beyond this particular arbitration. According to the Respondent, there are to date a number of other investment arbitration proceedings initiated by European investors against the Czech Republic pending.\(^\text{20}\) It seems likely, particularly in light of the outcome on this issue in *Eastern Sugar*, that investors will continue to invoke intra-EU BITs against EU Member States in the future.

It is apparent from the European Commission documents quoted in the award that the Commission opposes the application of investment treaties in the bilateral relations of Member States. Except for certain sections of the January 2006 letter, which do not appear entirely clear and which both the investor and the Czech Republic attempted to use to their own advantage,\(^\text{21}\) the Commission’s main concern is to avoid a difference in treatment between EU citizens as a consequence of the application of intra-EU BITs. An investor (natural or juridical person) who is a citizen of a particular Member State may, in fact, benefit from certain treatment in a host Member State under a BIT concluded between its own State of nationality and

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\(^\text{17}\) Germany entered into BITs with Greece and Portugal, before the two latter States acceded to the EU. See, with regard to the Germany-Greece BIT, *Vertrag zwischen der Bundesrepublik Deutschland und dem Königreich Griechenland über die Förderung und den gegenseitigen Schutz von Kapitalanlagen*, signed in Athens on 27 March 1961, which can be found at: wwwunctad.org (last visited 15 April 2009). With regard to the Germany-Portugal BIT, see the *Treaty concerning the encouragement and reciprocal protection of investment (with protocol and exchange of letters)*, signed in Bonn on 16 April 1980, 1337 UNTS 97.

\(^\text{18}\) See the lists of BITs entered into by each State, available on UNCTAD’s website at: www.unctad.org.

\(^\text{19}\) According to the data provided by UNCTAD, the Czech Republic and Hungary are the main signatories of BITs with other EU Member States (twenty-four BITs concluded by each of the two countries), whereas Ireland is a party to only one BIT with a EU Member State (the Czech Republic).

\(^\text{20}\) See the comments on this made by the Czech Ministry of Finance in a letter sent to the Czech government (*Eastern Sugar* v. *Czech Republic*, para. 127).

\(^\text{21}\) *Ibid.*, para. 120.
the host State. By contrast, a European investor of a different nationality may not be able to invoke vis-à-vis the same host State the same kind of protection, due to the absence of a relevant BIT entered into by its State of nationality.

The issue of differentiated treatment between EU nationals could first of all be considered in relation to those substantive standards of treatment that are usually accorded to foreign investors by BITs (“fair and equitable treatment”, “full protection and security”, protection from expropriation, nationalisation or equivalent measures, etc.). In this regard, however, it has been argued that BITs do not provide any “added value” in respect to EU Law.22 Under this perspective, principles such as the freedom of establishment, freedom of capital circulation, non-discrimination on the grounds of nationality and protection of private property, as embodied in EU legislation, provide investors with a protection which is said to be equivalent to the one they would enjoy under a BIT.23 The abundant case law of the ECJ which is usually quoted in this respect certainly adds strength to this argument.24

However, there is one major divergence between the European regime and BITs which appears hard to deny even if one were to agree that there is an identity between the substantive protection which investors enjoy under the two regimes. The major difference is that most BITs incorporate investor-State arbitration among dispute resolution mechanisms. In this regard, the Eastern Sugar Tribunal is certainly right in recalling that the arbitration clause appears to be the “most essential provision” in BITs.25 By contrast, the EU order does not provide any mechanism which can be


24) See Poulain, supra note 22, 813.

25) Eastern Sugar v. Czech Republic, paras. 165–166, where the Tribunal cites to other arbitral decisions underlining the importance of provisions included in BITs on the settlement of investor-States disputes.
deemed to be equivalent to investor-State arbitration. An investor wishing to assert its rights vis-à-vis the host State would have to pursue ordinary domestic judicial remedies, which could appear less advantageous to the investor than arbitration (for example, because a domestic proceeding may require more time than an arbitration). Considering this perspective, the discrimination concern expressed by the Commission would therefore seem justified: in fact, resort to arbitration is granted by BITs purely on the basis of nationality, i.e., based on the fact that the investor is a national of a State which has entered into a BIT with the host State. Hence, it may well be argued that the non-discrimination principle embodied in EU Law precludes a Member State from granting only EU citizens with a certain nationality the possibility to initiate arbitration, without extending such possibility to all EU citizens. The ECJ decision in Matteucci, dealing with the free movement of persons, has been recalled in that regard. In that case, the ECJ stated that a bilateral agreement between Member States could not prevent the application of the principle of equality of treatment set forth by EU Law, even where the agreement fell outside the scope of application of the EC Treaty and had been concluded before the EC Treaty had entered into force between the two Member States.

Further, a final argument put forward by those advocating against the application of BITs between Member States is that the principle of mutual trust between Member States’ institutions would bar international investment arbitration. It is unquestionable that the investor-State dispute resolution mechanisms included in BITs have been conceived and developed for the primary purpose of providing the foreign investor with the option to avoid the host State’s domestic courts, which may not be considered to be a sufficiently impartial forum. The quest for a neutral forum was presumably also one of the main reasons why, after the fall of the Berlin wall, first-generation Member States, not entirely trusting the judicial structures in Central and Eastern European countries, entered into BITs with these States. These BITs may arguably no longer have any rationale in

26) Ibid., para. 105.
28) Poulain, supra note 22, 816 ff. See the Czech Republic’s arguments at Eastern Sugar v. Czech Republic, para. 107: “[t]he application of the BIT would also breach the EU principle of mutual trust. This principle would imply that Eastern Sugar brings its claim before a Czech national court. There would be no room for international arbitration in this area.”
29) Poulain, supra note 22, 817.
the current post-enlargement context, which is rooted in mutual trust between Member States and founded on the development of a common favourable investment environment.30

Most of these arguments were raised in the Eastern Sugar case, but they did not appear to convince the Arbitral Tribunal, which, as has already been noted, stated that intra-EU BITs retain an important place in the EU context. One fact may have played in favour of the Tribunal’s finding on this issue: the European Commission, which would clearly favour, at least in principle, the progressive termination of intra-EU BITs, has not, at least as of today, started any infringement proceedings against Member States for failing to terminate such BITs.31 In this respect, it may be interesting to note how the Economic and Financial Committee (referred to above) revised its position in its annual reports to the Commission and the Council. In its 2006 report, the Committee pointed to the juridical “uncertainties” arising out of intra-EU BITs and the relating “risks” for Member States, presumably hinting at the risk for a State to be called as respondent in an arbitral proceeding initiated by a European investor. As a consequence of this situation, the Committee invited Member States to review the need for such BITs and to inform the Commission of the actions taken in this context. The Committee also reserved the right to review the progress achieved by 2007.32 However, in the following 2007 and 2008 reports, the Committee took note that many European States did not share the Commission’s concern about arbitration risks and discriminatory treatment of investors. On the contrary, “[a] clear majority of Member States prefer[red] to maintain the existing agreements, in particular with view to the provisions on expropriation, compensation, protection of investments and investor-to-state dispute settlement”.33 However, despite this remark,


31) Eastern Sugar v. Czech Republic, para. 121.


the Committee did not close the door on bilateral actions by Member States on this issue. \(^{34}\) In fact, absent unequivocal elements calling for the implied termination of BITs pursuant to Article 59 VCLT, only a new agreement expressly terminating the BITs between the State Parties could put an end to those “uncertainties” linked to the possible application of intra-EU BITs feared by the European Commission. BITs are, in fact, normally entered into for an initial period of ten years (or other duration) and are usually tacitly renewed for a further period, \(^{35}\) except where either Party denounces the treaty. In order to avoid “opportunistic” behaviour by host States, \(^{36}\) BITs usually include certain provisions whereby, in case of unilateral denunciation of the treaty by either party, investments made prior to the date of the denunciation continue to enjoy treaty protection for a further period of ten or fifteen years. \(^{37}\) Therefore, also with regard to intra-EU BITs, a unilateral denunciation of the treaty would release the host State from the risk of being called as respondent in an arbitration initiated by a European investor (having made his investment prior to the denunciation) after many years. 

Hence, an agreement between the two States parties putting the treaty to an end would appear to be the only reliable means of avoiding the risk of arbitration.

In the absence of such an express termination agreement, it is difficult to imagine that in the future arbitral tribunals confronted with the same issue as in *Eastern Sugar* will decide not to apply a BIT which is formally in force between Member States of the EU. In the *Eastern Sugar* case, the decision taken by the Arbitral Tribunal on its own jurisdiction appeared rather predictable, for a number of reasons. First, both the facts in dispute

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\(^{34}\) See 2007 **EFC Report**, *supra* note 33, para. 15: “Still a few Member States are seeking a solution for this issue. The EFC takes note that it remains the responsibility of Member States that have been informed of the Commission’s concerns to address the issue through bilateral actions and therefore invites Member States to do what is necessary in this regard”.

\(^{35}\) Some BITs set forth that, after the initial fixed period has expired, the treaty shall continue to be in force indefinitely, always subject to the right of either party to terminate the agreement by prior written notice. For such issues regarding duration and termination, see UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (2007) 20 ff.


\(^{38}\) See the comments made in this regard by the Czech Ministry of Finance (*Eastern Sugar v. Czech Republic*, para. 127).
and the initial act by the investor commencing the dispute settlement process (i.e., the filing of a request for amicable settlement) predated the Czech Republic’s accession to the EU. It might therefore be argued that, at the relevant time, the foreign investor could reasonably rely on the benefits and protection enjoyed under the BIT, according to the legitimate expectations doctrine often recalled by arbitral tribunals. Further, in order to state that the BIT had been tacitly terminated by the later EU Accession treaty, the tribunal would have had to acknowledge that the EC Treaty and the BIT covered the “same subject matter”. Even the European Commission’s position is not entirely clear on this issue. On the one hand, the Commission claims that with regard to intra-EU BITs “most of their content is superseded by Community law upon accession of the respective Member State”; on the other hand it appears to link the replacement of the BIT regime with “Community competence”, which however, at least under the Rome Treaty, does not extend to the regulation of foreign direct investment. At any rate, despite some possible overlap between the BIT regime and the EU regime on many of the substantive aspects, there is serious doubt as to whether the two regimes really are identical in terms of the protection accorded to the investor. This holds especially true if one considers the investor-State arbitration mechanism included in most BITs and which, by contrast, is lacking in the European legal order.

However, the argument of discriminatory treatment as between EU citizens could ultimately stand in the way of the continued application of intra-EU BITs. The idea of the EU as a level playing field where all EU investors are on an equal footing could be at risk, since an investor who is

able to have recourse to arbitration may have a competitive advantage in relation to other EU investors who cannot initiate an investor-State arbitration. However, should this issue of possible discriminatory treatment between EU citizens be raised in an arbitral proceeding, as happened in the *Eastern Sugar* case, it is unlikely that this would have any consequences with respect to the application of a BIT by the arbitral tribunal seized with the case. In such a case, any possible discrimination would not hurt the claimant – who benefits from the dispute settlement mechanism envisaged by the BIT – but other EU investors, not involved in the proceedings, which do not have access to that dispute mechanism. As stated by the *Eastern Sugar* Tribunal, “it will be for those other countries and investors to claim their equal rights”.

The issue may, sooner or later, find its resolution before the ECJ, should the European Commission decide to initiate infringement proceedings against Member States for not terminating intra-EU BITs. Nor can it be excluded that a request for a preliminary ruling may be filed to the ECJ by a domestic court of a Member State, dealing with a challenge to or annulment of an award in a case facing a European investor and a Member State. Until there is a conclusive pronouncement by the ECJ, arbitral tribunals might continue to rule on this issue. This will not necessarily result in uniform directions. This situation would result in increased uncertainty in an area that, instead, should be marked by the utmost predictability for investors and States.

41) *Eastern Sugar v. Czech Republic*, para. 170: “[i]f the EU Treaty gives more rights than does the BIT, then all EU parties, including the Netherlands and Dutch investors, may claim those rights. If the BIT gives rights to the Netherlands and to Dutch investors that it does not give other EU countries and investors, it will be for those other countries and investors to claim their equal rights. But the fact that these rights are unequal does not make them incompatible” (emphasis in the original). On the possible discrimination issue, see, in particular, Hanno Wehland, “Intra-EU Investment Agreements and Arbitration: Is European Community Law an Obstacle?”, 58 *International & Comparative Law Quarterly* (2009) 297, 310 ff. See also Eilmansberger, *supra* note 40, 402–403, arguing that this discrimination issue may be resolved by “applying a Most Favoured Nation approach”, i.e. by extending the privilege or preferential treatment in question to all other EU citizens. However, it is unclear how EU citizens not covered by an intra-EU BIT may concretely submit a possible dispute to arbitration. It is doubtful that these investors will be successful in commencing an arbitration, by simply claiming that other EU citizens would be entitled to resort to arbitration. In such a situation it would appear unlikely that an arbitral tribunal would accept jurisdiction.
IV. The Two Judgments of the European Court of Justice of 3 March 2009 Concerning Bilateral Investment Treaties with Third Countries

While the issue of intra-EU BITs has not been (at least so far) presented to the ECJ, the Court handed down two judgments on 3 March 2009 concerning the compatibility with EU Law of certain provisions included in BITs entered into between Member States and third countries. The two judgments are particularly interesting since it was the first time that the Court had ruled on an issue involving BITs.

Infringement proceedings were initiated by the Commission against Austria and Sweden for failure to take appropriate steps to remove alleged incompatibilities arising from third-country BITs concluded by the two States prior to their respective accession to the EU. The Commission contended that such BITs entered into with non-Member States did not provide for the restrictions on the free movement of capital to and from third countries envisaged by the EC Treaty, and that the two Member States had not fulfilled their obligation to take appropriate steps, pursuant to Article 307 EC Treaty, to eliminate such incompatibilities.

It may be useful to recall that EC Law does not automatically prevail upon treaties entered into between third States and Member States prior to their accession to the EU. The EC Treaty incorporates in Article 307 a so-called “subordination clause”, whereby rights and obligations arising out of pre-Community agreements with third States continue to be fully applicable regardless of the new obligations incumbent on Member States following the entry into force of the EC Treaty for them. According to the
case law of the ECJ, the purpose of Article 307 is “to lay down, in accordance with the principles of international law, that the application of the treaty does not affect the duty of the member state concerned to respect the rights of non-member countries under a prior agreement and to perform its obligations thereunder”.45

However, in the case of incompatibilities between the two treaties, Article 307(2) places an obligation on Member States to “take all appropriate steps to eliminate the incompatibilities established”. As clarified by the ECJ in past decisions, in the event of a failure to amend such pre-Community agreements by means of negotiations with the third State concerned, the option for the Member State to unilaterally denounce the treaty cannot be ruled out.46 According to the case law of the ECJ, unilateral denunciation of the treaty is to be used as a last resort and must further be “possible under international law”.47

The two cases at hand concerned transfer clauses included in BITs entered into by Austria and Sweden with third States. According to these clauses, investors of either Party to the BIT enjoy the right to freely transfer, without undue delay, the capital connected with their investment. These clauses, as noted by Advocate General Poiares Maduro in his Opinion of 10 July 2008, are “standard, and indeed central” to most BITs.48
While the free movement of capital between Member States as well as between Member States and third countries is central to the EU order, the EC Treaty nonetheless allows for certain restrictions on capital movements to be imposed by the Council of the EU. Pursuant to Article 57(2), the Council may adopt measures on the movement of capital to or from third countries involving direct investment, including measures which constitute a “step back” in Community law as regards the liberalisation of the movement of capital. Further, as detailed in Article 59, the Council may adopt temporary safeguard measures with regard to third countries where, in exceptional circumstances, movements of capital to or from such countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union. Finally, Article 60 enables the Council to take urgent measures on the movement of capital and payments with regard to third countries on the basis of a joint action relating to the common foreign and security policy. This action could, for example, be required in order to give effect to a United Nations Security Council resolution.49

The European Commission took the view that the absence in the BITs of any provision expressly reserving for the two Member States the possibility of applying such restrictions could make it “more difficult, or even impossible, for that Member State to comply with its Community obligations”.50 The Advocate General sided with the Commission and proposed that the Court should declare that Austria and Sweden had failed to take all appropriate steps to eliminate the incompatibilities.51

The Court agreed with the Commission and the Advocate General and, in two fairly concise judgments, found the two States in breach of their obligations under Article 307 EC Treaty.

The reasoning of the Court needs to be carefully analysed, particularly in view of the consequences that arise with regard to both the particular BITs at issue and to BITs between Member States and third countries in general.

In the two cases at hand, the viewpoint under which the Court was confronted with the issue of an incompatibility between pre-Community

49) Commission v. Austria, supra note 42, para. 31; and Commission v. Sweden, supra note 42, para. 32.
50) Commission v. Austria, supra note 42, para. 16; and Commission v. Sweden, supra note 42, para. 15.
51) Opinion of Advocate General Poiares Maduro, supra note 48, para. 71.
agreements and EU Law was somewhat unusual, and made the outcome of
the judgments slightly unpredictable. In fact, the Community measures
pursuant to Articles 57(2), 59, and 60 EC Treaty, which may, the Commis-
sion contended, cause a conflict with Member States’ obligations under the
BITs, have not yet been adopted by the Council, nor have they even been
envisaged.\textsuperscript{52} Hence, any alleged incompatibility would be merely hypo-
thesetical until the Council adopts the relevant provisions. The question is
therefore whether Article 307 goes so far as to require Member States to
take steps to eliminate even purely hypothetical incompatibilities arising
out of their third-country treaties. The Advocate General carefully elabo-
rated on this point, and overcame this conceptual difficulty only by resort-
ing to the duty of loyal cooperation enshrined in Article 10 EC Treaty,
which he used as the basis for the application of Article 307.\textsuperscript{53} In order to
support his reasoning, the Advocate General proposed to draw a parallel
with the obligations of Member States during the period prescribed for the
transposition of a directive. The Advocate General contended that as Mem-
ber States are, under the duty of loyal cooperation, obliged to refrain from
taking any measure liable to seriously compromise the result prescribed by
a directive,\textsuperscript{54} in the same way Member States are not allowed to jeopardise
a Community objective, even a potential one, by maintaining pre-Com-
community agreements that might compromise the effectiveness of legislation
that the Community may in future adopt.

The ECJ agreed with the Advocate General that the two Member States
were in breach of their obligations pursuant to Article 307. However, the
two judgments did not touch upon the duty of loyal cooperation pursuant
to Article 10 EC Treaty, nor did the Court adopt the suggested analogy
with Member States’ obligations during the period for transposing direc-
tives. In this regard, the parallel drawn by the Advocate General may
in fact leave room for some doubts. Not only, as the Advocate General
acknowledges, is the transposition period to end on a precise date, while
Community competence in the field of restrictions of capital movements

\textsuperscript{52} Measures adopted pursuant to Art. 60(1) EC Treaty have been adopted against the Republic
of Côte d’Ivoire and the former Socialist Federal Republic of Yugoslavia, but no conflict between
those sanctions and BITs have been alleged by the Commission. See Opinion of Advocate Gen-
eral Poiares Maduro, \textit{supra} note 48, fn. 4; and \textit{Commission v. Sweden, supra} note 42, para. 21.

\textsuperscript{53} Opinion of Advocate General Poiares Maduro, \textit{supra} note 48, paras. 33 ff.

\textsuperscript{54} \textit{Ibid.}, paras. 35 ff., citing to the ECJ judgment of 18 December 1997, \textit{Inter-Environnement
may never be exercised. Further, States are required to refrain from jeopardising a directive’s objective because they know the precise content and goals involved. By contrast, when it comes to possible restrictions on capital movements, there is complete uncertainty regarding the content of the measures, their scope and even third States concerned.

At any rate, by identifying a conflict between the BITs and possible future Community measures, the Court’s two judgments certainly have the effect of broadening the scope of Article 307. Whether this position reflects the wording and rationale of the text of the EC Treaty can be debated. The argument put forward by the Court in this respect is that the urgency of the Community measures, certainly characterizing at least the safeguard measures pursuant to Article 59 and the foreign policy-based restrictions envisaged by Article 60, justified such a broad interpretation of Member States’ obligations to eliminate incompatibilities in pre-Community agreements. The “effectiveness” of the measures restricting the free movement of capital and the need for immediate application, the Court ruled, cannot be hampered by the existence of international agreements such as the BITs entered into by Austria and Sweden. Interestingly, the Court found the existence of an incompatibility in each of the treaties that the Commission brought to its attention (i.e., seventeen BITs entered into by Sweden and six by Austria), disregarding the fact that the language of the transfer clauses was not completely identical in all agreements. In fact, certain clauses included in some of the BITs are worded so as to grant investors the right to free transfer of capital “subject to the [host State’s] laws and regulations”. In this regard, since there can be little doubt that EU Law is fully part of a Member State’s legislation, it could have been argued – as in fact it was by Sweden – that the “subject to” requirement would have allowed the Member State to enforce the possible Community measures at issue. Therefore, in light of the different wordings in the BITs, a treaty-by-treaty analysis by the Court may have been possible.

57) See, by way of example, the Sweden-China BIT or the Sweden-Pakistan BIT, both available at www.unctad.org (last visited 15 April 2009). On the possible restrictions on the free transfer of capital in BITs, see Rudolph Dolzer and Christopher Schreuer, Principles of International Investment Law (2008), 193–194.
Be that as it may, the question that now arises is what will happen to the BITs concerned following the ruling by the ECJ. Rather surprisingly, in the two judgments the Court did not invoke the obligation for Member States to denounce the treaties, as would follow from past case law. This is even more striking considering that in these cases denunciation would have been – to use the Court’s own expression – “possible under international law”, since BITs usually expressly provide such an option. The silence of the Court on this might have been due to the delicacy of the situation deriving from a denunciation of the BITs, which would have negative effects first and foremost for European investors (Austrian and Swedish in these cases) enjoying substantive and procedural protection under the BITs.\(^{58}\) The Court might have taken this concern into consideration, although the two decisions never expressly mention investors’ interests. The scenario is made even more complicated by the fact that all other Member States, in addition to Austria and Sweden, are parties to several hundreds of BITs with third countries. Most of these BITs incorporate similar clauses guaranteeing the free movement of capital without any exceptions. The Court seemed to be well aware of this and emphasized that “the incompatibilities with the [EC] Treaty to which the investment agreements with third countries give rise... are not limited to the Member State which is the defendant in the present case”.\(^ {59}\) Focusing on the second part of Article 307(2) EC Treaty, rather than drawing on past case law requiring denunciation, the Court called for mutual assistance between Member States in eliminating the incompatibilities established, and for efforts to adopt a “common attitude”. Further, the ECJ expressly called for the Commission to play an active role in facilitating joint action between Member States on this issue.\(^ {60}\)

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\(^{58}\) On this issue, see the Opinion of Advocate General Poiares Maduro, supra note 48, paras. 67–69, noting that “some Member States have argued that the interests of their investors abroad ought to be taken into account in determining the extent of the obligation to eliminate an incompatibility under Article 307 EC [Treaty]... However, those interests can never release Member States from their obligation to comply with Community law, unless there is a specific provision to that effect... [Article 307’s] purpose is not to authorise Member States to give precedence to such obligations over their Community obligations if that would be more favourable to the interests of their investors.”

\(^{59}\) Commission v. Austria, supra note 42, para. 43; and Commission v. Sweden, supra note 42, para. 43.

\(^{60}\) Commission v. Austria, supra note 42, para. 44; and Commission v. Sweden, supra note 42, para. 44.
It is easy to imagine that the Commission will take the lead in assisting Member States in renegotiating their BITs with third countries so as to make them fully compatible with EU Law. Such a situation would not be new to the European Commission, which in 2002 assisted acceding and candidate States in the process of adapting BITs entered into with the United States, in order to remove incompatibilities with the obligations which those States would have undertaken by joining the EU.61 Talks between the United States, on the one side, and the Commission and the acceding and candidate countries, on the other, culminated in the signature of an “Understanding” in 2003 and in a number of subsequent “additional protocols” amending the BITs.62 In this regard, it is noteworthy that while these negotiations were fully successful on most issues which the Commission considered to be potentially incompatible with EU Law,63 no agreement between the parties could be reached on the very issue of restrictions on capital movements.

It will be interesting to see whether negotiations on this specific point will be more effective in this occasion. Circumstances might, however, be different this time. In 2002, the failure to reach an agreement could possibly have led the Commission to require acceding and candidate States to denounce BITs with the US in order to fully implement the *acquis communautaire*.64 Hence, on that occasion it was mainly in the United States’ interest to maintain BITs with Central and Eastern European countries, in order to continue protecting US investors in that area. By contrast, if comprehensive negotiations begin revising all incompatible BITs entered into by European Member States, any scenario involving an obligation to

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63) For example, the amended BITs now include exceptions to non-discrimination obligations (national and most-favoured-nation treatment) for certain sensitive sectors and matters (agriculture, fisheries, etc.).

64) See the “Letters of Submittal” by the US Department of State to the US President, as well as the “Letters of Transmittal” by the US President to the Senate, which accompany each additional protocol.
denounce the BIT, following the ECJ ruling, would likely be feared by some of the major European capital exporting States (such as Germany, France or the Netherlands), whose investors would be especially harmed by the absence of further treaty protection.⁶⁵

It will be therefore worth carefully monitoring the developments taking place in this area, where traditional investment law issues are addressed against the backdrop of the peculiar problems and needs of an integrated political and economic area such as the EU.

⁶⁵ Furthermore, it is unlikely that the third country which will be asked by the concerned Member State to renegotiate the BIT will accept to merely incorporate EU exceptions in the transfer clauses. Especially if such State has a strong bargaining power vis-à-vis the concerned Member State, it might well insist on also having the right to impose restrictions in similar or other circumstances. One might wonder whether a transfer clause characterized by overly broad exceptions would not at that point be devoid of any significant value.