REFORMING INTRA-EU INVESTMENT PROTECTION

Amid a Running Battle of Interests

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ABSTRACT

This article scrutinizes the positions of stakeholders in the light of the arguments of incompatibility of the intra-EU BITs with EU law. Whereas the interest of the Commission and some EU Member States was to protect the legal certainty of EU law and budgetary expenditures, the selective short-term interest of deliberately invoking compliance with EU law conflicts with the long-term interests of the Union, the EU Member States, and investors, including enterprises wholly-owned by the national governments of EU Member State. While waiting for the Commission to come up with a solution to the issue of incompatibility, EU Member States might find themselves exposed to a substantial degree of moral hazard since Member States' courts should set aside the enforcement of arbitral awards that ignore the primacy of EU law. It is suggested that the tension between different interests may impact the competitiveness of the investment environment of the EU as a whole.

Keywords: bilateral investment treaties; investment arbitration; investor interest; moral hazard; public interest

§1. INTRODUCTION

Bilateral investment treaties (BITs) have been marked by a precipitously rising popularity in the second half of the 20th century and the main instigators were the Western European countries, with the Germany-Pakistan Treaty historically being the first BIT[1] in 1959.[2]

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1 A. Law and L. Paradell, *Practice of Investment Treaties: Standards of Treatment* (KLL, 2009), p. 42.

2 The treaty was renegotiated and at the end replaced by the Agreement on the Encouragement and Reciprocal Protection of Investments. After Pakistani ratification, Germany signed the treaty on

Over the years, bilateral investment treaties have created the most comprehensive investment platform both for states as well as investors. Increased articulation of principles by arbitration courts after *AAPL v. Sri Lanka*[3] confirmed the unique status of foreign direct investments (FDIs) in international law.[4]

The popularity of BITs has spread to all the continents and 2,495 BITs were signed as of 2005.[5] Political changes in Central and Eastern Europe (CEE) after 1989 brought about a vigorous adoption of free market economic policies. As a result, CEE states developed an impressive bilateral investment framework. Out of the total of 2,495 BITs, the CEE region accounts for 716 treaties.[6] FDIs protected by BITs were seen as a means to ensure economic progress of the region. For instance, in Hungary alone, the FDIs rose from $570 million in 1990 to $248 billion in 2009.[7] The increase is commonly attributed to the help of BITs to alleviate investors' concerns about the risks associated with investment.[8] Before ten CEE states joined the European Union in 2004, only two BITs between the EU Member States had been in effect.[9] After the enlargement, this number grew significantly to 150 BITs. The 2007 accession increased the total to 191 intra-European Union BITs.[10]

This article aims to analyse the positions of stakeholders, either directly involved (EU and EU Member States) or affected (investors) by the reform of the intra-EU investment policy by the EU. Firstly, the claim of incompatibility of intra-EU BITs with EU law is introduced in Section 2. The validity of the legal framework for investment protection, following the accession to European Union, is brought into doubt by the European Commission as well as, opportunistically, by the states themselves if it serves their defence in investment arbitration. Although both extra-EU and intra-EU BITs had been in alleged conflict since their respective contractors became EU Member States, the legal

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8th July 2011, www.pakistan.diplo.de/Vertretung/pakistan/en/05__Business__Economy/1__ExternalEconomicPromotion/Invest__Schutz__Abk__Seite.html.

3 *Asian Agricultural Products Ltd. v. Republic of Sri Lanka (AAPL v. Sri Lanka)*, ICSID Case No. ARB/87/3.

4 *AAPL v. Sri Lanka* upheld a unilateral recourse to arbitration and other substantive standards of investment protection. M. Sornarajah, *The International Law on Foreign Direct Investment* (CUP, 2010), p. 3.

5 UNCTAD, 'The Entry into Force of Bilateral Investment Treaties (BITs)', p. 1, www.unctad.org/en/docs/webiteiia20069_en.pdf.

6 D. Goryunov, 'The Effectiveness of FDI Promotion in Transition Economies', *UNCTAD* (2004), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.495.3902&rep=rep1&type=pdf, p. 7.

7 The United Nations Conference on Trade and Development, 'World Investment Report 2010', *UNCTAD Website* (2010), www.unctad.org/en/docs/wir2010_en.pdf, p. 172.

8 Nevertheless, the debate weighing the positive as well as negative effects of BITs has not been concluded yet. M. Carkovic and R. Levine, 'Does Foreign Direct Investment Accelerate Economic Growth?', *University of Minnesota* (2002), p. 2; S. Rose-Ackerman and J. Tobin, 'Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties', *Center for Law, Economics and Public Policy Developing Countries Yale Law School Research Paper* No. 293, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=557121, p. 2.

9 BIT between Germany and Greece (1981), and the Germany-Portugal BIT (1980).

10 W. Shan and S. Zhang, 'The Treaty of Lisbon: Halfway Toward a Common Investment Policy', 21 *EJIL* (2011), p. 4.

incompatibility manifested itself later by being invoked by the Commission in front of the Court of Justice of the European Union (CJEU) in extra-EU BITs cases.

Further, the alleged conflict was the topic in the amicus curiae briefs of the European Commission in the investment arbitration cases of *ADC v. Hungary*,[11] *AES v. Hungary*,[12] *Binder v. Czech Republic*,[13] *Eastern Sugar v. Czech Republic*,[14] *EDF v. Hungary*,[15] *Electrabel v. Hungary*,[16] *Eureko v. Slovakia*,[17] *European American Investment Bank AG v. Slovakia*,[18] *Micula v. Romania*,[19] and *Nordzucker v. Poland*.[20] Section 3 scrutinizes the positions of the EU, EU Member States and investors in these cases, in order to come up with unintended consequences that these claims bring about which will be discussed in Section 4. The fifth part focuses on the point of departure for a normative solution to conclude that the only way out is to find and adopt a policy that necessarily has to prefer certain interests over others – a balancing exercise that the Union has avoided undertaking until now.

§2. THE INCOMPATIBILITY OF BITS WITH EU LAW

EU law had essentially coexisted with BITs until the recent enlargement of the Union in 2004 and 2007,[21] after which their parallelism started to appear to be asymmetric with the European Commission's claims of EU law supremacy over BITs.[22] With judgments against Sweden and Austria released in 2009, BITs first came under harsh scrutiny from the Union's official judicial body. The compatibility of EU law and BITs had been contested even earlier, but this was done exclusively in front of arbitration courts in the *Eastern Sugar v. Czech Republic*[23] arbitration award from 2007. In parallel judgments in

11 *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16.

12 *AES Sumnit Generation Ltd and AES-Tisza Erömü Kft v. Hungary*, ICSID Case No. ARB/07/22.

13 *Binder v. Czech Republic*, UNCITRAL Award, not public (2011).

14 *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007).

15 *EDF International S.A. v. Hungary*, Ad hoc arbitration under UNCITRAL Rules.

16 *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19.

17 *Eureko v. Slovak Republic,* PCA Case No. 2008–13, Award on Jurisdiction, Arbitrability and Suspension (2010).

18 *European American Investment Bank AG (EURAM) v. Slovak Republic*, UNCITRAL Award.

19 *Ioan Micula, Viorel Micula and Others v. Romania,* ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility.

20 *Nordzucker v. Poland,* UNCITRAL Award, not public (2009).

21 With the exception of Ireland and Portugal, all old Members have entered into BITs between the new Members. H. Wehland, 'Intra-EU Investment Agreements and Arbitration: Is European Community Law an Obstacle?', 58 *ICLQ* (2009), p. 298.

22 EC Letter of 13 January 2006 in *Eastern Sugar BV v. Czech Republic* SCC Case No. 088/2004, Partial Award, (2007), para. 119; N. Lavranos, 'Member States' Bilateral Investment Treaties (BITs): Lost in Transition?', *Hague Yearbook of International Law* (2012), p. 283.

23 *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007).

Commission v. Sweden[24] and *Commission v. Austria*,[25] these two Member States were found to have failed to fulfil their obligations under the second paragraph of Article 307 TEC (now Article 351 TFEU).[26] Although the cases of Sweden and Austria concerned treaties with third states, they contributed to the increase of focus on the compatibility of BITs with EU law.

What is more, before the Treaty on the Functioning of the European Union came into effect in 2009, every Member State of the European Union had its own external investment policy within their national legal competence. Reconfiguration of investment policies brought external investment under the explicit competence of the European Union in Article 206 and Article 207 of the *Common Commercial Policy* section of the Treaty on the Functioning of the European Union.

The debate concerning the potential incompatibility of EU law and BITs is not within the scope of this article. Nevertheless, the author posits that there are two forms of protection in BITs that are incompatible with EU law.

Firstly, there is the provision allowing for dispute settlement in the form of arbitration, thereby excluding the cases of intra-EU BITs from EU judicial review and infringing the primacy and autonomy of EU law.[27]

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24 Case C-249/06 *Commission v. Kingdom of Sweden*, EU:C:2009:119; see also Opinion of Advocate General Sharpston in Case C-118/07 *Commission v. Republic of Finland*, EU:C:2009:525.

25 Case C-205/06 *Commission v. Austria*, EU:C:2009:118.

26 Article 351(1) TFEU allows a derogation from the principle of primacy of EU law but only in relation to agreements concluded prior to EU membership and, in principle, only to treaty relations between Member States and third states. According to settled case law, the purpose of the provision is to establish that the application of EU law does 'not affect the duty of the Member State concerned to respect the rights of non-member countries under a prior agreement and to perform its obligations thereunder.' A. Rosas, 'The Status in EU Law of International Agreements Concluded by EU Member States', 34 *Fordham International Law Journal* (2011), p. 1321.

27 Arbitration tribunals are bound to consider the law applicable to the case, unless another choice of law was provided for in the contract or BIT. Since arbitrators are to apply the applicable law, the possibility of applying EU law cannot be precluded. Also, the differences between national legal systems and laws of the European Union have become cloudy, as it is not always easy to clearly distinguish between EU and national measures, especially with EU law directives that are a part of the Union's as well as Member States' legal systems. For example, in *Eastern Sugar* (*Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007)), the tribunal faced the question of the relationship between national, international, and EU legal orders, but it did not declare the EU legal order to be part of the international or national legal order or a legal system on its own, nor did it state whether EU law was applicable to the contractual obligations at all. The burden of the primacy of EU law, which any dispute settlement mechanism that is involved in interpretation of EU law has to bear, was clearly demonstrated by the CJEU in its Opinion 1/09 on the European and Community Patents Court (ECPC), EU:C:2011:123. Since the ECPC aimed to establish an exclusive jurisdiction that was outside the institutional and judicial framework, the CJEU pronounced the agreement creating the unified patent litigation system incompatible with EU law. In response to the Opinion, the agreement was amended in order to introduce the Unified Patent Court (UPC) as a part of the EU judicial setting respecting the autonomy of EU, which also means that non-EU states may no longer be a party to the agreement. Furthermore, even if arbitral tribunals wanted to apply EU law, they are not entitled to request a preliminary ruling from the CJEU. According to *Cordenier v. Transorient* an arbitration court was not entitled to request a preliminary ruling by the CJEU due to its status as an arbitration

Secondly, it is the preferential treatment of investors given only to an investor from a state with a concluded BIT which conflicts with the non-discrimination principle. The breach of the EU internal market standards of free movement of people, goods and capital, lies in giving preference to one investor from a Member State, while denying this treatment to another. Such discrimination is therefore inconsistent with the country's obligations under the Article 18 TFEU.[28] Preferential treatment given in BITs should

court in which public authorities were not involved, failing to qualify the criterion in Article 267 TFEU (Case C-125/04 *Cordenier v. Transorient*, EU:C:2005:69; see also Case 102/81 *Nordsee*, EU:C:1982:107; and Case C-126/97 *Eco Swiss China Time Ltd v. Benetton International NV*, EU:C:1999:269). Recently, accession of the Union to the European Convention of Human Rights was found by the CJEU to affect the autonomy and effectiveness of the preliminary ruling procedure provided for in Article 267 TFEU. The argument of circumvention of EU law by the proposed structure failed to addressed the autonomy of EU law as 'it cannot be ruled out that a request for an advisory opinion made pursuant to Protocol No 16 by a court or tribunal of a Member State that has acceded to that protocol could trigger the procedure for the prior involvement of the Court of Justice, thus creating a risk that the preliminary ruling procedure provided for in Article 267 TFEU might be circumvented, a procedure which, as has been noted in paragraph 176 of this Opinion, is the keystone of the judicial system established by the Treaties.' By doing so, the Court consistently confirms the argumentation adopted in the cases of European and Community Patent Court where failure to adopt preliminary ruling was also considered to be incompatible with the autonomy of EU law. M. Burgstaller, 'European Law and Investment Treaties', 26 *Journal of International Arbitration* (2009), p. 192; Opinion 1/09 European and Community Patents Court, EU:C:2011:123, para. 89; P. Callens and S. Granata, *Introduction to the Unitary Patent and the Unified Patent Court* (KLI, 2013), p. 53; Case C-125/04 *Denuit and Cordenier v. Transorient*, para. 15–17; Case 102/81 *Nordsee*; Case C-126/97 *Eco Swiss China Time Ltd v. Benetton International NV*; Opinion 2/13 on Accession of the European Union to the European Convention for the Protection of Human Rights and Fundamental Freedoms, EU:C:2014:2454, para. 198–199.

28 Such a deviation from the national and most-favoured treatment, which in European context can be translated into non-discrimination principle in EU law, was featured in *Saint-Gobain* judgment (Case C-307/97 *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, EU:C:1999:438, para. 46–57). The dispute centred around the tax treatment of a branch of the French company Saint-Gobain in Germany. Germany claimed that the preferential treatment provided by the USA-Germany tax treaty can be only awarded to domiciled, resident companies in Germany for two reasons. Firstly, since the competence to conclude bilateral double-taxation treaties does not come within the sphere of Community competence and in the absence of unifying harmonizing measured on EU level, the Member States can act on a bilateral level and are at liberty reciprocally to prevent double taxation. Secondly, Germany argued that discrimination between resident and non-resident companies stems from their completely different tax status as non-resident companies enjoy benefits that residents do not. The CJEU did not uphold the arguments of Germany and declared that Member States may not disregard EU rules even in direct taxation, which is a matter falling within the competence of Member States. National as well as bilateral international tax treaties have to comply with EU law. As for the difference between residents and non-residents, the CJEU ruled: 'In the case of a double-taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies' (Case C-307/97 *Campagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, para. 58). Germany therefore had to expand the preferential treatment even to companies that are domiciled in a non-signatory state – in this case France. Bilateral tax treaties and BITs are substantially similar since they both used to fall within the competence of Member States. Applying the reasoning from *Saint-Gobain* to BITs, different

be either unilaterally extended, or dismissed for all investors.[29] It should, however, be affirmed that unless rescinded, BITs remain valid. As it was clearly expressed in *Eureko v. Slovakia*, '(…) it is not for an arbitral tribunal to cancel rights created by a valid treaty in order to safeguard a State party against the possibility that it might one day decide to apply the treaty in a way that could violate its obligations under one or more other later treaties.'[30]

§3. DEFENDING THE EU INTERNAL MARKET AND MEMBER STATES IN INVESTMENT ARBITRATION

Most of the BITs contain an arbitration clause that enables parties to have recourse to investment arbitration. In several cases, the Member States defended their positions by claiming that BITs were superseded by the European Union law when countries entered the EU in order not to be found responsible for interference with the protection of relevant foreign investments. According to the EU, claiming the protection of the BITs in the internal market conflicts with EU law,[31] hence no protection out of BITs should be given to an investor. Whereas the Union supported the claims of the Member States in front of arbitration courts, the EU Member States have shown support for the existence of BITs on other occasions if it suited them.[32]

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treatment of investors that come from Member States with and without a BIT, is therefore unjustifiable and incompatible with EU law.

29 Case C-55/00 *Gottardo v. INPS*, EU:C:2002:16, para. 32.

30 *Eureko v. Slovak Republic,* PCA Case No. 2008–13, Award on Jurisdiction, Arbitrability and Suspension, (2010), para. 267.

31 'For facts occurring after accession, the BIT is not applicable to matters falling under Community competence. Only certain residual matters, such as diplomatic representation, expropriation and eventually investment promotion, would appear to remain in question. Therefore, where the EC Treaty or secondary legislation are in conflict with some of these BITs' provisions – or should the EU adopt such rules in the future – Community law will automatically prevail over the non-conforming BIT provisions. As you mention correctly, the application of intra-EU BITs could lead to a more favourable treatment of investors and investments between the parties covered by the BITs and consequently discriminate against other Member States, a situation which would not be in accordance with the relevant Treaty provisions. The Commission therefore takes the view that intra-EU BITs should be terminated in so far as the matters under the agreements fall under Community competence.' EC Letter of January 13, 2006 in *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007), para. 119; *Eureko v. Slovak Republic,* PCA Case No. 2008–13, Award on Jurisdiction, Arbitrability and Suspension, (2010), para. 175–196.

32 'In a December 2008 report issued by the Economic and Financial Committee (EFC) of the European Union, a majority of EU member-governments signalled their disagreement with the European Commission with respect to any "arbitration risks" and "discriminatory treatment of investors" arising out of the patchwork of bilateral investment treaties concluded between EU member-governments.' The report is not available online. L.E. Peterson, 'Details surface of jurisdictional holdings in Binder v. Czech Republic; ad hoc tribunal saw no conflict between BITs and European Law; More recently, majority of EU member-states have taken similar view', 2 *Investment Arbitration Reporter* (2009), p. 5.

The introduction of a new pricing standard that contained fixed electricity tariffs led to three arbitration actions against Hungary: *EDF v. Hungary*;[33] *Electrabel v. Hungary*;[34] and *AES v. Hungary*.[35] The contention was centred around the long-term Power Purchase Agreements (PPAs), which were effectively terminated by the adoption of a new pricing scheme. In *AES v. Hungary* as well as in *Electrabel v. Hungary*, the Commission supported Hungary's position that the PPA violated EU law. Specifically, in *AES v. Hungary*, the investment tribunal declared that the motivation to introduce a new administrative pricing scheme was not linked to the pressure from the European Commission as stated by Hungary. The Commission intervened in the proceedings and its amicus curiae submission suggested that the PPAs, for which protection was claimed under the investment treaty, had the potential to restrict the competition within the internal market of the EU.[36]

In *ADC v. Hungary*,[37] the responding state claimed that it expropriated the investment in order to satisfy the requirements given by EU law. Specifically, ground handling at the Budapest Airport had to be harmonized with EU Directive 96/67[38] in a way that air traffic control had to be separated from airport operation services pursuant to EU law.[39] The Tribunal dismissed the notion that intention to comply with EU law mandated justification of Hungary's steps to expropriate the investment as the investment could have been restructured without the company being effectively taken over by the State.[40]

The notable judgment of *Eastern Sugar v. Czech Republic*[41] contributed significantly to the debate related to the collision of BITs and EU law. The case revolves around the agricultural policy of the European Union that imposed quotas on agricultural production in connection with high import tariffs. Domestic agricultural production was capped through governmental decrees. In particular, the third governmental decree became the centre of contention in the case, as Eastern Sugar B.V. claimed that their investment was not properly treated,[42] in other words, that the decree(s) was(were) discriminatorily designed to damage the investor.

The defence strategy of the Czech state in *Eastern Sugar* can be considered as similar to the one in *Binder v. Czech Republic*. The European Commission submitted two

33 *EDF International S.A. v. Hungary*, Ad hoc arbitration under UNCITRAL Rules.

34 *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19.

35 *AES Sumnit Generation Ltd* and *AES-Tisza Erömü Kft v. Hungary*, ICSID Case No. ARB/07/22.

36 J.P. Gaffney, 'Threats to Investment Protection in the EU Energy Sector', *King and Spalding Energy Newsletter* (2012), www.kslaw.com/library/newsletters/EnergyNewsletter/2012/August/article1.html.

37 *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16.

38 Council Directive 96/67/EC of 15 October 1996 on access to the groundhandling market at Community airports, [1996] OJ L 272/36.

39 *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, para. 268.

40 Ibid., para. 271.

41 *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007).

42 Ibid., para. 12.

letters to the arbitration tribunal, in which the Commission emphasized the application preference of EU law, stating that if the EC Treaty or secondary legislation is in conflict with a BIT, the European law shall prevail over the non-confirming provisions.[43] To confirm its own position, the EU's Economic and Financial Committee's Memorandum from November 2006 invited Member States to gradually pull back from upholding intra-EU BITs.[44]

This opinion was not endorsed by the arbitral tribunal in *Eastern Sugar*. The tribunal rejected arguments of the Czech Republic that stated that BITs and EU law cover the same matter and that the later EU Treaty superseded the BITs. According to some, the fact that the Commission submitted a letter was a calculated act and the Commission's opinions were against the fundamental principles of public international law.[45] The tribunal, however, quoted the letter extensively in the judgment,[46] despite the acknowledgement that it was not bound by the Commission Letter[47] and upheld the applicability of intra-EU BITs until they would be terminated. Similarly, the isoglucose high fructose corn syrup quotas were at the centre of contention in *Cargill v. Poland*, where Poland claimed to have followed the regulation requirements of the EU when limiting the investment.[48]

In *Binder v. Czech Republic*,[49] all the above-mentioned arguments of incompatibility can be found in the defendant's reasoning. The final award, which was not published, ruled on the alleged frustration of investment of German national Rupert Joseph Binder by the state of the Czech Republic. Due to bullying from Czech Customs authorities, Binder asked for damages ranging from CZK 2.3 to 5 billion ($136–195 million) because it was not foreseeable that Czechoslovakia would split, and as a result he had to clear goods, that had been left in Slovakia, through Czech customs.[50] *Binder v. Czech Republic* also features

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43 Ibid., para. 119.

44 D. Vis-Dunbar, 'EU Member States reject the call to terminate intra-EU bilateral investment treaties', *International Institute for Sustainable Development* (2009), https://www.iisd.org/itn/2009/02/10/eu-member-states-reject-the-call-to-terminate-intra-eu-bilateral-investment-treaties/.

45 The fact that the Commission's Memorandum called for Member States to avoid legal uncertainty and other risks, including *forum shopping*, and that intra-EU BITs should be denounced, is, according to Belohlavek, in a strict conflict with international public law. It also directly threatens the interest of EU citizens and legal persons investing outside the EU internal market since Member States would then find themselves in conflict either with a third state or the EU. See A.J. Belohlavek, *Ochrana Primych Zahranicnich Investic v Evropske Unii* (C.H. Beck, 2010), para. 143, 182. In *Eastern Sugar v. Czech Republic*, the tribunal ruled that the Commission's views might only be considered as non-binding observations: 'As the European Commission correctly points out, the answer to the questions raised must be given by judicial authorities, which clearly excludes the European Commission, and, admittedly less clearly, includes an arbitral tribunal such as the Arbitral Tribunal in the present arbitration.' *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007), para. 124.

46 M. Burgstaller, 'European Law Challenges to Investment Arbitration', in M. Waibel et al. (eds.), *The Backlash against Investment Arbitration: Perception and Reality* (Kluwer, 2010), p. 458.

47 *Eastern Sugar BV v. Czech Republic,* SCC Case No. 088/2004, Partial Award, (2007), para. 123–125.

48 *Cargill v. Poland,* UNCITRAL Award, not public (2011).

49 *Binder v. Czech Republic*. UNCITRAL Award, not public (2011).

50 V. Balas, 'Comment on Award on Jurisdiction in the Binder Case Appealed at Czech Courts', 2 *Czech Yearbook of International Law* (2011), p. 273.

argumentation according to which the Vienna Convention on the Law of the Treaties Germany-Czech Republic BIT was terminated by the later accession to the European Union; and that intra-EU arbitration breaks the principle of mutual trust; and also that BITs among EU Member States constitute discrimination.[51] The tribunal dismissed these arguments since they were not found to conflict with the substantive protections offered in EU law; arbitration clauses did not disadvantage third Member States; and among others, the tribunal found no reasons to request a preliminary ruling from the CJEU.[52]

In *Eureko v. Slovakia*,[53] the Slovak Republic argued that the accession to the EU divests the tribunal of their jurisdiction. According to Slovakia, the claim should have been led in front of the CJEU since the arbitration tribunals also lacked the competence to apply and interpret EU law. In their amicus curiae brief that was submitted to the arbitration tribunal, the European Commission stated that granting a right to recourse to arbitration to one state, while not to others, constitutes a serious potential for discrimination between investors from Member States with an investment treaty and from Member States without it. Claims of the Commission have met little sympathy in front of the arbitration tribunal, and the Commission's arguments were rejected, as they were in *Eastern Sugar v. Czech Republic*.[54] On 10 May 2012, the Frankfurt Higher District Court (*Oberlandesgericht*), which the arbitration award in *Eureko v. Slovakia* was appealed to, did the same. In the last instance – in the German Federal Constitutional Court (*Bundesverfassungsgericht*) – the appeal was declared procedurally inadmissible due to a release of a final arbitral award in the meantime.[55] Initially, the lower instance court (the Frankfurt Higher District Court), had decided not to request a preliminary ruling from the CJEU since the court was confident about the interpretation of Article 344 TFEU.[56] In late 2013, the

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51 L.E. Peterson, 2 *Investment Arbitration Reporter* (2009), p. 3.

52 Ibid.

53 *Eureko v. Slovak Republic,* PCA Case No. 2008–13, Award on Jurisdiction, Arbitrability and Suspension (2010).

54 Ibid., para. 266–267. 'The consequence is that in any particular case investors protected by the BIT may have wider rights than those given under the substantive provisions of EU law to have wider rights than those given under the substantive provisions of EU law to investors of (other) EU Member States. Affording such wider protection to those investors while not affording it to investors of other EU States may violate EU law prohibitions on discrimination. But that is not a reason for cancelling Claimant's wider rights under the BIT. More significantly, it is still less a reason for treating the Parties' consent to these arbitration proceedings as invalid or otherwise ineffective, particularly where the first stage of such consent pre-dated the relevant EU Treaties, the second stage pre-dated the Lisbon Treaty, and Claimant is an EU investor. There is moreover no reason, legal or practical, why an EU Member State should not accord to investors of all other EU Member States rights equivalent to those which the State has bound itself to accord to investors of its EU bilateral investment treaty partners – or, indeed, to investors from States that are not members of the EU. Certainly, it is not for an arbitral tribunal to cancel rights created by a valid treaty in order to safeguard a State party against the possibility that it might one day decide to apply the treaty in a way that could violate its obligations under one or more other later treaties.'

55 BGH, Beschluss vom 19. September 2013 – III ZB 37/12 – OLG Frankfurt/Main.

56 K. von Papp, 'Clash of "Autonomous Legal Orders": Can EU Member State Courts Bridge the Jurisdictional Divide between Investment Tribunals and the ECJ? – A Plea for Direct Referral from Investment Tribunals to the ECJ', 50 *Common Market Law Review* (2013), p. 9.

final arbitral award was released, against which Slovakia might appeal in front of the Frankfurt Court of Appeals again.[57] Interestingly, in a latter case of *HICEE v. Slovakia*,[58] which was argued under the same BIT as *Eureko* and *Eastern Sugar* (Czechoslovakia – Netherlands BIT), the conflict of EU and BIT jurisdictions did not arise.

Another case linked to the regulatory measures in the Slovak Republic's health insurance sector that were taken in the years 2007–2008[59] is *European American Investment Bank AG v. Slovak Republic*.[60] The award on jurisdiction from 2012 is not public,[61] however the issue of validity of the investment protection given under the Austrian – Slovak BIT was allegedly instigated.[62] Other investment arbitration cases involving the question of compatibility of EU legal order with BITs include *Nordzucker v. Poland*[63] concerning allegations that the Polish state reversed their initial commitment to sell two state-owned sugar producers to the German firm.

Micula v. Romania[64] features the claim of the Micula brothers (Swedish nationals) that Romania frustrated their investment due to the changes to the Romanian legal framework linked to accession of Romania to the European Union. Romania adjusted its legal system to EU law and, as a result, the Romanian state ceased to award investment subsidies in 2004, which the business enterprise of the Micula brothers used to receive.[65] The enthralling essence of *Micula* is based on the claim that the petitioners made, which is effectively *restitutio in integrum*. In other words, the arbitration court was to face a possibility of awarding parties' entitlements to be given back subsidies that they used to receive, even though this would be in blatant conflict with EU law. The European Commission was allowed to participate in the proceedings as amicus curiae.[66] The Commission claimed that any award requiring Romania to re-establish a legal framework of investment schemes would be incompatible with EU state aid rules and could not be enforced by EU

57 This is after the German Federal Supreme Court ruled in September 2013 on the appeal against Frankfurt Higher District Court (*Oberlandesgericht*), and declared it inadmissible due to the fact a final award was released in the meantime, and the petitioner was appealing against an interim award.

58 *HICEE B.V. v. the Slovak Republic*, PCA Case No. 2009–11 (2009).

59 'EURAM claims that it suffered damages after acquiring, through its Slovak subsidiary, E.I.C., a.s. ("EIC"), a 51% stake in APOLLO zdravotná poisťovňa, a.s. ("Apollo"), in 2007. Although EIC sold its stake in Apollo in 2008, EURAM seeks compensation for damages allegedly resulting from regulatory measures introduced by Slovak authorities in the health insurance sector in late 2007 and early 2008. The EURAM claim is the third arbitration brought against Slovakia in connection with Slovakia's adoption of regulations governing the operations of private health insurers.' See Ministry of Finance of the Slovak Republic, www.finance.gov.sk/en/Default.aspx?CatID=10&id=63.

60 *European American Investment Bank AG (EURAM) v. Slovak Republic*, UNCITRAL Award.

61 Investment Treaty Arbitration, www.italaw.com/cases/1706.

62 N. Lavranos, *Hague Yearbook of International Law* 2011 (2012), p. 394.

63 *Nordzucker v. Poland*. UNCITRAL Award, not public (2009).

64 *Ioan Micula, Viorel Micula and Others v. Romania*, ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility.

65 Ibid., para. 46.

66 Ibid., para. 27.

Member State courts due to its illegality.[67] In its final award, the International Centre for Settlement of Investment Disputes (ICSID) tribunal found that Romania violated the BIT between Sweden and Romania by failing to secure fair and equitable treatment to the investment by repealing the economic incentives and to inform the investor in a timely manner that Romania would ultimately do so.[68] The ICSID decided that it would be 'inappropriate for the tribunal to base its decisions in this case on matters of EU law that may come to apply after the award has been rendered. It will thus not address the parties' and the Commission's arguments on enforceability of the award'.[69]

However, none of the arbitration courts mentioned allowed defendant Member States to shield themselves against obligations to pay damages to investors in these cases, and all arbitration courts dismissed the Commission's and Member States' views of incompatibility of BITs with EU law as conflicting with guarantees of international public law.[70] The CJEU has not spoken yet since the only possibility for the matter of incompatibility to be submitted to the attention of the CJEU is from a national court, but not from a court of arbitration within the meaning of the Treaty.[71]

§4. SHORT-TERMISM AND MORAL HAZARD OF MULTI-LEVEL GOVERNANCE

Investment policies should ideally balance entrepreneurs' natural criterion of profitability with other government aims.[72] Fundamentally, it is not in any government's interest to

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67 *Ioan Micula, Viorel Micula and Others v. Romania*, ICSID Case No. ARB/05/20, Final Award, para. 330–340.

68 Ibid., para.1329b. 'The Claimants' claim that the Respondent has violated Article 2(3) of the BIT by failing to ensure fair and equitable treatment of the Claimants' investments is upheld by majority. In view of this decision, the Tribunal does not need to determine whether the Respondent has breached the BIT by impairing the Claimants' investments through unreasonable or discriminatory measures (Article 2(3) of the BIT, second part) or by expropriating the Claimants' investments without the payment of prompt, adequate, and effective compensation (Article 4(1) of the BIT).'

69 Ibid., para. 340.

70 In *Eureko v. Slovakia* the tribunal noted: 'The fact that, at the merits stage, the Tribunal might have to consider and apply provisions of EU law does not deprive the Tribunal of jurisdiction. The Tribunal can consider and apply EU law, if required, both as a matter of international law and as a matter of German law. This jurisdictional objection therefore is rejected.' See *Eureko B.V. v. the Slovak Republic*, PCA Case No.2008–13, (2008), para. 175–196. Similarly, the link between EU law and the ECT treaty was assessed in *Electrabel v. Hungary*: 'Accordingly, in the Tribunal's view, there is no fundamental difference in nature between international law and EU law that could justify treating EU law, unlike other international rules, differently in an international arbitration requiring the application of relevant rules and principles of international law.' See *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, para. 4.126.

71 Article 267 TFEU.

72 N. Van Phuc, *Entrepreneurship, Investment and Economic Growth: The Essential Role of the Entrepreneurial Environment* (Shaker Publishing B.V., 2006), p. 134.

adopt a set of measures that significantly contravene commercial activity,[73] which would result in general deterioration of the business environment. If that is still the case, and political steps unduly interfere with commercial activities, then it might be for other reasons such as political goals (for example, nationalization of entire industries in the host economy), or incompetence in aligning the desired set of commercial goals with other aims.[74]

If an individual does not benefit from a productive activity, the incentive to engage in such an activity significantly decreases.[75] The moral hazard[76] comes into play if national governments can justify a breach of an investment treaty by the incompatibility of BITs with the EU, even though the Member State is a party to both the investment treaty as well as to the EU Treaties. In other words, two parties agree on a contract but one party afterwards takes an action that is not observed by one of the agents in order to increase the welfare of the informed agent at the expense of the uninformed agent.[77] Not only have the governments conferred their competence to negotiate and sign investment treaties onto the Union, from the analysis above, they show no hesitation to transfer the responsibility for interference with a foreign investment in their territory either. By doing so, national governments might have acted as conscientious guardians of state budgets, yet their actions are rather reckless to the stability of the investment environment, and

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73 Excluding economic activities restricted or outlawed by national law, such as production of weapons or drugs. In order not to gain protection to such illegal investments, bilateral investment treaties commonly require investments to be performed in accordance with host state law. For further analysis of illegal investment, see S. Schill, 'Illegal Investments in Investment Treaty Arbitration', 11 *Law and Practice of International Courts and Tribunals* (2012).

74 If the extent of public policy intervention is excessive, the intensity of impact is limited. Da Rocha and Dib mention the case of the French company *Decathlon*, that failed to establish a large store in Copenhagen due to restrictive land-use regulation, and built a smaller unit in Aalborg instead, whose lesser impact on the market made the company withdraw from Scandinavia in following years. See J. Dawson, 'Towards a Model of the Impacts of Retail Internationalisation', in J. Dawson et al. (eds.), *The Internationalisation of Retailing in Asia* (Routledge, 2003), p. 202.

75 J. Klick and G. Mitchell, 'Government Regulation of Irrationality: Moral and Cognitive Hazards', 90 *Minnesota Law Review* (2006), p. 1644.

76 'Moral hazard refers to a situation where economic actors make profit-maximising but inefficient decisions because they are able to avoid costs associated with their conduct. The problem of moral hazard is often associated with insurance – when someone takes out insurance against a given type of harm, they no longer have an incentive to take prudent (efficient) steps to reduce the risk of that harm occurring. In practice, the protections contained in IITs operate as a form of insurance for investors against harm caused by future government conduct. This raises the risk of moral hazard – that investors might undertake projects without adequately assessing the externalities created by their projects, and the associated risk that future governments might redress such externalities when they begin to crystallise.' See J. Bonnitcha, 'The problem of moral hazard and its implications for the protection of "legitimate expectations" under the fair and equitable treatment standard', *Investment Treaty News* (2011), www.iisd.org/itn/2011/04/07/the-problem-of-moral-hazard/. See also T. Baker, 'On the Genealogy of Moral Hazard', 75 *Texas Law Review* (1996).

77 The notion of moral hazard. R. Lensink, H. Bo and E. Sterken, *Investment, Capital Market Imperfections and Uncertainty* (Edward Elgar, 2001), p. 15.

thus to the interests of foreign investors, the EU, and in the long-term, of the EU Member States themselves.

Firstly, for the reasons of invalidity of the intra-EU BITs, governments might start to engage in discriminatory treatment of investors. Bearing the signs of moral hazard, they may not have the incentive to refrain from interfering with investments if the cost is borne by the other party; in this case either investors themselves or potentially the EU, should the compensation mechanism be activated.[78] This might be prone to happen particularly in crucial economic sectors which are of key political and economic significance with a lower amount of competitors and higher exposure to governmental interference.[79]

For instance, the Hungarian government has recently – yet repeatedly – declared that it does not want more than half of the local banks to be owned by foreigners.[80] As a result, Hungary has been adopting measures that tighten economic conditions for banking,[81] going as far as predicting that four institutions will not sustain their presence in the market.[82] In July 2014, the Hungarian parliament passed a controversial bill that requires local banks to compensate mortgagors who took loans in foreign currencies and whose amount of borrowed money increased due to the fluctuation of the Hungarian Forint.[83] The bill rings of moral hazard as retail banks are to bear the burden of retroactive compensation to borrowers who took mortgages in a foreign currency when compared to those who took loans in Forint, and the government puts a strain on retail banks despite the fact that it is the policies of the Hungarian government and of the Hungarian National Bank that have a decisive impact on the currency rate.

In the same month, the Hungarian government agreed on a proposal to tax advertising revenues of all media enterprises with the exception of those that are locally owned.[84] Orbán's government has also introduced higher supervision and inspection

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78 Regulation (EU) No 912/2014 of the European Parliament and of the Council of 23 July 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.

79 J. Klick and G. Mitchell, 'Government Regulation of Irrationality: Moral and Cognitive Hazards', 90 *Minnesota Law Review* (2006), p. 1657.

80 CNBC, 'Hungarian central bank to tighten rules on banks, sees shake-up', 22 May 2014, www.cnbc.com/id/101696796.

81 Bloomberg, 'Hungary's Battered Banks Brace for Latest Bad-Debt Cure', 10 September 2013, www.bloomberg.com/news/2013–09–09/hungary-s-latest-toxic-debt-plan-rattling-banks-voters.html.

82 The Wall Street Journal, 'Hungary Central Banker: Four Major Banks May Leave Hungary', 20 December 2013, http://online.wsj.com/news/articles/SB10001424052702304866904579270513885095586.

83 The Wall Street Journal, 'Hungary Parliament Passes Bill To Compensate Retail Borrowers', 4 July 2014, http://blogs.wsj.com/emergingeurope/2014/07/04/hungary-parliament-passes-bill-to-compensate-retail-borrowers/.

84 If enacted, the tax of the biggest foreign-controlled TV RTL would reach nine times its 2013 profits. Emerging Europe Monitor, 'Political Risk Analysis – Media Tax To Strain EU Relations – SEPT 2014', September 2014, www.emergingeuropemonitor.com/political-risk-analysis-media-tax-strain-eu-relations-sept-2014; R. Greenslade, 'Hungarian media tax threatens press freedom, says newspaper

fees on supermarkets,[85] while announcing that a foreign-dominated market shall cease to exist if Hungarian daughter companies of supermarket chains fail to become profitable.[86] Furthermore, the Hungarian government declared the intention to absorb remaining funds of sixty thousand contributors to a private pension scheme that had already survived significant nationalization changes in a pension reform introduced in 2010.[87]

Should the goal be to nationalize a section of an economic sector with strict rules, Hungary might be facing accusations of (creeping) expropriation,[88] from which investors might be protected by BITs but not by the internal market rules since EU law does equally protect expropriation of private property. What is more, on other occasions, Hungarian and Romanian governments have tested the limits of European integration, and the Union found itself in a precarious position to accommodate their lack of compliance with EU law.[89] The trend of European governments' interference with foreign investments is also reflected in the number of current investment claims that the states are facing. Whereas in 2013, the EU Member States were respondents in around one quarter of investment claims registered at the ICSID, more than half of the claims filed in 2014 were claims against EU Member States, with Hungary unsurprisingly leading the count.[90]

Secondly, even if some newly accessed Central and Eastern European EU Member States[91] decide to terminate the treaties due to their incompatibility, some Western European Member States have actively opposed this effort, presumably trying to secure

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editor', The Guardian, 4 June 2014, www.theguardian.com/media/greenslade/2014/jun/04/hungary-advertising.

85 The Guardian, 'Hungary Raises Taxes on Advertising and Supermarkets', 18 November 2014, www.theguardian.com/world/2014/nov/18/hungary-taxes-advertising-supermarkets-soap.

86 Reuters, 'New Rules Could Drive Supermarket Chains Out of Hungary, Lobby Says', 19 November 2014, www.reuters.com/article/2014/11/19/us-hungary-retail-levy-idUSKCN0J31TW20141119; Euractiv, 'Foreign Supermarket Chains Threatened by Hungary', 20 November 2014, www.euractiv.com/sections/euro-finance/foreign-supermarket-chains-threatened-hungary-310174.

87 Euractiv, 'Hungarians Accuse Orban of Stealing Their Pension Money', 27 November 2014, www.euractiv.com/sections/elections/hungarians-accuse-orban-stealing-their-pension-money-310381.

88 Creeping expropriation is a 'slow and incremental encroachment on one or more of the ownership rights of a foreign investor that diminishes the value of its investment. The legal title to the property remains vested in the foreign investor but the investor's rights of use of the property are diminished as a result of the interference'. See UNCTAD, 'Taking of Property', *UNCTAD Series on Issues in International Investment Agreements* (2010), p. 10.

89 D. Kochenov, 'Overestimating Conditionality', *University of Groningen Faculty of Law Research Paper Series* No. 03/2014 (2014), www.rug.nl/research/portal/publications/overestimating-conditionality%28e9b0b19d-1ecf-4e51–95da-4ad4c5ba4ae0%29/export.html, p. 5.

90 12 out of 40 cases registered in 2013. 8 out of 15 in 2014. See ICSID Statistics (2014), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDNewsLettersRH&actionVal=ShowDocument&DocId=DCEVENTS31.

91 For instance, the Czech government has been actively renegotiating the status of BITs. Due to resistance from other EU Member States only six intra-EU BITs had been terminated. See C. Olivet, 'A test for European solidarity: The case of intra-EU Bilateral Investment Treaties', *Transnational Institute* (2013), www.tni.org/sites/www.tni.org/files/download/briefing_on_intra-eu_bits_0.pdf, p. 6.

investment protection for their investors as long as possible. Since such a position exposes economically weaker EU Member States to investment arbitration from the economic powerhouses of Germany, the UK, and the Netherlands that defy termination of their intra-EU BITs, it may be argued that old Member States do so not only at the expense of EU law, but also European solidarity.[92]

Thirdly, investors are left in the dark about whether they can depend on such treaties themselves. An important argument that seems to have been unaddressed in the debate is that despite the fact that EU Member States are used to act as respondents in the investment arbitration, they might find themselves as indirect petitioners too, especially in the case of state-owned companies. Should the investor be a wholly state-owned company, the loss incurred to the enterprise is strictly against the interest of a Member State. Swedish Vatenfall, 100% owned by the Swedish state, registered a claim against Germany at the ICSID in 2013.[93] The Federal Province of Lower Austria owns a majority stake in EVN AG, which seeks redress for Bulgarian investment interference.[94] The Hungarian government owns a significant stake in MOL, the petitioner at the ICSID against Croatia.[95] Gas Holding B.V., which initiated arbitration against Slovakia, is a consortium of E.ON Ruhrgas and GDF Suez; the French government has a stake in GDF Suez, and Slovakia owns 51% of the shares of SPP, a subsidiary of Gas Holding B.V. and obligations of whom are invoked in the arbitration.[96] Furthermore, the Czech state-owned energy giant ČEZ is threatening to sue Bulgaria if the licence for energy supply is

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92 'Furthermore, it adds insult to injury the fact that some of the lawsuits originate as a result of change in legislation that was demanded by the EC itself. The notion of European solidarity is already being tested during the Eurozone debt crisis. If countries like Germany, the Netherlands and UK do not change their position and start terminating the extensive web of intra-EU BITs, European solidarity will sound increasingly like empty rhetoric.' Solidarity should not be mistaken for a market-building model. Yet, solidarity has developed primarily on market or labour-derived areas of EU law. Although national solidarity is a principle of EU law, the Union competences to redistribution remain limited to areas such as cross-border health care, social security coordination, or free movement of workers. See C. Olivet, 'A test for European solidarity: The case of intra-EU Bilateral Investment Treaties', *Transnational Institute* (2013), www.tni.org/sites/www.tni.org/files/download/briefing_on_intra-eu_bits_0.pdf, p. 7; W. Lamping, 'Mission Impossible?: Limits and Perils of Institutionalizing Post-National Social Policy', in M. Ross and Y. Borgmann-Prebil, *Promoting Solidarity in the European Union* (OUP, 2010), p. 71–73; P. Ploscar, *The Principle of Solidarity in EU Internal Market Law* (PhD, University of Antwerp, 2013), p. 313–322; G. Davies, *European Union Market Law* (Cavendish, 2003), p. 211.

93 N. Bernasconi-Osterwalder and R. Tamara Hoffman, 'The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the new dispute Vattenfall v. Germany (II)', *IISD Briefing Note* (2012), www.iisd.org/pdf/2012/german_nuclear_phase_out.pdf; *Vattenfall AB and others v. Federal Republic of Germany,* ICSID Case No. ARB/12/12.

94 *EVN AG v. Republic of Bulgaria,* ICSID Case No. ARB/13/17.

95 *MOL Hungarian Oil and Gas Company Plc v. Republic of Croatia,* ICSID Case No. ARB/13/32.

96 *Slovak Gas Holding BV, GDF International SAS and E.ON Ruhrgas International GmbH v. Slovak Republic,* ICSID Case No. ARB/12/7; French government has a 33% stake in GDF Suez, www.gdfsuez.com/en/shareholders/gdf-suez-share/shareholder-structure-2/; Settlement Deed between Slovak Gas Holding B.V., GDF International S.A.S., E.ON Ruhrgas International GmbH and the Slovak Republic, www.italaw.com/sites/default/files/case-documents/italaw1369.pdf.

taken away from them.[97] Restructuring of investments via a BIT, signed between one of the EU Member States and a third state, may be an optimal solution; the source investment activity necessarily moves the home economy of the FDI to a third state. Not only does this highlight a damaging change to the reputation of the investment environment of the EU Member States, but it also signifies the loss of economic interaction between the Member States, which would have further economic impact.

Whereas there is notable competition amongst host state jurisdictions[98] and the incentives they offer,[99] it is an investor's decision whether he or she would take the ultimate step of executing investment activities in a foreign country, and if so, in which state. Weiss strongly argues that the flexible state capacity lies at the heart of global competition, and policy-making authorities may embark on enacting strategies to adjust to global competition. It is not uncommon for governments to attempt to decrease the responsibility of states for a change in order to succeed in a competitive environment,[100] but it is rare for national decisions to spill over to other states and international organizations and have an impact on the investment environment as is happening in the case of the EU. Apart from the instruments of international law, such as BITs or the Energy Charter Treaty,[101] the flows of capital have become common also due to the introduction of the EU internal market.

Fourthly, as contours of future intra-EU policy are substantially lacking, investors might find it more profitable to move their offices to a third country. Operating from third countries, at least on paper, would qualify them to enjoy the benefits of extra-EU BITs before they are challenged by the Regulation 1219/2012.[102] Even in that case, however, as confirmed by the recent Comprehensive Trade and Economic Agreement

97 Reuters, 'Power firm CEZ files complaint with EU against Bulgaria', 29 March 2013, www.reuters.com/article/2013/03/29/cez-bulgaria-idUSL5N0CL16620130329.

98 According to the World Bank's and International Finance Corporation's 2014 Ease of Doing Business Index Singapore, Hong Kong (SAR of the PRC), and New Zealand have the most conducive regulatory environment to operating a commercial enterprise. In the EU, Denmark, the UK, and Finland scored best. See, World Bank and International Finance Corporation, 'Ease of Doing Business Index 2014', *Doingbusiness* (2014), www.doingbusiness.org/rankings.

99 Studies on incentives are limited and therefore inconclusive as to whether fiscal incentives have a significant effect on locational decision. See B. Bora, 'The International Distribution of Multinational Production', in B. Bora, *Foreign Direct Investment: Research Issues* (Routledge, 2002), p. 56.

100 Central coordination is essential when systemically benefiting from independent economic sectors such as linkages between the petrochemical industry and plastic and synthetic fibres; semiconductor fabrication and the computer industry; or robotics engineering and the robot-using industry. See L. Weiss, *The Myth of the Powerless State: Governing the Economy in a Global Era* (Cornell University Press, 1998), p. 5–6.

101 The Energy Charter Treaty, 17 December 1994.

102 Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries, [2012] OJ L 351/40.

between the EU and Canada, investors from non-EU states might be able to retain high protection in future extra-EU BITs and investment agreements.[103]

Finally, since the Commission objects to any resort to arbitration in disputes among Member States, claims of state interference with the investment should be submitted to national courts. Moreover, as the Commission correctly points out, BITs allow for exclusion of the EU judicial review, which is against the principle of uniform application of EU law by the CJEU. Therefore, EU Member States' courts should set aside and deny enforceability of awards where EU law was completely ignored based on the principle of equivalence. This may be done in the name of public policy that constitutes an exception to the principle of finality of arbitral awards in the New York Convention 1958,[104] which all EU Member States signed.

Whereas the consensus on the view that BITs among the EU Member States have no future is due, EU Member States might be facing the moral hazard of a multilevel governance character. Theoretically, even if Member States realized that losing BITs might make investments from other EU Member States notably less attractive and interference with the investment less punishable, and therefore more probable, Members States are precluded to act on their own due to the exclusive competence conferred on the EU. The Union may propose a future intra-EU policy, but there have been no signs of it until now. It is, however, the national governments that might be suddenly facing significant challenges when attracting investment to strategic areas of their economies such as energy supplies and distribution, or banking. Since the risk is felt by the Member States more than by the Commission or the European Parliament themselves, the moral hazard of elongation of the lack of internal investment policy increases.

§5. RESOLUTION TO DIVERGENT INTERESTS

Stakeholders' positions in the intra-EU investment differ, as is apparent from the analysis above. Apart from considerable width of various interests, EU Member States might prefer a different solution when they are the host economy, and when investing themselves through a state-owned enterprise in other EU Member States. Governance should solve problems through integration of values and trust.[105] The reputation of the

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103 CETA provides for arbitration in Section 6, which has been recently among the most contested investment guarantees in the light of TTIP. Consolidated text of CETA available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

104 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the 'New York Convention').

105 S. Turnbull, 'A New Way to Govern: Because World Best Practices are the Problem Not the Solution', *International Institute for Self-Governance, Sustainable Money Working Group Paper* (2003), www.researchgate.net/publication/228165668_A_New_Way_to_Govern_Because_'World_Best_Practices'_are_the_Problem_Not_the_Solution, p. 1.

EU has, however, sustained a serious blow when constructing the investment competence and policy.

There are two avenues to take for a possible solution: the legal (judicial) and policy-setting level. On the legal level, the potential for a solution is limited. The new intra-EU policy cannot be introduced by arbitral tribunals or national courts since they lack competence to do so. It would be helpful if there were a binding and clear interpretation of the incompatibility. The CJEU is meant to provide for this.[106] As mentioned, arbitral tribunals may not submit requests for preliminary rulings and therefore the matter would have to be submitted to the CJEU via the challenge to an arbitral award in front of the national court.[107]

Even in the case that there is a decision for or against the incompatibility, intra-EU policy will still have to be proposed by the European Commission. EU Member States conferred on the EU the exclusive competence on FDI[108] and the Commission and the European Parliament might have to face the uneasy political task of reforming and balancing not only intra-EU investor interests but also regulatory public interests. Furthermore, extra-EU BITs may be subjected to renegotiation or denunciation pursuant to the Regulation.[109] Hypothetically, a transitional solution might be for the EU to step back and cease to claim that there is an incompatibility of the intra-EU BITs with EU law. Such a decision may, however, become ineffective if some EU Member States, including state-owned investors such as *Vattenfall*, would not follow this view in order to protect their interests. But even if the EU and all EU Member States would follow the idea of choosing not to claim the incompatibility, such a decision would be doctrinally problematic,[110] inconsistent, and most significantly would not replace needed intra-EU investment policy.

§6. CONCLUSION: A SHOT IN THE FOOT

The policy of deflecting the claims from investors by CEE states might have been considered as a brilliant, but spineless idea when submitted to arbitration courts ten years ago. Although the claims of incompatibility were based on a well-founded legal assessment, they followed only short-term interests of some EU Member States at the expense of the EU, other Member States, and the investors. Conceivably, the fear of substantially high damages that the host state may be ordered to pay, motivated EU Member States' governments to use all available valid arguments in the proceedings,

106 Article 267 TFEU.

107 '(…) the national courts have the most extensive power, or even the obligation, to make a reference to the Court if they consider that a case pending before them raises issues involving an interpretation or assessment of the validity of the provisions of European Union law and requiring a decision by them (…)'. See Opinion 1/09 European and Community Patents Court, para. 83.

108 Article 206 TFEU.

109 Regulation (EU) No 1219/2012.

110 Doctrinally, the author posits that the incompatibility exists. See Section 2.

despite the fact that the EU Member States were otherwise active in their national investment policies and the TFEU was not even adopted at the time when most disputes arose. It remains to be noted that the argumentation used by the Member States affirming that pre-existing BITs were implicitly terminated upon the accession of the country to the EU was entirely unsuccessful in front of arbitration courts. The step of relying on the incompatibility of BITs with EU law would be economically justifiable should the EU have a European policy up their sleeve.

Although the external investment policy is being negotiated,[111] and the EU also has recently adopted a mechanism whereby the EU could replace a Member State on the side of a defendant,[112] no solution to the issue of incompatibility of BITs among the EU Member States has been proposed. Although private as well as public interests in foreign investments would welcome clarification and a potential deepening of the guarantees of the EU internal market, as opposed to the incompatible BITs, the goal of a favourable and clear intra-EU investment policy seems to be far-fetched despite it being in the long-term interests of all agents involved: private investors, states, as well as the EU. Considering the criticism surrounding the creation of a comprehensive investment policy of the EU that has been full of unintentional destructivism,[113] by protecting national and EU interests without considering their reciprocal dependence, as well as investor interests in the long run, the investment environment of the European Union has sustained another injury in a battle of interests that is not over yet.

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111 Most notably the Comprehensive Economic and Trade Agreement (CETA), and the Transatlantic Trade and Investment Partnership (TTIP).

112 Regulation (EU) No 912/2014.

113 The debate about extending the Union's competence was materially developed during the Constitutional Convention meetings beginning in 2002, despite the discussion being insufficient in general and ranging wildly from non-exclusive powers to an exclusive Union competence. Belohlavek holds a similar view and accuses the Commission of pure arrogance. Koutrakos criticizes the vagueness of the competence wording in the Constitutional Treaty. Kuijper asserts that with the adoption of the Treaty of Lisbon, the EU even failed clearly to delineate its treaty-making powers and opted for a solution that may lead to a considerate controversy in such an important area of the Treaty instead. Meunier points out that the process of investment competence conferral could be labelled as harshly as a historical accident or action happening by stealth. Leal-Arcas confirms the existing doubts surrounding FDI matters in the EU, pointing out uncertain interpretation and the lack of preparations. Lastly, Lavranos suggests that there have been severe indications of a continuous incompetent approach of the Parliament to the matter. See M.P. Maduro, 'Europe and the Constitution: What If This Is As Good As It Gets?', in J.H.H. Weiler and M. Wind, *European Constitutionalism Beyond the State* (CUP, 2003), p. 77; A.J. Belohlavek, *Ochrana Primych Zahranicnich Investic v Evropske Unii*, para. 37, 479; P. Koutrakos, *EU International Relations Law* (Hart, 2006), p. 495; P.J. Kuijper, 'Super-Power Frustrated? The Cost of Non-Lisbon In the Field of External Relations', 51 *German Yearbook of International Law* (2009), p. 18–19; S. Meunier, 'Integration by Stealth: How the European Union Gained Competence Over Foreign Direct Investment', *Paper prepared for the 7th Annual Conference of the Political Economy of International Organizations, January 16–18, 2014, Princeton University* (2014), http://wp.peio.me/wp-content/uploads/2014/04/Conf7_Meunier-05.09.2013.pdf; R. Leal-Arcas, 'The European Union's Trade and Investment Policy after the Treaty of Lisbon', *Legal Studies Research Paper* No. 64/2010 (2010), p. 487; N. Lavranos, 'In Defence of Member States' BITs Gold Standard: The Regulation 1219/2012 Establishing a Transitional Regime for Existing Extra-EU BITs – A Member States' Perspective', 10 *Transnational Dispute Management* (2013), p. 12.