22 October 2015

Legality of investor-state dispute settlement (ISDS) under EU law

Legal study

ClientEarth

Contents

Executive summary

This study finds that including investor-state dispute settlement (ISDS) mechanisms in EU trade agreements may not be compatible with EU law**,** including the new 'Investment Court System' proposed by the Commission on September 16 2015.

ISDS mechanisms would set up an arbitration system outside of, but binding on, the EU judicial system. Such mechanisms would introduce an additional judicial relief within the EU legal order that is independent of the EU courts. It would, in effect, be a system that would enable foreign investors to sideline the EU courts and resort to claims that are not available to domestic investors.

EU law, and settled case-law of the European Court of Justice (ECJ), suggest that such a system of external judicial control may be incompatible with the EU legal order because it would (1) undermine the autonomy of the EU legal order and the powers of the EU courts in particular and (2) negatively affect the completion of the internal market, and more specifically the EU competition rules.

There are four EU legal hurdles that ISDS mechanisms, reformed or not, will face:

- The ECJ has exclusive jurisdiction to provide for a definitive interpretation of EU law within the EU legal order and will reject any external judicial or quasi-judicial body that will interpret or apply EU law. As a fundamental purpose of ISDS is to enable investors to challenge EU decisions, it is unavoidable that an ISDS arbitration tribunal would have to consider questions of EU law, and could declare an EU measure to conflict with the TTIP or other trade agreements in a way that would significantly undermine the Court's competences;
- The EU courts have exclusive jurisdiction to rule on non-contractual liability of the EU. As ISDS would allow arbitration tribunals to hear claims for damages by individuals and to award damages against the EU such a system would undermine the EU courts' exclusive competences to rule on non-contractual liability of the EU and would significantly broaden the EU's exposure to claims for liability;
- The ECJ has exclusive jurisdiction to decide on the division of competences between the EU and Member States. A number of envisaged ISDS provisions allow arbitrators to decide on responsibility between the EU and the Member States which would prejudice the ECJ's right to decide on the division of competences between the EU and the Member States;
- ISDS awards may result in distortion of competition on the EU internal market and discriminatory treatment of EU undertakings and EU nationals, hampering the completion of the internal market. In particular, ISDS awards may conflict directly with the EU state aid rules.

A request for an Opinion of the European Court of Justice may clarify the legality of ISDS under EU law and forestall complications which would result from legal disputes concerning the compatibility with the Treaties of international agreements binding upon the European Union.

1 Introduction

The purpose of this study is to provide an EU legal analysis of an important feature of the EU's future trade agreements: Investor-State Dispute Settlement (ISDS). ISDS is an external judicial system that is open to foreign investors only and enables them to sue governments on the basis of investment provisions that guarantee 'fair and equitable treatment' and compensation for 'indirect expropriation'.

ISDS has led to considerable civil unrest with many civil society organisations opposing it in the context the negotiations of the Transatlantic Trade and Investment Partnership (TTIP) between the EU and the US and the EU-Canada Comprehensive Economic and Trade Agreement (CETA). Moreover, ISDS faces opposition within the European Parliament, in particular by the Greens and a not insignificant number of other Parliament Members. The European Parliament resolution of 8 July 2015 has called upon the Commission to address a number of concerns regarding ISDS, including its discriminatory nature, inherent bias and opaque nature of proceedings.[1] The Commission's consultation on ISDS in 2014 resulted in an unprecedented 149399 responses of which 97% were negative. As a result, the Commission is currently seeking to reform ISDS and has published a textual proposal for reforming the ISDS mechanism under the TTIP.[2] The Commission and French and German governments have as a result sought to limit the scope of investment norms in particular.[3] Nonetheless, Commissioner Malmström has indicated that the establishment of a permanent arbitration court, one of other the ideas for potential reform, will not be implemented under the TTIP.[4]

While there is an intense debate on the political desirability of ISDS in EU trade agreements, the legal question whether the EU can even conclude an international agreement containing ISDS in the first place has so far received less attention.[5] As this study finds, there are several reasons to doubt the compatibility of ISDS with EU law. EU law, and case-law of the European Court of Justice (ECJ), suggest that such a system of external judicial control may be incompatible with the EU legal order because it would (1) undermine the autonomy of the EU legal order and the powers of the EU Courts in particular and (2) negatively affect the completion of the internal

[1] European Parliament, 'European Parliament resolution of 8 July 2015 containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)' (July 8 2015).

[2] European Commission, ' Commission draft text TTIP - investment' (16 September 2015) http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf [accessed on 21 September 2015].

[3] European Commission, 'Concept paper: Investment in TTIP and beyond - the path for reform' (6 May 2015) http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF [accessed on 14 August 2015]; Government of the French Republic, ' Vers un nouveau moyen de régler les différends entre États et investisseurs' (May 2015) http://transatlantique.blog.lemonde.fr/2015/06/02/tribunaux-darbitrage-la-france-presente-ses-propositions-a-bruxelles/#document [accessed on 14 August 2015]; Markus Krajewski, 'Modalities for investment protection and Investor-State Dispute Settlement (ISDS) in TTIP from a trade union perspective' http://library.fes.de/pdf-files/bueros/bruessel/11044.pdf [accessed 14 August 2015].

[4] European Commission, 'Discussion on Investment in TTIP at the meeting of the International Trade Committee of the European Parliament' (press release) (18 March 2015) http://europa.eu/rapid/press-release_SPEECH-15-4624_en.htm [accessed on 18 August 2015]

[5] There has been an academic debate on this issue: Marise Cremona, 'Guest Editorial: Negotiating the Transatlantic Trade and Investment Partnership (TTIP)' (2015) 52 Common Market Law Review, 351–362, at 360; Hannes Lenk, ' Investor-state arbitration under TTIP: Resolving investment disputes in an (autonomous) EU legal order (2015:2)' (Report for Swedish Institute for European Policy Studies (SIEPS)) (June 2015) http://www.sieps.se/sites/default/files/Sieps%202015_2%20web.pdf [accessed 14 August 2015]; Angelos Dimopoulos, 'The Compatibility of Future EU Investment Agreements with EU Law' (2012) 39 Legal Issues of Economic Integration, 447–471; Angelos Dimopoulos, 'The involvement of the EU in investor-state dispute settlement: A question of responsibilities' (2014) 51 Common Market Law Review, 1671–1720; Andrea Carta, 'Do investor-to-state dispute settlement mechanisms fit in the EU legal system? [2014] Environmental Law Network International, 30; Jan Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of The Energy Charter Treaty' (2012) 15 Journal of International Economic Law,85-109; Steffen Hindelang, 'Repellent Forces: The CJEU and Investor-State Dispute Settlement' (2015) 53 Archiv des Völkerrechts, 68-89; Ingolf Pernice, 'Part III: Study on International Investment Protection Agreements and EU law' (European Parliament Study) (September 2014) available at http://www.europarl.europa.eu/RegData/etudes/STUD/2014/534979/EXPO_STU%282014%29534979%28ANN01%29_EN.pdf [accessed on 8 October 2015]; Nikolaos Lavranos, 'Designing an International Investor-to-State Arbitration System after Opinion 1/09' in M. Bungenberg and C. Herrmann (eds.), Common Commercial Policy after Lisbon (Springer 2013).

market, and more specifically the EU competition rules. While the TTIP ISDS provisions may deviate from the provisions negotiated in EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the EU-Singapore Free Trade Agreement (FTA) in light of the revisions that the Commission is seeking to implement, none of these amendments are likely to address most of the objections the ECJ will likely have, as these objections are mostly of a fundamental nature.

It is of utmost importance that the actors responsible for concluding international agreements containing ISDS check whether such agreements can be concluded in the first place. Such a check prevents the EU from getting into serious difficulties and might give rise to adverse consequences for all interested parties, including third countries party to such agreements. [6] It is for this reason that the EU Treaties contain a special provision in article 218 (11) TFEU which enables the EU institutions and the Member States to check whether the EU can conclude an envisaged international agreement.

A request would be in line with statements made by the European Commission, the European Parliament and the European Economic and Social Committee. In the resolution of the European Parliament adopted on July 8 2015 recommended the Commission to ensure that 'the jurisdiction of courts of the EU and of the Member States is respected.'[7] The President of the European Commission Jean-Claude Juncker has stated in his political guidelines that he will not accept 'EU courts' jurisdiction to be limited by special regimes that limit parties' access to national courts or that allow secret courts to have the final say in disputes between investors and states.'[8] Lastly, the European Economic and Social Committee in an Opinion adopted on 27 May 2015 also stated that there

> *'are considerable EU treaty-related and constitutional law concerns regarding the relations of ISDS ruling with the EU legal order. Private arbitration courts have the capacity to make rulings which do not comply with EU law or infringe the CFR [Charter of Fundamental Rights]. For this reason, the EESC feels that it is absolutely vital for compliance of ISDS with EU law to be checked by the ECJ in a formal procedure for requesting an opinion, before the competent institutions reach a decision and before the provisional entry into force of any IIAs, negotiated by the EC.'* [9]

2 Legality of ISDS under EU law

As a matter of principle, all international agreements concluded by the European Union must be compatible with the EU's constitutional framework. This means that the EU must have the competence to conclude the international agreement, and that the agreement must be compatible with the Treaty on European Union (TEU), the Treaty on the Functioning of the European Union (TFEU), the Charter of Fundamental Rights, and general principles of law. The EU Treaties, therefore, impose legal limits on what the EU can do on the international plane.

These limits do not only concern the scope of the EU's external powers in a particular policy area, such as trade policy or transport policy, but also institutional and constitutional limits, in particular the extent to which the introduction of an external judicial body can affect the powers

[6] *Opinion 1/09 Creation of a unified patent litigation system* [2011] ECR I- 1137, paras 47-48.

[7] European Parliament, 'European Parliament resolution of 8 July 2015 containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)' (July 8 2015).

[8] Jean-Claude Juncker, ' A Reasonable and Balanced Free Trade Agreement with the U.S.' (27 June 2014).

[9] European Economic and Social Committee, 'Opinion of the European Economic and Social Committee on Investor protection and investor to state dispute settlement in EU trade and investment agreements with third countries' (27 May 2015).

entrusted to the EU and national courts. While the Court has made clear that the EU can in principle conclude international agreements introducing external judicial bodies with powers to interpret those agreements, it has equally held that the EU can only do so if such a system is compatible with the EU's constitutional framework. In that regard, the ECJ has found a number of agreements — including the accession to the European Convention of Human Rights and the agreement setting up a European Patent Court — incompatible with the EU Treaties.

Before looking at the compatibility of ISDS with EU law in detail, this study makes a number of general observations in relation to the Court's rulings.

- The Court has never found an external judicial body having jurisdiction to hear *claims by individuals within the EU* (a core competence of the EU courts) compatible with EU law[10];
- The Court has only found such agreements compatible with EU law where the external judicial body had jurisdiction to rule on disputes between the contracting parties (EU-third state) or where the external judicial body had jurisdiction to hear claims by individuals that do not concern the EU or its Member States.[11] In its second Opinion on the European Economic Area (EEA) Agreement setting up the EFTA[12] Court (*Opinion 1/92*), for example, the Court found a judicial system operating entirely outside the EU and outside the EU legal framework compatible with EU primary law.[13] The Court reached a similar conclusion in relation to the European Common Aviation Area (ECAA) Agreement.[14]

A general concern for the Court, therefore, could be the wider potential effects the external judicial body may have on the EU's own legal order if individuals were able to seek judicial relief against the EU without involvement of the EU Courts. This effect is far less if the judicial body does not have such powers, as individuals will remain dependent on the EU legal and judicial system for the incorporation of international obligations internally within the EU legal order. [15] For example, the EU's accession to the WTO and its dispute settlement system is less of a threat to the EU legal order, because the Court can determine how and to what extent individuals within the EU can rely on such an agreement and judicial rulings in particular, for example to challenge EU legislation. By contrast, when an external judicial body and the provisions that body protects are directly available to individuals, this may warrant a more cautious approach requiring a number of precautions to be taken in order to preserve the autonomy EU legal system and the powers of the EU judiciary in particular. After all, the past has proven that external judicial relief for individuals can have significant effects on domestic legal systems.[16]

This concern resonates when it comes to a system such as ISDS. If the EU were to conclude trade agreements containing ISDS provisions with its major trading partners, a significant number of individuals can sideline the EU judicial system and seek judicial relief against the EU through arbitration tribunals. In fact, the main purpose of ISDS is to enable foreign investors to have their own court system when seeking relief against the host state. This does not only affect the powers of the EU judicial system, but also has effects on the EU legal system as a whole, in particular when it comes to discretion of public authorities to take decisions in the public interest but that affect foreign investment.

---

[10] *Opinion 1/76 re Inland Waterways* [1977] ECR 741; *Opinion 1/91 on the creation of the European Economic Area* [1991] ECR I-6079, *Opinion 2/94 Accession to the ECHR* [1996] ECR I1759; *Opinion 1/09* (cited at footnote 6), *Opinion 2/13 Accession to the ECHR* (Full Court 18 December 2014).
[11] *Opinion 1/92 on the creation of the European Economic Area* [19920 ECR I-2821, *Opinion 1/00 ECAA Agreement* [2002] ECR I-3493.
[12] EFTA stands for European Free Trade Association States.
[13] *Opinion 1/92* (cited at footnote 11), para 19.
[14] *Opinion 1/00* (cited at footnote 11).
[15] Case C-377/02 *Léon Van Parys NV v Belgisch Interventie- en Restitutiebureau (BIRB)* [2005] ECR I-1465.
[16] Case 26/62 *Van Gend en Loos v Nederlandse Adminstratite der Belastingen* [1963] ECR 1.

Our analysis below finds four main grounds for why the ECJ may find ISDS incompatible with EU law:

- The ECJ has exclusive jurisdiction to provide for a definitive interpretation of EU law within the EU legal order and will reject any external judicial or quasi-judicial body that will interpret or apply EU law. As a fundamental purpose of ISDS is to enable investors to challenge EU decisions, it is unavoidable that an ISDS arbitration tribunal would have to consider questions of EU law, and could declare an EU measure to conflict with the TTIP or other trade agreements in a way that would significantly undermine the Court's competences (see below section 2.1);
- The EU courts have exclusive jurisdiction to rule on the EU's liability to pay damages (the non-contractual liability of the EU). As ISDS would allow arbitration tribunals to hear claims for damages by individuals and to award damages against the EU such a system would undermine the EU courts' exclusive competences to rule on non-contractual liability of the EU and would significantly broaden the EU's exposure to claims for liability(see below section 2.2);
- The ECJ has exclusive jurisdiction to decide on the division of competences between the EU and Member States. A number of envisaged ISDS provisions allow arbitrators to decide on responsibility between the EU and the Member States which would prejudice the Court's right to decide on the division of competences between the EU and the Member States (see below section 2.3);
- ISDS awards may result in distortion of competition on the EU internal market and discriminatory treatment of EU undertakings and EU nationals, hampering the completion of the internal market. In particular, ISDS awards may conflict directly with the EU state aid rules (see below section 2.4).

This study will examine each of these grounds in turn.

2.1 External judicial control within the EU legal order

ISDS mechanisms in EU international agreements such as CETA and the EU-Singapore FTA would significantly affect the autonomy of the EU legal order, in particular because such mechanisms would undermine the Court's exclusive competence to give a definite interpretation of EU law.

The Commission (DG Trade) concept paper 'Investment in TTIP and beyond' seems to suggest that ISDS is compatible with EU law in this regard. It states that 'a risk of such incompatibility would exist especially if ISDS tribunals were to interpret EU law in a manner that would be binding on the EU institutions. Since ISDS tribunals only interpret the international agreement in question and would examine EU law only as a matter of fact, one may argue that concerns related to the autonomy of EU law are unfounded.' [17] In the textual proposal of 16 September, the Commission elaborates upon this point of view by introducing provisions that exclude domestic law from the 'applicable law' and to make interpretation of domestic law by arbitration tribunals not binding on domestic courts.[18]

[17] European Commission, 'Concept paper: Investment in TTIP and beyond - the path for reform', http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF [accessed on August 13 2015], at 10

[18] European Commission, ' Commission draft text TTIP - investment' (cited at footnote 2), article 13 (3) and (4).

We do not agree with DG Trade's assessment that there is no risk of incompatibility, which is also in contradiction with *amicus curiae* submissions made by the Commission's legal service in the Member State investor-state arbitration cases.[19] Even the new provisions in the textual proposal of 16 September 2015 that are not present in the draft CETA and EU - Singapore FTA text, would be insufficient in addressing this risk.

Only an incomplete reading of the ECJ's case-law could point in the direction of DG Trade's views. It is true that the Court has on multiple occasions held that:

> *'[A]n international agreement providing for the creation of a court responsible for the interpretation of its provisions and whose decisions are binding on the institutions, including the Court of Justice, is not, in principle, incompatible with EU law; that is particularly the case where, as in this instance, the conclusion of such an agreement is provided for by the Treaties themselves. The competence of the EU in the field of international relations and its capacity to conclude international agreements necessarily entail the power to submit to the decisions of a court which is created or designated by such agreements as regards the interpretation and application of their provisions'.*[20]

Moreover, in *Opinion 1/09* the Court held that the judicial systems in the ECAA Agreement and the EEA Agreement were compatible with the EU legal order because they 'were designed, in essence, to resolve disputes on the interpretation or application of the actual provisions of the international agreements concerned.'[21]

However, the Court has equally held that **'an international agreement may affect its own powers only if the indispensable conditions for safeguarding the essential character of those powers are satisfied and, consequently, there is no adverse effect on the autonomy of the EU legal order'**.[22] This is well-established case-law, reflected in no less than six of the twenty Opinions ever rendered by the Court.[23] In particular, an international agreement must not have the effect of binding the EU to a particular interpretation of EU law.[24] These conditions are particularly hard to satisfy in the case of an ISDS mechanism. The case of the ECtHR in *Opinion 2/13* demonstrates the difficulty.

An ISDS tribunal exercises external control over the EU and its institutions the same way the ECtHR would have: the ECtHR may declare an EU measure to conflict with the ECHR, and the arbitration body may declare an EU measure to conflict with the investment provisions in EU international agreements. Whether the ECtHR or the arbitration body may invalidate EU law is not relevant. Both systems provide an interpretation of the respective international agreement, and as the EU is a signatory of the ECHR or an international agreement containing ISDS, the EU and the Court of Justice of the EU in particular is bound by such interpretation.[25] The binding nature of rulings of investment tribunals on the parties to the dispute is confirmed, for instance, by articles X.39 of the draft text of CETA and 9.30 (1) of the draft text of the EU-Singapore FTA. It is also envisaged in the Commission draft text for the TTIP in article 30 of section 3. By virtue

[19] European Commission, Amicus Curiae submission in *European American Investment Bank AG (EURAM) v. Slovak Republic* (13 October 2011) SJ.i.dir (2011) 1154556; Commission Amicus Curiae submission as quoted by the arbitration tribunal in *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (award on jurisdiction 7 December 2012), para 193

[20] *Opinion 1/91* (cited at footnote 10), paras 40 and 70; *Opinion 1/09* (cited at footnote 6), para 74; *Opinion 2/13* (cited at footnote 10), para 182.

[21] *Opinion 1/09* (cited at footnote 6), para 77.

[22] *Opinion 2/13* (cited at footnote 10), para 183; see *Opinion 1/00* (cited at footnote 11), para 21, 23 and 26; *Opinion 1/09*(cited at footnote 6, para 76.

[23] *bid; Opinion 1/76* (cited at footnote 10)*, paras 17-22; Opinion 1/91*(cited at footnote 10),*; Opinion 1/92* (cited at footnote 11).

[24] *Opinion 2/13*(cited at footnote 10), para184.

[25] *Opinion 2/13* (cited at footnote 10), paras 182, 184, 185.

of article 216 (2) TFEU these arbitration awards are also binding on the EU institutions, including the Court of Justice of the European Union.

In *Opinion 2/13* the Court held that the draft agreement for the EU's accession to the ECHR did not enable the specific characteristics of the EU and EU law to be preserved because the accession agreement did not enable the Court to give a definite interpretation of all EU law, including secondary law, and in particular on the power to give a definite interpretation of EU law in light of the rights guaranteed by the ECHR.[26] It is worth quoting these paragraphs of the Opinion in full:

> *'If the Court of Justice were not allowed to provide the definitive interpretation of secondary law, and if the ECtHR, in considering whether that law is consistent with the ECHR, had itself to provide a particular interpretation from among the plausible options, there would most certainly be a breach of the principle that the Court of Justice has exclusive jurisdiction over the definitive interpretation of EU law.*
>
> *[...] Accordingly, limiting the scope of the prior involvement procedure, in the case of secondary law, solely to questions of validity adversely affects the competences of the EU and the powers of the Court of Justice in that it does not allow the Court to provide a definitive interpretation of secondary law in the light of the rights guaranteed by the ECHR.'*[27]

The ISDS mechanisms envisaged in the EU-Singapore FTA and CETA will all breach the conditions set by the Court. The Court considers the interpretation of both primary law and secondary law off limits to external judicial bodies within the EU if it is not involved in the procedure of giving a definitive interpretation of that law. Moreover, the Court explicitly does *not* limit its exclusive jurisdiction to the *validity of EU law*. The interpretation of EU law by an external judicial or quasi-judicial body without the prior involvement of the ECJ is not allowed, whether or not that body has the power to invalidate EU law. This is particularly important for ISDS. Similar to the ECHR, ISDS bodies do not have the power to invalidate EU legislation, but merely the power to award damages for a breach of an international agreement. [28]

As Roberto Baratta has pointed out in the human rights context, 'the Strasbourg Court [ECtHR] usually considers the domestic law of the contracting parties as a matter of fact, without dwelling in depth on its interpretation. According to settled caselaw it is primarily for national authorities, notably the courts, to interpret and apply domestic law, the Strasbourg Court's role being confined to ascertaining that the effects of such an interpretation are compatible with the Convention.' [29]

Merely taking note of domestic (in the trade context, EU law) is the bare minimum level of interpretation that investment tribunals engage in. They often go well beyond that. The issue of EU law already arises under EU member state bilateral trade agreements. Konstanze Von Papp,

[26] *Opinion 2/13* (cited at footnote 10), paras 246-247.
[27] ibid.
[28] Which after conclusion by the EU becomes an integral part of the EU legal order, see Case 181/73 *R. & V. Haegeman v Belgian State* [1974] ECR 449, para 5
[29] Roberto Baratta, 'Accession of the EU to the ECHR: The rationale for the CJEU's prior involvement mechanism' (2013) 50 Common Market Law Review, 1305–1332 at 1325, citing Kruslin v. France ,Appl. No. 11801/85, Judgment of 24Apr. 1990, paragraph 29; Slivenko v. Latvia, Appl. No. 48321/99, Judgment of 9 Oct. 2003, para 105; W. v. Netherlands , Appl. No. 20689/08, Judgment of 20 Jan. 2009 (admissibility); Guérin Automobiles v. 15 Etats de l'Union européenne , Appl. No. 51717/99, Judgment of 4 July 2000; Markovich and others v. Italy , Appl. No. 1398/03, Judgment of 14 Dec. 2006, para 108.

for instance, states that in the context of Member State international investment agreements[30] 'EU law could enter an investment treaty arbitration either as part of public international law or the applicable domestic law; or even just as a matter of fact. Accordingly, investment treaty tribunals are divided as to the proper basis for the application of EU law. However, most tribunals seem to accept that EU law can become relevant for the arbitration.'[31]

This has become evident in a number of rulings of arbitration tribunals where tribunals established under Member State bilateral investment treaties found that they could apply and interpret EU law. [32] By analogy, in a recent award under NAFTA, an arbitration tribunal ruled that the Canadian government had not followed federal and provincial law when raising environmental objections to a quarry project in Nova Scotia.[33]

Such powers by ISDS tribunals have been contested by a number of *amicus curiae* submissions by the legal service of the Commission.[34] For instance in *Achmea B.V. v. Slovakia* the Commission's legal service argued that

> *'[t]here are some provisions of the Dutch-Slovak BIT that raise fundamental questions regarding compatibility with EU law. Most prominent among these are the provisions of the BIT providing for an **investor-State arbitral mechanism** (set out in Art. 8), and the provisions of the BIT providing for an inter-State arbitral mechanism (set out in Art. 10). **These provisions conflict with EU law on the exclusive competence of the EU court for claims which involve EU law, even for claims where EU law would only partially be affected.** The European Commission must therefore [...] express its reservation with respect to the Arbitral Tribunal's competence to arbitrate the claim brought before it by Eureko B.V.'*[35]

In *AES v Hungary*, an arbitral tribunal even held that EU law was subordinate to international investment law, and that international investment law would take precedence in the case of conflict with EU law (which is the purpose of granting additional, non-constitutionally reviewable rights to investors in the first place). [36]

There will be numerous instances were arbitration tribunals will have to make an assessment of EU law. This may be the case, for instance, when a foreign investor is obstructed in exercising his free movement rights through a company incorporated under the laws of a Member State. Or when EU or national authorities take decisions on the basis of EU legislation, for example when penalties are handed out or permits are being revoked. For an investment tribunal such decisions may, for instance, amount to a breach of the national treatment or fair and equitable treatment standards. The investment tribunal might find those standards are breached because

[30] Member State international investment agreements also raise concerns over the compatibility with EU law when investment tribunals interpret EU law. See Konstanze Von Papp, 'Clash of "autonomous legal orders": Can EU Member State courts bridge the jurisdictional divide between investment tribunals and the CJEU? A plea for direct referral from investment tribunals to the CJEU' (2013) 50 Common Market Law Review,1039–1081.

[31] *ibid*, 1039-1040.

[32] See for example, *European American Investment Bank AG (EURAM) v. Slovak Republic*, UNCITRAL, (award on jurisdiction 22 October 2012), paras 248-267; *Maffezini v. Spain*, ICSID Case No. ARB/97/7 (Award on the Merits, 13 November 2000), para 69; *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (award on jurisdiction 7 December 2012), paras 278-283

[33] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada*, UNCITRAL, PCA Case No. 2009-04 (award on jurisdiction and liability 17 March 2015), paras 600-604 in particular

[34] European Commission, Amicus Curiae submission in *European American Investment Bank AG (EURAM) v. Slovak Republic* (13 October 2011) SJ.i.dir (2011) 1154556; Commission Amicus Curiae submission as quoted by the arbitration tribunal in *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (award on jurisdiction 7 December 2012), para 193

[35] As quoted by the arbitration tribunal in *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (award on jurisdiction 7 December 2012), para 193

[36] *AES v. Hungary* ICSID Case No. ARB/07/22, (award of 23 September 2010), at para 7.6.6. see Matthew Parish, 'International Courts and the European Legal Order' [2012] European Journal of International Law, 141-153 at 148.

EU legislation is applied in a discriminatory or arbitrary way, or even that EU legislation itself is breached. In both instances arbitration tribunals are giving meaning to the basic EU legislative act.

It will be difficult to avoid the issue of ISDS affecting the ECJ's competence to give a definitive interpretation of EU law. For one thing, it is unlikely the Court will consider arbitration tribunals that result out of ISDS to constitute a 'court or tribunal of a Member State'.[37] Therefore, arbitration tribunals cannot refer questions of interpretation of EU law to the Court on the basis of article 267 TFEU. For another, in *Opinion 2/13*, the Court asks for specific instruments to contain a development in which the essential powers and the autonomy of the legal order are put at risk.[38] However, such limitations or safeguards are not provided by the EU-Singapore FTA, CETA or are likely to be considered in the TTIP.

There is, for instance, no system envisaged within the current trade agreements negotiated by the Commission that would allow the Court to provide for a definite interpretation of EU law. As the Commission in its concept paper acknowledges, 'CETA and the EU/Singapore FTA [...] do not provide explicit guidance on how domestic law should be handled.' [39] Accordingly, the EU-Singapore FTA and CETA would seem to be incompatible with the EU constitutional framework. Moreover, it is unlikely that such a system is likely to be realized in future international investment agreements envisaged by the EU, as it would remove key perceived advantages, independence from domestic courts and easily accessible and quick remedies, of ISDS.[40] The Commission in both its concept paper and its draft text of September 16 2015 also does not envisage any system within the ISDS framework that would enable the prior involvement of the ECJ. Quite the contrary article 13 (5) of section 3 of that draft text empowers a Committee set up under the TTIP to adopt decisions as regards matters of interpretation, introducing an additional external body that may infringe upon the competences of the EU courts.

Moreover while article 13 (3) of section 3 draft text on the TTIP of September 16 2015 does prohibit arbitration tribunals from applying EU law, arbitration tribunals would still have to consider questions of EU law, interpret and assess EU law, and declare that EU law conflicts with investment provisions of trade agreements. The distinction introduced by the Commission that arbitration tribunals would only interpret EU law as a matter of fact, and would therefore be compatible with EU law is untested before the EU courts and is not part of the Court's reasoning in *Opinion 2/13*. Moreover, the Commission's proposition that arbitration tribunals 'shall follow the prevailing interpretation' of EU law made by the EU courts, begs the question what should happen if no such interpretation yet exists. Also, the Appeal Tribunal would have the power to review whether the Tribunal in First Instance has manifestly erred in following the prevailing interpretation of domestic law as well as the appreciation of domestic law.[41] This power to review whether the Tribunal of First Instance has correctly appreciated EU law 'as a matter of fact' would require the involvement of the ECJ as the Appeal Tribunal would be reviewing whether

[37] Case 102/81 *Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. and others* [1982] ECR 1095, from para 7 onwards.
[38] *Opinion 2/13* (cited at footnote 10), paras 190, 195, 199.
[39] European Commission, 'Concept paper: Investment in TTIP and beyond - the path for reform' (see footnote 17), 10.
[40] See Markus Burgstaller, 'Dispute Settlement in EU International Investment Agreements with Third States: Three Salient Problems' (2014) 15 The Journal of World Investment & Trade, 551-569 at 565; Steffen Hindelang, 'Circumventing Primacy of EU Law and the CJEU's Judicial Monopoly by Resorting to Dispute Resolution Mechanisms Provided for in Inter-se Treaties? The Case of Intra-EU Investment Arbitration' (2012) 39 Legal Issues of Economic Integration, 179–206.
[41] Article 29 (1) (b) of section 3 of the Commission proposal.

the Tribunal has assessed EU law correctly.[42] An additional aggravating factor is that there is no remedy against any breach of EU law by the arbitration tribunals.[43]

Furthermore, the addition of article 13 (4) of section 3 of that draft text, stating that 'the meaning given to the relevant domestic law made by the Tribunal shall not be binding upon [the EU Courts] or authorities', is equally questionable considering the binding nature of a final award and the significant financial consequences awards may have and the precedence such rulings may set for future claims.

Furthermore, it is unlikely that the Court will accept a system of prior involvement in the context of ISDS. While a system of prior involvement might work in the context of the ECHR, this is because it would not affect the competences of the courts of the Member States and EU courts as the ECHR requires exhaustion of national remedies before a case can be brought. However, an ISDS mechanism would deprive courts of Member States of their powers in relation to the interpretation and application of EU law.[44] The limitation of the powers of the courts of Member States is further extended by the draft provisions of CETA and the EU-Singapore FTA as well as the Commission's draft text of September 16 2015 that state that investors may not bring a parallel claim when they bring a claim under the ISDS and investment provisions (the "no u-turn" approach).[45] As the legal service of the European Commission has pointed out in the context of Member State investment agreements:

> *'The arbitral tribunal is not a court or tribunal of an EU Member State but a parallel dispute settlement mechanism entirely outside the institutional and judicial framework of the European Union. Such mechanism deprives courts of the Member States of their powers in relation to the interpretation and application of EU rules imposing obligations on EU Member States, which are presumably relevant in the arbitral proceeding.'*[46]

The options of limiting the effects of awards of tribunals giving a particular interpretation of EU law or imposing limitations on the regulatory powers of EU institutions are severely limited (in line with the rationale of ISDS to have an alternative and independent source of judicial relief). ISDS introduces a legal remedy that escapes the substantive judicial scrutiny of national courts, and constitutional courts in particular, with the exception of a limited possibility of procedural review in cases of manifest unfairness and exceptionally where the award would violate the forum state's most basic notions of morality and justice.[47] The possibility for EU Member State courts to make a preliminary reference on the basis of this exception is further limited by the possibility to enforce an award outside the EU. Moreover, if a tribunal would be established under the International Centre for Settlement of Investment Disputes (ICSID) convention (the EU and Poland are not a party to this convention), enforcement of awards is automatic.[48]

Moreover, it is clear that the provisions establishing investor rights applied by arbitration bodies are very broad, and that challenges may as a result affect significant parts of the EU legal

[42] Consider the situation in which one of the Parties appeals because it claims that EU law has been wrongly interpreted by the Tribunal in First Instance or that the Tribunal did not follow the prevailing interpretation of domestic law.

[43] See Opinion 1/09 (cited at footnote 6), paras 83-89. Within the EU legal order the Commission has the power to start infringement proceedings against a Member State if a court of a Member State infringes EU law and individuals can claim damages on the basis of non-contractual liability of the Member State. See Case C-224/01 *Gerhard Köbler v Republik Österreich* [2003] ECR I-10239.

[44] Opinion 1/09 (see footnote 6), paras 66-70, and 89 in particular.

[45] Article X.21 of CETA and article 9.20 of the EU-Singapore FTA. This provision can also be found in the Commission's draft text of September 16 2015 under article 14 (1) of section 3.

[46] European Commission, Amicus Curiae submission in *European American Investment Bank AG (EURAM) v. Slovak Republic* (13 October 2011) SJ.i.dir (2011) 1154556

[47] Article V of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 38; 21 UST 2517; 7 ILM 1046 (1968). The public policy exception is commonly regarded as imposing a very high standard for the state to meet.

[48] Article 53 of the ICSID Convention 17 UST 1270, TIAS 6090, 575 UNTS 159

framework. This means that in addition to interpreting and applying EU law, ISDS mechanisms provide for a broadly framed remedy against EU institutions and legislation adopted by the EU. Investors may resort to arbitration where they claim that the EU has breached one of the substantive investment protection measures. For instance, in the Singapore-EU FTA, an investor may bring a claim for a breach of 'fair and equitable treatment' in relation to its investments which consists out of 'denial of justice in criminal, civil and administrative proceedings', a 'breach of due process', 'manifestly arbitrary conduct', 'harassment, coercion, abuse of power or similar bad faith conduct' and breach of 'legitimate expectations'. [49] These are broad and subjective terms, potentially applying to all EU actions.

Such vast competence of arbitration bodies to review EU law threatens the powers of EU institutions, and the autonomy of the legal order. The 'regulatory chill'[50] resulting out of investor-state arbitration may take many forms that not only directly relate to the decision-making powers of EU institutions.[51] An example of how the decision-making powers may be affected by recourse to ISDS in the EU is restrictions imposed on the use of MMT in fuels. A challenge before the EU courts on EU restrictions on MMT in fuels was unsuccessful.[52] However, in Canada the US firm Ethyl Corporation succeeded in removing a federal government ban on MMT in fuel through an ISDS claim.[53]

The regulatory chill may not only come from the reluctance to regulate in face of arbitration claims, but also from a reluctance to comply with rules. For instance, Member State authorities may have a financial incentive not to comply with EU environmental legislation, if compliance results in arbitration proceedings. [54] Similarly, investor-state arbitration may be initiated when a Member State seeks to comply with a ruling of the European Court of Justice, *de facto* penalizing the Member State for complying with EU law. The guarantees the Commission has sought to provide in article 13 (4) of section 3 of the draft text of September 16 2015 are not particularly meaningful in that regard. Another example is claims the EU and its Member States may experience when restructuring public debt.[55]

---

[49] Another example is the conflict, for instance, between the prohibitions on 'performance requirements' with EU legislation imposing quotas and performance requirements in various sectors such as agriculture, European content required in television broadcasting, and maritime transport services. See Jan Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of The Energy Charter Treaty' (2012) 15 Journal of International Economic Law,85-109, at 90; Council Regulation 3921/91 laying down the conditions under which non-resident carriers may transport goods or passengers by inland waterway within a Member State [1991] OJ L 373/91, Article 2 (1); Council Directive 89/552/EEC on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities [1989] OJ L 298/12, Article 4.

[50] 'Regulatory chill' is understood here as the concept that paying damages by the government for its regulatory activities makes it more difficult for that government to regulate socially desirable ideas.

[51] Under the Pesticides Regulation, for example, a Commission decision to withdraw authorization for a particular pesticide (but not for another) may affect the investment of a foreign investor. Such a decision may then be challenged in front of ISDS under the fair and equitable treatment standard. Other examples may be situations under REACH. The Commission might be reluctant to add new substances to the final list of Substances of very High Concern or to deny permission to market such substances within the EU.

[52] Case C-343/09 *Afton Chemical Limited v Secretary of State for Transport* [2010] ECR I-7027.

[53] Public Citizen, 'NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement' (Report) (February 2005), 21.

[54] See by analogy *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany*, ICSID Case No. ARB/09/6 (award of 11 March 2011). See also Nathalie Bernasconi, 'Background paper on Vattenfall v. Germany arbitration' (IISD, July 2009) http://www.iisd.org/pdf/2009/background_vattenfall_vs_germany.pdf [accessed on 12 August 2015].

[55] The CETA text (Annex X on Public Debt) and Annex II: Public debt in the Commission's TTIP proposal does protect collective action clauses against ISDS claims. However, the level of protection offered by the EU courts appears to be much higher. In T-79/14 Accorinti (judgment of 7 October 2015) the General Court held in general terms that investment in public debt is not protected under EU law. The General Court held (para. 121) that ' le préjudice invoqué par les requérants ne dépasse pas les limites des risques économiques inhérents aux activités commerciales dans le cadre du secteur financier, notamment aux transactions portant sur des titres de créance négociables émis par un État, surtout, lorsque cet État présente, comme la République hellénique à partir de la fin de 2009, une notation réduite. Au contraire, indépendamment du principe général selon lequel tout créancier doit supporter le risque d'insolvabilité de son débiteur, y compris étatique, de telles transactions s'effectuent sur des marchés particulièrement volatils, souvent soumis à des aléas et à des risques non contrôlables s'agissant de la baisse ou de l'augmentation de la valeur de tels titres, ce qui peut inviter à la spéculation pour obtenir des rendements élevés dans un laps de temps très court. Dès lors, à supposer même que tous les requérants

The threat of a 'regulatory chill' as a result of damages claims for the EU's legislative activities is exactly the reason why the Court has been very cautious and deferential in awarding damages on the basis of article 340 TFEU (see further section 2.2). In *FIAMM,* for instance, the Court held that the reason for its strict approach towards damages claims is that 'exercise of the legislative function must not be hindered by the prospect of actions for damages whenever the general interest of the [EU] requires legislative measures to be adopted which may adversely affect individual interests.'[56] ISDS mechanisms and their accompanying investment provisions are, however, not hindered by any such considerations, neither in the investment provisions themselves, nor by their institutional set-up: the raison d'être of ISDS mechanisms is to provide foreign investors an alternative dispute settlement system *independent* of the host state.

Stephan Schill has argued that the threat to the autonomy of the EU legal system and the Court's powers to give a definitive interpretation of EU law is limited because CETA denies direct effect of the agreement.[57] The EU-Singapore FTA contains similar but considerably weaker language.[58] However, this point was not explicitly addressed in *Opinion 2/13*, nor does the ECHR require the Parties to the Convention to give direct effect to the judgments of the ECtHR. In fact, there are countries that do not grant direct effect to the rulings of the Strasbourg court or limit its effects in the domestic legal order.[59] If the Court would have been concerned with direct effect of ECtHR judgments, it could have accepted the draft accession agreement and limited the effects of ECtHR judgments in the EU legal order afterwards.[60] The Court did not do so. And like the judgments of the ECtHR, decisions of ISDS tribunals are binding on the Parties.[61]

More importantly, ISDS provisions pose a considerably larger threat to the autonomy of the EU legal order than the ECtHR in a number of other respects. Firstly, under ISDS there is no need to exhaust domestic remedies first, while the ECHR requires exhaustion of domestic remedies.[62] This means that foreign investors can sideline the EU courts if they seek to challenge EU actions and decisions. Secondly, the amount of compensation awarded by ISDS tribunals is considerably larger than the ECtHR. ISDS awards generally reach tens of millions of euros and can even be as high as several billion euros.[63] In the case of *Occidental Petroleum Corporation v Equador* an ICSID tribunal awarded 2 billion euros in damages to an investor, equalling Equador's annual health care budget.[64]

---

ne soient pas engagés dans des transactions de nature spéculative, ils devaient être conscients desdits aléas et risques quant à une éventuelle perte considérable de la valeur des titres acquis.'

[56] Joined cases C-120/06 P and C-121/06 P *Fabbrica italiana accumulatori motocarri Montecchio SpA (FIAMM) and others v Council and Commission* [2008] ECR I-6513, para 174

[57] Stephan Schill, 'The Proposed TTIP Tribunal and the Court of Justice: What Limits to Investor-State Dispute Settlement under EU Constitutional Law?' (Verfassungsblog, 29 September 2015) http://www.verfassungsblog.de/en/the-proposed-ttip-tribunal-and-the-court-of-justice-what-limits-to-investor-state-dispute-settlement-under-eu-constitutional-law/#.VhPdKPkYMmA [accessed on 6 October 2015].

[58] Article 17.15 of the EU-Singapore FTA.

[59] Christina Eckes, 'EU Autonomy and Decisions of (Quasi-) Judicial Bodies: How Much Differentness is Needed?' (2011) Amsterdam Centre for European Law and Governance 2011 - 10 http://acelg.uva.nl/binaries/content/assets/subsites/amsterdam-centre-for-european-law-and-governance/map-1/acelg-wp-2011-10.pdf [accessed on 6 October 2015]

[60] See article 46 (2-5) of the ECHR in particular and by analogy Case C-377/02 *Léon Van Parys NV v Belgisch Interventie- en Restitutiebureau (BIRB)* [2005] ECR I-1465.

[61] For the ECHR see article 46 (1) of the Convention. For the EU-Singapore FTA see article 9.30 (1) of the agreement. For CETA see article X.39. For the Commission draft text TTIP - investment of 16 September see article 30 (1) of Section 3.

[62] See article 35 (1) of the ECHR.

[63] Diana Rosert, 'The Stakes Are High: A review of the financial costs of investment treaty arbitration' (IISD Report) (July 2014).

[64] *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador,* ICSID Case No. ARB/06/11 (award of 5 October 2015). See VPRO documentary 'Tegenlicht' of 8 October http://tegenlicht.vpro.nl/afleveringen/2015-2016/ttip.html [accessed on 6 October 2015].

2.2 ISDS affects the exclusive jurisdiction of the EU Courts to rule on the non-contractual liability of the EU (art. 340 TFEU and 19 EU Treaty)

The second legal problem facing ISDS mechanisms is a direct conflict with the exclusive jurisdiction accorded under the EU treaties to the Court of Justice of the European Union to determine when compensation should be awarded to individuals for damage caused by the EU institutions. Moreover, even if a mechanism such as ISDS can formally be distinguished from article 340 TFEU, the exclusive jurisdiction of the EU courts to rule on the non-contractual liability of the EU and to hear claims by individuals (art. 340 TFEU and 19 EU Treaty) is significantly affected. Investment protection provisions guarded by ISDS mechanisms employ lower standards for damages claims, undermining the exclusive powers of the EU courts under article 340 TFEU. The inclusion of ISDS therefore may infringe the principle of institutional balance as the EU legislator would delegate one of the powers of the Court to investment tribunals without adequately respecting the ECJ's competences.

Under Article 340(2) TFEU, the EU 'shall, in accordance with the general principles common to the law of the Member States, make good any damage caused by the institutions or by its servants in the performance of their duties'. Under Article 268 TFEU, the Court of Justice of the EU decides 'in disputes relating to the compensation for damage provided for in the second and third paragraph of Article 340'. This means that cases for damages under Article 340 (2) TFEU have to be brought before the EU Courts. It is settled case-law that

> *'With regard to the [EU]'s non-contractual liability, such disputes fall within the jurisdiction of the Court of Justice. Article [19 TEU] provides that the Court of Justice has jurisdiction to hear and determine actions seeking compensation for damage brought under the second paragraph of Article [340 TFEU], which covers such non-contractual liability. That jurisdiction of the [EU] Courts is exclusive.'*[65]

This means that cases for damages under Article 340 (2) TFEU have to be brought before the EU Courts. An ISDS arbitration body that decides on cases for damages would interfere with this competence of the EU Courts and would therefore not be compatible with the Treaty.

It has been argued that article 340 TFEU does not preclude the EU from incurring responsibility for violations of an international agreement, and that therefore article 340 TFEU does not preclude the EU from concluding an international agreement containing investment protection and ISDS provisions.[66] While it is true that article 340 TFEU does not preclude the EU from incurring international responsibility *generally*, it is questionable whether the possibility of incurring international responsibility automatically makes a mechanism such as ISDS compatible with article 340 TFEU.

First of all, being able to incur international responsibility does not mean that the EU can circumvent its constitutional framework, the EU Treaties.[67] While the EU may assume international obligations towards third states such as the United States and assume liability for breaching those obligations, it does not necessarily entail that the creation of an external judicial

[65] Case C-377/09 *Hanssens_Ensch v. European Community* [2010] ECR I- 7751, para 16. See also Case C-275/00 *European Community v First NV and Franex NV* [2002] ECR I- 10943, para 43; Case C-282/90 *Vreugdenhil v Commission* [1992] ECR I-1937, para 14; Case 281/84 *Zuckerfabrik Bedburg AG and others v Council and Commission* [1987] ECR 49, para 12; Case 101/78 *Granaria BV v Hoofdproduktschap voor Akkerbouwprodukten* [1979] ECR 629, para 14.
[66] Angelos Dimopoulos, 'The involvement of the EU in investor-state dispute settlement: A question of responsibilities' (2014) 51 Common Market Law Review, 1671–1720, at 1705
[67] Case 294/83 *Parti écologiste "Les Verts" v European Parliament* [1986] ECR 1339, para 23.

body that can award damages against the EU in response to claims made by third country nationals (investors) through an international agreement is compatible with the EU Treaties.[68]

Secondly, it is not true that the exclusive jurisdiction of the Court under article 340 TFEU would make it impossible for the EU to incur international responsibility simply because international responsibility is not necessarily the same as claims for damages by individuals against public authorities. The concept of international responsibility is traditionally understood as a concept that applies between entities that have international legal personality.[69] That concept only in certain cases encompasses individuals and usually refers to states or international organisations. Article 340 TFEU, by contrast, is a remedy internal within the EU legal order open to individuals claiming damages for losses suffered caused by the EU. It is obvious therefore that the EU may still incur international responsibility for numerous other international agreements even if an ISDS mechanism were to be found incompatible with article 340 TFEU including trade agreements without ISDS.

Even if a damages claim on the basis of an international agreement by individuals can be formally distinguished from a claim under article 340 TFEU, it is clear that ISDS mechanisms would *de facto* significantly undermine the EU Courts' competences to rule on the EU's non-contractual liability. Investment protection provisions guarded by ISDS mechanisms employ lower standards for damages claims.[70] The EU Courts employ high standards, both procedurally and substantively, in allowing claims for damages for reasons that do not necessarily apply to investment tribunals. In addition, foreign investors may bring claims on behalf of EU companies owned or controlled by that investor.[71] Moreover, the draft texts of CETA and the EU-Singapore FTA specify that investors may not bring a claim under article 340 TFEU when they bring a claim under the ISDS and investment provisions (the "no u-turn" approach), further undermining the jurisdiction of the EU Courts under article 340 TFEU.[72]

There are two main reasons for the strict approach of the EU courts towards damages claims. Firstly, the Court is wary of a regulatory chill that may result out of awarding damages. Secondly, the Court attaches greater importance to the public interest than to the rights of individuals when in relation to awarding damages. In the words of the Court, the 'exercise of the legislative function must not be hindered by the prospect of actions for damages whenever the general interest of the Community requires legislative measures to be adopted which may adversely affect individual interests.'[73] As a result, damages are only awarded if there is 'a sufficiently flagrant violation of a superior rule of law for the protection of the individual'.[74] The sufficiently serious breach entails that the EU public authority in question 'manifestly and gravely disregarded the limits on its discretion'.[75] Accordingly, it is very difficult to claim damages for lawful acts of the EU.[76]

---

[68] A potential accession to the ECHR is different in this regard as accession is explicitly mandated by article 6 (2) TEU.

[69] Malcolm N. Shaw, *International Law* (Cambridge University Press 2003), at 175-247.

[70] As Jan Kleinheisterkamp (see footnote 49) notes at 100 'It is not all that clear why and how arbitral tribunals should on [the basis of broad investment provisions] engage in a balancing of private and public interests that is equivalent to the mechanisms of judicial review of administrative acts under national laws and, by extension, under EU law.'

[71] Article 9.14 draft EU-Singapore FTA

[72] Article X.21 of CETA and article 9.20 of the EU-Singapore FTA

[73] Joined cases C-46/93 and C-48/93 *Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others* [1996] ECR I-1029, para 45

[74] Case 5/71 *Aktien-Zuckerfabrik Schöppenstedt v Council* [1971] ECR 116, para 11.

[75] Case C-352/98P, *Laboratoires Pharmaceutiques Bergaderm SA and Jean-Jacques Goupin v Commission* [2000] ECR-I 5310, para 43.

[76] Joined Cases C-120 & 121/06P *FIAMM and Fedon v Council and Commission* [2008] ECR I-6513, paras 175-176.

Such general considerations do not apply to ISDS mechanisms set up by international investment agreements. These agreements are explicitly created to give individuals (foreign investors) an additional remedy and additional individual rights against the state irrespective of the legality of the measure under domestic law. Moreover, international investment agreements do not mandate arbitrators to be concerned with the effects of regulatory chill their awards may have, nor are arbitrators part of the system of government of the host state. Their necessary independence from the host state precludes such reasoning and the texts of investment chapters do not require them to show sufficient deference towards public interests. For instance, the draft texts of CETA and the EU-Singapore FTA investment chapters do not provide any explicit guarantee that arbitration tribunals will protect the right to regulate or protect and uphold the legislation of the host state.[77]

The stricter approach by the Court is exemplified by the obligation of the injured party to 'show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the loss or damage himself'.[78] As a result, investors bringing a claim under article 340 TFEU must generally seek annulment of the act causing damage insofar as it is reasonable to pursue annulment.[79] By contrast, under the draft investment and arbitration provisions of CETA and the EU-Singapore FTA do not require the foreign investor to exhaust local remedies, and allow a claim to be brought directly.

As Jan Kleinheisterkamp notes: 'Investment treaties concluded by the Union [...] would de facto change the existing balance of judicial recourses established by the Treaties for the determination of whether EU law has been breached and relegate the primary remedy of judicial challenge to the same ranks as the secondary remedy of damages. Foreign investors could short-cut the existing mechanisms by relying exclusively on the protection standards found in the investment agreement and seek damages directly.'[80]

The principle of institutional balance, reflected in article 13 (2) TEU requires that each institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them. According to the Court, this principle 'requires that each of the institutions must exercise its powers with due regard for the powers of the other institutions.'[81] Therefore, actions by one or several of the EU institutions 'cannot deprive the other institutions of a prerogative granted to them by the Treaties themselves.'[82]

The inclusion of ISDS mechanisms and investment provisions in international agreements concluded by the EU, however, affects the exclusive competences of the EU courts to rule on claims for damages under article 340 TFEU because international tribunals would become competent to hear similar claims for damages by individuals operating on the EU internal market and against a lower standard. Moreover, while the ECJ remains competent to rule on actions for damages by EU legal and natural persons, ISDS provisions in EU trade agreements further limit the Court's competences by including 'no U-turn' provisions.[83] Such provisions require foreign investors to withdraw claims in front of the Court if it seeks to pursue damages claims in front of

[77] In the EU, by contrast, this is guaranteed by article 19 TEU

[78] Case C-445/*06 Danske Slagterier v Germany* [2009] ECR I-02119, para 61

[79] See Jan Kleinheisterkamp, 'Financial Responsibility in European International Investment Policy' (2014) 63 International and Comparative Law Quarterly, 449 at 460

[80] *ibid*

[81] C-409/13 *Council v Commission* (CJEU 14 April 2014), para 64; C-70/88 Parliament v Council [1990] ECR I-217, para 22, and C-133/06 Parliament v Council [2008] ECR I-257, para 57

[82] Case 149/85 *Wybot* [1986] ECR 2391, para 23

[83] European Commission, ' Commission draft text TTIP - investment' (cited at footnote 2) article 14 (1) of section 3; Article X.21 of CETA and article 9.20 (f) of the EU-Singapore FTA

an arbitration tribunal. Lastly, the limitation of the Court's competences is further amplified by the fact that undertakings incorporated within the EU may also indirectly benefit from ISDS provisions to the extent that their shareholders are beneficiaries to the ISDS and investment provisions of EU international agreements and EU undertakings controlled by foreign investors may directly benefit from ISDS in disputes against the EU and its Member States.

2.3 ISDS and the division of competences between the EU and the Member States

The third problem with an ISDS mechanism is that arbitration cases brought under ISDS could involve questions about the division of competences between the EU and Member States. In this regard, ISDS presents a challenge with respect to determining who the respondent in a case is. Should the investor sue the EU or a Member State over a particular rule? This question is important, because it touches on the issue of competences in the EU. Under EU law, such questions must be determined exclusively by the ECJ. In *Opinion 2/13* the Court equated the question of whether the EU or a Member State is responsible under international law with the question whether the EU or a Member State has competence under EU law to take a specific measure. The Court found that an assessment of whether the EU is responsible for violating an international agreement is a matter for the EU alone and subject to the exclusive jurisdiction of the ECJ. The Court held that:

> '*The question of the apportionment of responsibility must be resolved solely in accordance with the relevant rules of EU law* ***and be subject to review, if necessary, by the Court of Justice, which has exclusive jurisdiction to ensure that any agreement between co-respondent [ie the EU] and respondent [ie the Member State] respects those rules.*** *To permit the ECtHR to confirm any agreement that may exist between the EU and its Member States on the sharing of responsibility would be tantamount to allowing it to take the place of the Court of Justice in order to settle a question that falls within the latter's exclusive jurisdiction.*'[84]

Only the Commission's draft text of September 16 2015 might meet these requirements.[85] Article 5 (3) of section 3 states that the EU will make the determination of respondent within 60 days. It is unclear, however, what happens if the EU does not make such determination.

It is apparent that the ISDS mechanisms in the CETA, and the EU-Singapore FTA do not meet this requirement set out by the Court, even when read in conjunction with Regulation 912/2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party.[86]

While Article 9.18 paragraph 2 of the EU-Singapore FTA states that the Union shall make a determination regarding who will be the respondent (EU or Member State) to an investment claim, the EU only has two months to do so. After these two months, paragraph 3 of Article 9.18, states that the arbitral tribunal will itself make a determination about whether the EU or a

---

[84] *Opinion 2/13* (see footnote 10), para 234.

[85] European Commission, ' Commission draft text TTIP - investment' (cited at footnote 2), article 5 of section 3.

[86] Regulation 912/2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party (2014) OJ L 257/121.

Member State is the respondent. This possibility would be tantamount to allowing the arbitral tribunal to settle a question that falls within the Court's exclusive jurisdiction.[87] Moreover, the period of two months is too short to allow the Court decide on the division of competences and corresponding international responsibility of the EU and the Member States.[88]

CETA contains similar provisions under article X.20 to that of the EU-Singapore FTA. Article X.20 even explicitly states that the 'tribunal shall be bound by [...] the application of paragraph 4,' which lays down the rules according to which responsibility is to be determined.[89] There is no reason to assume that the TTIP's ISDS mechanism will not also infringe on the Court's jurisdiction in the same way. Article X.27 CETA even makes things worse by permitting the Trade Committee to adopt interpretations of CETA including the determining the respondent to a case that are binding on the Tribunal. A similar provision is included in the EU-Singapore FTA.[90]

2.4 ISDS affects and conflicts with internal market provisions and other rules of primary law

ISDS is not only in apparent conflict with the EU judicial system, it also conflicts with the EU's core constitutional objectives: the completion of the internal market. Foreign investors, in contrast to domestic investors, even if they are affected in the same way by the same law, can challenge and nullify the effects of measures taken in the context of operating the internal market, most notably the EU state-aid and competition rules enshrined in articles 101-109 TFEU. However, EU undertakings not under foreign control and EU nationals do not have this possibility. As a result, the objectives of the internal market are not only undermined, but also explicit discrimination against EU undertakings not under foreign control as well as EU nationals is introduced. This is apparent from the conflict between ISDS and a number of internal market provisions and other rules of primary law.

Firstly, investors could challenge State aid law and decisions before arbitration tribunals. For instance, arbitrators may consider an order requiring investors to repay unlawful subsidies to be in breach of fair and equitable treatment, and order that damages be paid to the investor, even where the order was made in accordance with State aid rules. Such an award would clearly be incompatible with EU state aid rules. The Commission in its concept paper acknowledges that this situation is problematic from the perspective of EU law:

> *'Disputes involving state aid have raised specific problems. In a recent case under an intra-EU BIT in a pre-accession situation, the Tribunal found that a Member State's decision to discontinue the granting of a measure involving prohibited State aid was in breach of the Fair and Equitable Treatment (FET) clause. The Commission views this decision as an incorrect application of the FET clause given that EU law consistently denies legitimate expectations to investors as regards state aid. It has also taken the*

[87] *Opinion 2/13* (see footnote 10), para 234.
[88] There is a two month appeal period when against a decision of the General Court which shall in first instance rule on the legality of acts of the EU in direct actions. See article 56 of the Statute of the Court of Justice of the European Union.
[89] Article X.20 paragraph 4 reads: "4. If the investor has not been informed of the determination within 50 days of the notice referred to in paragraph 1:
(a) where the measures identified in the notice are exclusively measures of a Member State of the European Union, the Member State shall be respondent.
(b) where the measures identified in the notice include measures of the European Union, the European Union shall be respondent."
[90] Article 9.22

> *view that the compensation ordered by the Tribunal amounts de facto to the reinstatement of the prohibited state aid.*[91]

However, under ISDS it is not the Commission applying the Fair and Equitable Treatment standard in a dispute but an arbitration tribunal.

A clear example of how an award of an arbitral tribunal may conflict with EU state aid provisions, which are established by primary law, is the currently pending case *Micula and Others v Commission.* In *Micula*, a Swedish company has appealed a Commission decision ordering Romania to recover incompatible state aid as the result of an arbitral award.[92]

T-646/14 *Micula and Others (pending)* - how arbitral awards conflict with EU state aid rules

In December 2013 an arbitral tribunal ordered Romania to compensate Swedish claimants for not being able to benefit in full from an abolished investment incentive scheme. The scheme was abolished in 2005 before its scheduled expiry in 2009. The arbitral tribunal found that Romania had infringed a bilateral investment treaty between Romania and Sweden and ordered compensation equivalent to the amount provided by the abolished investment incentive scheme.

The scheme was abolished, however, because it was incompatible with EU state aid rules. Under EU state aid law, an undertaking cannot derive any legitimate expectations from aid granted if that aid is found to be incompatible state aid. In that case, all aid has to be paid back in full.

An obligation to pay back incompatible state aid on the basis of EU law therefore directly conflicts with the obligation under the arbitral award to grant the equivalent amount of funds by the Member State in question. As a matter of EU primary law, the undertaking will have to pay back incompatible state aid, yet under an international investment agreement the undertaking is entitled to compensation.

The Commission therefore issued a suspension injunction obliging Romania to pay the award issued by the tribunal on May 26 2014 as this would constitute unlawful State aid. Micula and other claimants in the award challenged this decision before the General Court in T-646/14 *Micula and Others*.

The *Micula* case is by no means an isolated case. In *Electrabel v Hungary* Electrabel brought an ISDS case against Hungary because Hungary had changed the electricity pricing regime and terminated a power purchase agreement with Electrabel's subsidiary in Hungary. However, Hungary had made those changes in order to comply with the Commission's decision 2009/609/EC of 4 June 2008 on the State aid awarded by Hungary through Power Purchase Agreements.[93] While this decision was later confirmed b the General Court and the ECJ,[94] a

[91] European Commission, 'Concept paper: Investment in TTIP and beyond - the path for reform' (see footnote 4)

[92] Case T-646/14 *Micula and Others v Commission (pending)*, see also *Micula v Romania (ICSID arbitration award)* (Case SA.38517) Commission Decision C/393/2014 [2014] OJ C 393/27.

[93] *$ - Hungarian stranded costs* (Case SA.17365) Commission Decision 2009/609/EC [2008] OJ L 225/53

decision by the investment tribunal awarding damages to Electrabel could nullify the effects of the Commission's decision, jeopardizing the effectiveness of articles 107 and 108 TFEU and distorting competition on the EU internal market.

Similar claims were made in *AES v Hungary* and *EDF v Hungary*.[95] Equally, in *U.S. Steel v Slovak Republic,* U.S. Steel brought a claim against Slovakia terminating exemptions to pay charges for the consumption of electricity.[96] As the Commission stated in its *amicus curiae* submission in the case, the exemptions constituted unlawful State Aid.[97] Quite clearly, any payment of an award would result in a violation of the EU State Aid rules, as the damages would *de facto* result in re-allocating the forbidden economic benefit to U.S. Steel and therefore distort competition on the EU internal market.[98]

The Commission is no doubt aware of this situation, and has therefore proposed to include a clause seeking immunity for the application of EU state aid rules in the international investment agreement:

> *'In order to ensure that these types of problems cannot arise, it should be considered, for greater certainty, to clarify that the investment protection standards are not to be construed as preventing from discontinuing the granting of state aid, and/or requesting the reimbursement of state aid already paid, when such state aid has been declared prohibited by its competent authorities.*
>
> *A provision clarifying that the agreement shall not be construed as preventing a Party from discontinuing the granting of state aid, and/or requesting the reimbursement of state aid already paid, when such state aid has been declared prohibited by its competent authorities.'*[99]

In the Commission draft text of September 16 2015 this incompatibility is addressed in article 2 (4) of section 2.[100] Such a provision, however, is neither part of CETA, nor clearly part of the EU-Singapore FTA[101], nor has it yet been included in the TTIP. The exception included in the EU-Singapore FTA in article 9.2 is ambiguous as to its relationship with the EU state aid rules in that respect.

Secondly, ISDS arbitration can also undermine the proper functioning of EU competition rules. A Commission decision fining an undertaking for breaching EU competition rules could result in an arbitral claim before an ISDS tribunal, for instance if that tribunal finds that the way the Commission handled the case was in breach of 'fair and equitable treatment'. If the tribunal

---

[94] Case T-179/09 *Dunamenti Erőmű Zrt v European Commission* (judgment of 30 April 2014); Case T-468/08 *Tisza Erőmű kft v European Commission* (judgment of 30 April 2014); Case C-357/14P Electrabel *v European Commission* (judgment of I October 2015).

[95] *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*, ICSID Case No. ARB/07/22 (award of 23 September 2010) where the Tribunal rejected the claim; *EDF International SA v Hungary (ad hoc* arbitration under UNCITRAL Rules). See Kleinheisterkamp (see footnote 49), 91 at footnote 25.

[96] *U.S. Steel Global Holdings I B.V. v. The Slovak Republic, UNCITRAL, PCA Case No. 2013-6 (pending)*

[97] European Commission, 'Amicus Curiae Brief In PCA case No.2013-6 *U.S. Steel Global Holdings I B.V. v. The Slovak Republic'* (15 May 2014).

[98] See also Kleinheisterkamp (see footnote 49), 92

[99] European Commission, 'Concept paper: Investment in TTIP and beyond - the path for reform' (see footnote 4), 5.

[100] European Commission, ' Commission draft text TTIP - investment' (cited at footnote 2), article 2 (4) of section 2, in particular footnote 2.

[101] It appears that the EU-Singapore FTA contains a provision along these lines, although the provision only partially addresses the issue: Article 9.2 (2) states "[Notwithstanding any other provision in this Agreement,]Article Y4 [National Treatment] shall not apply to subsidies or grants provided by a Party, including government-supported loans, guarantees and insurance. For greater certainty, a Party's decision not to issue, renew or maintain a subsidy or grant, (a)in the absence of any specific commitment under law or contract to issue, renew, or maintain that subsidy or grant; or (b)in accordance with any terms or conditions attached to the issuance, renewal or maintenance of the subsidy or grant shall not constitute a breach of Article 9.4[Standard of Treatment] or be considered an expropriation." It is unclear whether this provision covers the repayment of unlawful state-aid.

(without any involvement of the European courts) finds that the Commission has breached provisions of an EU international investment agreement, this may result in compensation being awarded that would offset the fine imposed by the Commission. Such awards would not only undermine the powers of the Commission pursuant to article 103 (2) (a) TFEU to ensure compliance with the EU competition rules by means of fines and periodic penalty payments, it would also conflict with article 101 and 102 TFEU as conduct contrary to those articles would be without effective punishment.

More generally, similar problems arise with any EU or Member State decision imposing fines on the basis of EU internal market legislation. Article 114 TFEU gives the EU legislature the power to regulate the internal market. Such powers only exist to the extent that the rules in question remove obstacles to trade or significant distortions of competition resulting from disparities in national legislation.[102] However, ISDS effectively reintroduces distortions of competition where the EU has imposed penalties for breaching EU internal market legislation, because foreign investors (in contrast to domestic investors) would have the opportunity to nullify the effects of any such penalties through ISDS. ISDS therefore jeopardizes the goals the EU is mandated to attain on the basis of article 114 TFEU. For example, penalties imposed on foreign investors for breaching the Market Abuse Directive could be nullified by an arbitral award, whereas domestic investors would not have recourse to such remedy.[103] As a result, foreign and domestic investors would not be competing under the same terms and on the same playing field because only foreign investors could escape the effects of breaching internal market legislation.

Moreover, an ISDS mechanism may be found to be incompatible with articles 54, 49, 56, and 63 TFEU. Article 54 requires natural persons who are nationals of Member States to be treated in the same way as companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union. However, a foreign investor can use ISDS for claims of loss or damage to its locally established company and can act on behalf of a locally established company which it owns or controls.[104] As a result, an EU company owned by a foreign investor has more rights and a specific additional mechanism for judicial relief under ISDS that are not conferred on all EU nationals.[105] There is no apparent justification for this discriminatory treatment, as will be discussed below.

In a similar vein, the provisions on the freedom of establishment (article 49 TFEU) and freedom to provide and receive services (article 56 TFEU) is breached. Foreign owned undertakings established under the laws of one Member State will receive better treatment than EU undertakings owned by EU nationals established under the laws of another Member State. For example, a foreign owned Slovakian undertaking would be able to sue the Slovakian government for breaching investment provisions by changing its health care system, whereas a Czech undertaking owned by Czech nationals in a similar situation in Slovakia would not have recourse to ISDS. The fact that the EU itself is concluding an international agreement

[102] Case C-58/08 *The Queen, on the application of Vodafone Ltd and Others v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] ECR I- 4999, paras 32-36

[103] Regulation 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC [2014] OJ L 173/1, articles 30-31

[104] See for instance article 9.14 of the Draft EU-Singapore FTA text.

[105] See Angelos Dimopoulos, 'The Compatibility of Future EU Investment Agreements with EU Law' (2012) 39 Legal Issues of Economic Integration, 447–471, at 454

introducing such discrimination and not solely the Member States is immaterial. The internal market provisions are not only binding on the Member States but also on the EU institutions.[106]

In addition, article 63 TFEU prohibits restrictions on capital movements to and from Member States, as well as third countries. ISDS would create a distinction in treatment between capital movements between EU Member States and capital movements between the EU and third countries and could therefore breach article 63 TFEU. ISDS does not only formally distinguish between these two types of capital movement, by providing foreign investors an additional remedy and a court system that is not open to investors from Member States, but also materially discriminates between Member State investors and foreign investors. We recall that the standards for awarding damages differ between the EU standard and the standard afforded under international investment law, enabling foreign investors to rely on stricter standards than Member State investors. These findings suggest that such a system may breach article 63 TFEU. Moreover, it is clear that article 63 TFEU (at least partially) covers the subject matters contained in the investment chapters in the EU's future trade agreements. Article 63 TFEU concerns both direct investment[107] as well as portfolio investment.[108]

It is not self-evident that the EU would be able to rely on any derogation contained in the TFEU or case-law based justifications.[109] It is true that the Court has given the EU institutions a broad discretion to enact measures that may breach the internal market provisions: the Court will only invalidate an EU measure where it 'is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue'.[110] Nonetheless, it remains for the EU institutions to provide a public interest justification for the inclusion of investment provisions and ISDS in particular. In that regard, Takis Tridimas notes the more critical exercise of EU competence 'through an exhaustive examination of the institutions' reasoning, a re-creation of the decision-making process'.[111]

In that regard, the justification for introducing ISDS appears to be that such provisions either attract foreign investment resulting in economic growth or avoid that the EU loses investment to other countries.[112] These grounds for justification are not covered by the derogations in the Treaties. For example, express derogations only cover capital restrictions by Member States and in any event are *prima facie* inapplicable to these two rationales for investment protection and ISDS.[113] Lastly, it is not evident that the EU institutions will be able to argue that investment provisions and an ISDS mechanism are suitable measures to attract foreign investment. Economic studies appear to be inconclusive on this point. [114] The Court may either accept the

[106] So far, only article 34 TFEU has been applied to EU measures: Joined Cases C-154/04 and C-155/04 *National Association of Health Stores and Others* [2005] ECR I-449, para 47. However, nothing in the text of articles 49, 56, and 63 TFEU suggest that they do not apply to the EU institutions that are bound to respect primary EU law.
[107] Case C-367/98 *Commission v Portugal (Golden Share)* [2002] ECR I-4731, para 38
[108] Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141, para 19
[109] In particular articles 51, 52 (1), 62, 64, 65, and 66 TFEU
[110] Joined Cases C-154/04 and C-155/04 *National Association of Health Stores and Others* [2005] ECR I-449, para 52
[111] Takis Tridimas, *The General Principles of EU law* (2nd edn, OUP 2006), 145-146
[112] European Commission, 'Investment Protection and Investor-to-State Dispute Settlement (ISDS) in EU agreements' (March 2014) http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152290.pdf [accessed on 14 August 2015]. See also European Commission, ' Towards a comprehensive European international investment policy' (COM/2010/343 final) 7.7.2010, 9: ' Investor-state dispute settlement, which forms a key part of the inheritance that the Union receives from Member State BITs, is important as an investment involves the establishment of a long-term relationship with the host state which cannot be easily diverted to another market in the event of a problem with the investment. Investor-state is such an established feature of investment agreements that its absence would in fact discourage investors and make a host economy less attractive than others. For these reasons, future EU agreements including investment protection should include investor-state dispute settlement.'
[113] Articles 65 (1) (a) and (b) refer to measures necessary for tax measures and measures necessary for public policy, public security and measures necessary for 'the prudential supervision of financial institutions' or for the purposes of administrative or statistical information.
[114] UNCTAD, World Investment Report 2003, p. 89: 'An aggregate statistical analysis does not reveal a significant independent impact of bilateral investment treaties in determining FDI flows. At best, bilateral investment treaties play a minor role in influencing global FDI flows and explaining differences in their size among countries.' See also, World Bank, World Development Report, p. 129: 'Countries that had concluded a BIT were no more

reasoning that ISDS mechanisms can help attract investment in the abstract or it may require a more extensive explanation why discriminatory measures are necessary in that regard. In any event, even if the Court would accept that ISDS attracts additional investment, the additional investment attracted would be the result of an assessment that EU legal order itself is an obstacle to making the investment. This should be inherently problematic for an institution whose main task is to 'ensure that in the interpretation and application of the Treaties the law is observed.'[115]

Lastly, ISDS more generally infringes the principle of non-discrimination and the non-discrimination provisions in the TFEU and the Charter of Fundamental Rights. As explained above, ISDS provides a remedy for non-EU investors that EU nationals do not have, even if they are affected in the same way by the same law.[116] An EU national in the same position as a foreign investor and affected in the same way by EU law would not have recourse to ISDS whereas the EU investor would have. This breaches the principle of non-discrimination. That general principle of EU law is codified in Article 20 of the Charter ('everyone is equal before the law'). Article 21 of the Charter is a particular expression of that principle, which prohibits *any discrimination on any ground* such as property and nationality.[117] According to settled case-law of the Court, this principle 'requires the EU legislature to ensure, in accordance with Article 52(1) of the Charter, that comparable situations must not be treated differently and that different situations must not be treated in the same way unless such treatment is objectively justified [...]. A difference in treatment is justified if it is based on an objective and reasonable criterion, that is, if the difference relates to a legally permitted aim pursued by the legislation in question, and it is proportionate to the aim pursued by the treatment concerned'.[118]

Accordingly, while the EU legislature is permitted to deviate from the principle and the Charter rights, it must provide an objective justification and exercise its powers in accordance with the principle of proportionality. The EU legislature does have a broad discretion in this regard, and the Court limits itself to verifying whether there has been ' a manifest error of assessment or a misuse of powers, or whether the legislature has manifestly exceeded the limits of its discretion'.[119] However, the where the EU legislature has such discretion, it must base its choice on objective criteria and it must ensure that fundamental rights are observed.[120] As discussed above, the EU legislature will have to demonstrate that introducing a discriminatory external judicial system open for foreign investors only is suitable and necessary to achieve its commercial policy aims. In that respect, it will need to overcome evidence that there is no clear link between introducing an ISDS mechanism and attracting additional foreign investment.[121]

---

likely to receive additional FDI than were countries without such pact.' See more generally with a number of references to studies M. Sornarajah, The International Law on Foreign Investment (third edition, Cambridge University Press 2010), 172-235.

[115] Article 19 TEU

[116] Articles 9.1, 9.14 and 9.19 of the EU-Singapore FTA.

[117] Article 21 Charter

[118] Case C-356/12 *Wolfgang Glatzel v Freistaat Bayern* [2014] ECR I-250, para 43 citing Case C‑550/07 P *Akzo Nobel Chemicals and Akcros Chemicals v Commission* [2010] ECR I-512, paras 54-55; Case C‑127/07 *Arcelor Atlantique and Lorraine and Others* [2008] ECR I-728, para 47, and Case C‑101/12 *Schaible* [2013] ECR I-661, para 77.

[119] Case C-356/12 *Wolfgang Glatzel v Freistaat Bayern* [2014] ECR I-250, para 52; citing Case C‑425/08 *Enviro Tech (Europe)* [2009] ECR I-635, para 47; Case C‑343/09 *Afton Chemical* [2010] ECR I-419, para 28; and Case C‑15/10 *Etimine* [2011] ECR I-504, para 60

[120] Case C-356/12 *Wolfgang Glatzel v Freistaat Bayern* [2014] ECR I-250, para 53 citing Case C‑58/08 *Vodafone and Others* [2010] ECR I-321, para 53; Joined Cases C‑92/09 and C‑93/09 *Volker und Markus Schecke and Eifert* [2010] ECR I-662, para 46; Case C‑236/09 *Association belge des Consommateurs Test-Achats and Others* [2011] ECR I-100, para 17

[121] UNCTAD, World Investment Report 2003, p. 89: 'An aggregate statistical analysis does not reveal a significant independent impact of bilateral investment treaties in determining FDI flows. At best, bilateral investment treaties play a minor role in influencing global FDI flows and explaining differences in their size among countries.' See also, World Bank, World Development Report, p. 129: 'Countries that had concluded a BIT were no more likely to receive additional FDI than were countries without such pact.' See more generally with a number of references to studies M. Sornarajah, The International Law on Foreign Investment (third edition, Cambridge University Press 2010), 172-235

3 Concluding remarks

Article 218 (11) TFEU gives the EU institutions and Member States the power to ask the European Court of Justice whether an EU international agreement is compatible with the EU Treaties. It is an important power that has been used 24 times in order to clarify the legality under EU law of an envisaged international agreement. The European Parliament has only recently (since 2003) received this power in light of its increased responsibilities for EU treaty making powers.

Such a request for an Opinion is an essential tool for the EU in international relations. It not only gives the EU institutions and the Member States the possibility to check whether its actions are legal and in compliance with the EU Treaties, it also prevents the EU from getting into difficulties both under international law and in relation to its relations with third countries.

This study has found that there are doubts whether an international agreement containing ISDS is legal under EU law. ISDS may be found incompatible with the EU Treaties because it would (1) undermine the autonomy of the EU legal order and the powers of the EU Courts in particular and (2) negatively affect the completion of the internal market, and more specifically the EU's system of undistorted competition.

Since legal doubts exist, and the importance attached by the Commission, the European Parliament and the European Economic and Social Committee to respect the powers of the EU courts, it is essential for the EU to verify whether ISDS is compatible with EU law.

Laurens Ankersmit
EU Trade & Environment Lawyer
+32(0)20 808 4321
lankersmit@clientearth.org
www.clientearth.org

Karla Hill
Director, Programmes
+44(0)20 7749 5972
khill@clientearth.org
www.clientearth.org

22 October 2015

ClientEarth study - Legality of ISDS under EU Law

ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

ClientEarth is funded by the generous support of philanthropic foundations, institutional donors, and engaged individuals.

Brussels	London	Warsaw
4ème Etage	274 Richmond Road	Aleje Ujazdowskie 39/4
36 Avenue de Tervueren	London	00-540 Warszawa
1040 Bruxelles	E8 3QW	Poland
Belgium	UK	