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COMPETENCE SHIFT ON FDI FROM THE EU MEMBER STATES TO THE EU

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Table of Contents

List of Abbreviations

BIT	Bilateral Investment Treaty
CAFTA	Central America Free Trade Agreement
CCP	Common Commercial Policy
CJEU	Court of Justice of the European Union
CFSP	Common Foreign and Security Policy
DG Relex	Directorate General External Relations
DS	Dispute Settlement
DSU	Dispute Settlement Understanding
EC	European Commission
ECJ	European Court of Justice
ECT	Energy Charter Treaty
ECtHR	European Court of Human Rights
EP	European Parliament
ESDP	European Security and Defence Policy
EU	European Union
EUMS	European Union Member States
FAO	Food and Agricultural Organization
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FYROM	Former Yugoslav Republic of Macedonia
HR	Human Rights
ICC	International Chamber of Commerce
ICSID	International Centre for the Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
INTA	Committee on International Trade
MAI	Multilateral Agreement on Investment
MEP	Member of European Parliament
MERCOSUR	Mercado Común del Sur (Common Market of the South)
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NYC	New York Convention
OLP	Ordinary Legislative Procedure

PCA	Partnership and Cooperation Agreement
REIO	Regional Economic Integration Organization
SCC	Stockholm Chamber of Commerce
SIA	Sustainable Impact Assessment
TEC	Treaty establishing the European Community
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
ToL	Treaty of Lisbon
UNCITRAL	United Nations Commission on International Trade Law
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

Executive Summary

With the entry into force of the Lisbon Treaty, **FDI is now included in the CCP** which gives the EU exclusive competence over it. It covers both investment liberalization and protection, flows and stocks. On the short term the EU will authorize existing BITs and empower MS to conclude new ones. It should however work fast on the development of its external FDI policy and IIA treaty-making capacities. The treaty does not offer a definition of FDI, but from EU practice we can deduct that portfolio investment is not included. An EU FDI policy shall be undertaken following the Union's principles. There is express reference to these principles in the treaties and attention to issues such as human rights, environmental sustainability goes beyond mere context. This might lead to an upgrade of existing sustainable impact assessments to include human rights and other values in its social component. Also the EP, which now has co-decision power, is analysing the possibility to adopt legislation to develop a system through which benefits from FTAs are stopped if grave HR violations are found. This would go beyond HR assessment at just the conclusion stage of the IIA.

As to the question whether the IIA would have to be **a mixed or a "pure" Union agreement**, two different situations have to be distinguished. First, if a future IIA seeks to include portfolio investments or if investment provisions are to be taken up in free trade agreements, then the agreement will have to be mixed. Second, it is not crystal-clear what would happen in pure IIAs. While pure Union agreements are possible even if the subject matter touches upon EUMS competences, it is so that they cover more broad and general provisions, rather than specific regulations. If the EU plans on including effective investment protection clauses that would affect MS' competences, it should conclude its IIAs as mixed agreements. Also the duty of cooperation that governs mixity, would ensure a more streamlined implementation of the IIA's provisions and guide the contrast between external liability of the Union for Member States' measures and internal competence for the implementation of the treaty. The EU can take temporary measures in awaiting EUMS ratifications. It can either conclude an interim agreement or provide for provisional application. A possible fast-track system for national parliaments is possible, but potentially unnecessary if there is a provisional application of the treaty or an earlier democratic control on the work of the Council. Whether they are mixed or not, at the conclusion stage of IIAs the Commission will make recommendations, work closely with the Council and report regularly to the EP. It will also be the sole negotiator in the actual negotiations. The Council will authorize negotiations, assist the Commission via the Trade Policy Committee and adopt negotiation directives. The role of

the EP is enhanced as it now has co-decision making power in the CCP. The CJEU can rule on the compatibility of the IIA with EU law and can rule on potential excess competence.

The **allocation of competences and responsibility** will be dealt with in either an ECT or a WTO like system. First, in a system that would distinguish among EU and EUMS competences, it is possible to either make a declaration of competences or decide upon this question at the adjudication stage. As the former would be difficult to do in detail for future IIAs and because it could lead to internal finger pointing between the EC and Member States, the EU could apply an ECT like system in which a third party or investor must ask the EU who is responsible for a measure and who will be the respondent in the proceedings. This answer can be provided through a political process or, if this does not suffice, a question to the CJEU. The second option is a system in which there is no distinction between respective competences. The model for such a system is the WTO, where the EU and EUMS have joint liability. The EU could take up the external defence for all proceedings, even when they are against specific MS, while working out an internal system to arrange for the payment of an international award if the case would be lost. It would remain possible for investors to press charges against an individual Member State. Whether the EU would/could allow this without taking up the defence is unclear. A treaty of joint liability for investment claims would be a novelty in international investment law and perhaps the starting point for the improvement of the whole system. It appears that the EU will go for a WTO like system.

As to **dispute settlement** two different situations could arise. First, when a MS would be the respondent in the case of an ECT like system or if the EU would not take up the defence when an investor presses charges against an individual EUMS in a WTO like system, existing international investment DSM could apply. In any case an investor could go to national courts to pursue his claim if the agreement is mixed. These courts do not have the jurisdiction to interpret EU Law, only to ask the CJEU for a preliminary ruling. Second, regarding measures taken by EU institutions such as directives or direct regulations, three points are of specific relevance. One, in case of directives there is a presumption that the investor should first look at the Member States' implementation. Two, in case of EU measures, investors have the legal capacity to resort to the CJEU. In our view, as investors would have the option to resort to internal courts under EU IIAs, those treaties would have direct effect in the Union's legal order. Third, nor the ICSID Convention neither the ICSID Additional Facility Rules would be applicable in case of an EU measure without amending their provisions. UNCITRAL, ICC

and SCC are flexible enough to allow the EU as a party to them. State-state dispute settlement could be maintained together with investor-state/EU arbitration, specifically for disputes regarding the interpretation of IIAs.

A **new hybrid system with panel and appeal** is possible, and it is the time for the EU to pursue it. Third states will not accept that its investors can only have recourse to the CJEU or challenge the implementation measure of the MS. International arbitration against EU measures should be possible. Amending ICSID will just open a Pandora's box and other international DSM such as UNCITRAL, ICC and SCC do not fit the principles of the EU. If the EU is serious about fairness of tribunals, coherence and transparency, it should not include them in its IIAs but rather develop a new dispute settlement system with *ad hoc* arbitral tribunals and a permanent appellate body similar to that of the WTO. This could lead to a more coherent and predictable investment dispute settlement system and real case-law could be developed. Elements of the existing investment dispute settlement that should be kept include: possibility of investor-state claims, the value of awards as a final judgment of an internal court, and the "judicial" component of investor-state arbitrations. It speaks for itself that rules on transparency, public hearings, access to documents, and submission of *amicus curiae* brief should be more developed in a new system. The EU can and should push for this. If it would jump on the UNCITRAL wagon out of pragmatism, pressure for third countries to negotiate such a new system would decrease and the opportunity at hand would be lost.

Enforcement of awards against MS would still be governed by either the ICSID convention or New York Convention. However, in case of the latter, if it would concern an implementation measure of an EU decision (e.g. directives), there is the possibility that the MS would invoke the *EcoSwiss* doctrine before local courts to set aside the award. Enforcement of awards against the EU would be ideally governed by the new system with panel and appeal which would include final rulings and direct enforcement. The EU can become a party to neither the ICSID nor the New York Convention. In case the EU is respondent and the wrongful measure is indeed an EU measure, the EU should have the capacity to pay for such an award. A budget line should be added in the EU budget for such purposes. In case the EU is respondent but the wrongful measure was one of a Member State, the EU would simply request the MS to pay. If a MS would refuse to pay, both the EU and other Member States can demand this before the CJEU based on legal obligations under the constituent treaties.

Introduction

The purpose of this legal memorandum is to examine the shift of competence on Foreign Direct Investment (FDI) to the European Union (EU). Now the Lisbon Treaty has entered into force, FDI is a part of the Common Commercial Policy (CCP) and thus the EU has exclusive competence over it.[1] However, it remains unclear how competences are divided among EU institutions and EUMS, and how future EU FDI practice will be. Complex legal questions arise with two recurrent areas of tension. The first is the interplay between four legal actors: the EU, the EUMS, third countries and third country investors. The second is the existence of three legal orders of which the relation among each other is not clear and often contested: EU Law, MS' national legal orders and international law. To guide us through these areas of tension and the complex legal questions, this memorandum will rely on four overarching principles on which the authors believe future EU investment practice should be based upon: transparency, predictability, coherence and fairness of dispute settlement mechanisms.

This memo thus focuses on the longer term developments of EU International Investment Agreements (IIAs). Our analysis will contain five core parts. (1) We will look at the inclusion of FDI in the CCP, its definition and the context in which an EU IIA will be concluded. (2) Then we will discuss whether EU IIAs will be mixed or "pure" Union agreements. We will also explain how EU IIAs will be concluded and ratified. (3) This will be followed by an analysis of the allocation of international responsibility for IIAs. In the EU there can be a difference between internal division of competence and who is the external respondent in proceedings. We will discuss two main options: the most probable WTO like system, and an ECT like system. (4) The fourth part will go on possible dispute settlement mechanisms. We will investigate two main possibilities. First the recourse to internal tribunals (Member States or CJEU). And second mechanisms provided for in international law (ICSID and others). We will suggest a possible new system with panels and appeal which would entail the core principles we want the future investment system to be based upon. (5) And fifth, we will look at the ways of enforcement against EUMS and the EU once an award would have been granted to a foreign investor, based on the EU IIA. We will not deal with the substantive content of future EU IIAs nor its relations with previous EUMS BITs.

[1] The Lisbon Treaty entered into force on December 1, 2009.

Chapter 1: The Lisbon Treaty and Foreign Direct Investment

I. The inclusion of FDI under the Common Commercial Policy

- Competence on FDI lied almost exclusively with EUMS before the Lisbon treaty
- The EU has exclusive competence for the CCP
- The Lisbon Treaty includes FDI under the CCP
- This FDI competence includes both investment liberalization and protection

1. Before the entry into force of the Lisbon Treaty the competences on FDI could almost exclusively be found within the legal competences of EU Member States (EUMS).[2] Every EUMS had its own foreign direct investment policy and most of them had their own model BIT.[3] All followed a practice of concluding BITs with third countries or even with other EUMS (the so-called intra-EU BITs[4]). This situation did not impede the EU and its Member States to have a common policy in negotiating the Energy Charter Treaty (ECT) and the unsuccessful Multilateral Agreement on Investment. In addition, the Free Trade Agreements (FTAs) concluded by the EU and the EUMS also contained clauses related to FDI.[5] Even if the majority of the FTAs only contain regulations on capital movements, other free trade agreements do have additional clauses on foreign investment, most on the admission of foreign investment such as the degree of liberalization of capital movements and the conditions for the establishment of foreign investors.[6] However, they do not include clauses on foreign investment protection such as provisions on expropriation or on fair and equitable treatment. Note that in other countries agreements on investor-protection normally came first and provisions on investment liberalization or establishment followed later on. In EU agreements, the evolution is thus the other way around.

2. The Common Commercial Policy (CCP) is one of the areas of external action of the

[2] J. Ceyssens, "Towards a Common Foreign Investment Policy? - Foreign Investment in the European Constitution" (2005), 32 *Legal Issues of Economic Integration*, 259-291.
[3] See, for example the UK, Germany and France model BITs, available at http://www.investmentclaims.com/subscriber_treaties_bilateral
[4] Most of those intra-EU BITs date back the accession of the so-called 'new' EU Member States (CEEC) and are between the 'old' 15 EU Member States and the 12 'new' Member States that joined the EU from 2004 on. Since the accession of those countries, no new intra-EU BITs have been concluded.
[5] A. Dimopoulos, "EU Free Trade Agreements: An Alternative Model for Addressing Human Rights in Foreign Investment Regulation and Dispute Settlement?," at p. 565, in *Human Rights in International Investment Law and Arbitration,*edited by P.M. Dupuy, E--U. Petersmann, and F. Francioni..
[6] *Id*., at p. 569.

EU[7]and one of the areas where the Union has exclusive competence.[8] The Europa Glossary defines the CCP as "one of the main pillars of the European Union's relations with the rest of the world", and adds that this "area of exclusive Community responsibility" implies "uniform conduct" of relations with third countries.[9] Article 3 of the TFEU clearly states that the CCP is an area where the Union has exclusive competence.[10] This practically means that only the Union may legislate and adopt legally binding acts. The Member States are only able to do so themselves if empowered by the Union or for the implementation of the Union acts.[11] The CCP covers both pure EU measures adopted by the Community institutions and conventional measures negotiated with third countries and international organizations at the EU level.[12]

3. The aforementioned experience of the EC in including provisions on investment has lead to the configuration of an implicit competence on foreign investment.[13] Now, with the entry into force of the Lisbon treaty, we go beyond an implicit competence to an exclusive competence under the CCP. The Treaty of Lisbon indeed clearly includes FDI in the CCP of the Union.[14] In itself, the CCP is formed by TFEU Article 206 (ex Article 131 TEC) and Article 207 (ex Article 133 TEC). Both articles include FDI:

> TFEU Art 206: By establishing a customs union in accordance with articles 28 to 32, the Union shall contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on *foreign direct investment*, and the lowering of customs and other barriers. (Emphasis added)

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[7] The other areas include: Association, partnership, and co-operation; development policy, technical co-operation, and humanitarian aid; external environmental action; external dimensions of internal policies.

[8] Article 3 TFEU establishes that the Union shall have exclusive competence in the following areas: Customs Union, Competition rules necessary for the functioning of the internal market, Monetary policy for Member States which have adopted the Euro, Conservation of marine biological resources under the common fisheries policy, Common commercial policy, Conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or insofar as its conclusion may affect common rules or alter their scope

[9] Europa Glossary, Common Commercial Policy, available online at: http://europa.eu/scadplus/glossary/commercial_policy_en.htm (last visited 2 May 2010).

[10] TFEU Article 3 (1)(e): "The Union shall have exclusive competence in the following areas: (e) common commercial policy."

[11] TFEU Article 2 (1): "When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member states being able to do so themselves only if so empowered by the Union or for the implementation of Union acts."

[12] Paul Craig and Gráinne De Búrca, *EU Law: Text, Cases, and Materials*, 4th ed. (Oxford: Oxford University Press, 2008), at p. 183.

[13] T. Eilmansberger, "Bilateral Investment Treaties and EU Law" (2009) 46 *Common Market Law Review* 390.

[14] Technically speaking, the ToL amends two treaties: the Treaty on European Union (TEU) and the old Treaty establishing the European Community (TEC) which is renamed as the Treaty on the Functioning of the European Union (TFEU). These two treaties actually govern the Union. The Common Commercial policy can be found under Title II of Part Five (External Action) of the TFEU.

> TFEU Art 207 (1): The Common Commercial Policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, *foreign direct investment*, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action. (Emphasis added).

4. From the text of these articles we can conclude that the Union has an obligation to contribute to the abolition of restrictions on foreign direct investment, that the CCP shall be based on uniform principles, and that the CCP shall be conducted in the context of the principles and objectives of the Union's external action. Article 206 reflects current practice and is more about investment flows and establishment, than about investor protection. However, the new Article 207 TFEU, by referring more broadly to the "Common Commercial Policy", goes beyond this goal of investment liberalization. Reasoning the other way around, not including investment protection would remove the clauses including FDI under the CCP of any *effet utile* as nothing would change with current practice.[15] Finally, both the literature as the European Commission make it clear that there is consensus that the competence on FDI includes investment protection.[16]

II. Defining FDI in the Lisbon Treaty

- Classic definition of FDI as opposed to portfolio investment
- The lack of definition in the Lisbon treaty, the practice of Eurostat and its implications for the EU: Competent for FDI, not for portfolio investments
- If the EU wants to include both in an IIA, this agreement will have to be mixed

5. Investments have usually been characterized as direct or portfolio investments.[17] In practice, the problem is that it is not always easy to draw the line within those two types of investment. BITs for example normally do not distinguish between FDI and portfolio investments. They usually have a broad definition of investment that, according to some

[15] S. Woolcock, "EU Trade and Investment Policymaking After the Lisbon Treaty" in *Intereconomics*, 2010, 22-25.
[16] Interview with Tomas Baert, Directorate General for Trade, Services and Investment, Graduate Institute Geneva, 27 April 2010.
[17] OECD, International Investment Law, Understanding Concepts, and Tracking Innovations, 2008, at p. 47, (available online at http://www.oecd.org, last visited 2 May 2010)

authors, includes portfolio investment protection.[18] The typical definition of investment contained in BITs refers to "every kind of asset", followed by a non-exhaustive list of covered assets. On the other hand, other IIAs do establish an exhaustive list of assets, and exclusions. This is the case for example in NAFTA Article 1139, which states that investment under NAFTA would include portfolio investment (equity securities). In NAFTA there is thus a list, with portfolio investment included. This contrasts with other investment agreements which specify that they only apply to foreign direct, as opposed to portfolio, investment.[19] In some BITs, portfolio investments are excluded because they are simply less desirable than FDI. This is clearly because they generally do not bring technology transfer, training or other benefits associated with FDI. Also, the risks involved in some portfolio investments for the investor are not as high as the ones involved in a direct investment, as the former investment could normally be pulled out of a host country more easily than the latter.[20]

6. The Lisbon Treaty does not give a definition of either "investment" or "foreign direct investment." However, the express inclusion of the wording foreign "direct" investment in TFEU Articles 206 and 207, implies that there is some type of foreign "indirect" investment that would not be part of the CCP. This seems to be the case for portfolio investments. We deduct this knowledge from the definition and benefits of FDI, the EU uses for statistical purposes:

> • Foreign direct investment is the category of international investment in which an enterprise resident in one country (the direct investor) acquires an interest of at least 10 % in an enterprise resident in another country (the direct investment enterprise). Subsequent transactions between affiliated enterprises are also direct investment transactions.
>
> • As it gives the investor an effective voice in the management of the enterprise and a substantial interest in its business, FDI implies a long-term relationship between the direct investor and the direct investment enterprise.
>
> • Investment may take place through the establishment of an entirely new firm, so-called 'greenfield' investment, or through the complete or partial purchase of an existing firm via a merger or an acquisition.[21]

When referring to the benefits of FDI for the investee state, Eurostat writes:

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[18] *Id.*, p. 49

[19] P. Muchilinsky, "Scope and Definition", *UNCTAD Series on issues in international investment agreements* 2nd Edition p. 23.

[20] M. Sornarajah, *The International Law on Foreign Investment*, Cambridge. Cambridge University Press, 2004, pp. 227-228

[21] Eurostat, European Union Foreign Direct Investment Yearbook 2007, at p. 22, available at http://epp.eurostat.ec.europa.eu (last visited 2 May 2010).

• As it is less liquid and tradable than portfolio investment, FDI flows are usually less volatile. Especially in the case of developing countries, this type of financing reduces the risk of external speculation and liquidity crises. FDI contributes positively to the recipient's balance of payments, both through the initial transaction and by adding to export growth.

• FDI contributes to growth in the target country by increasing the production base, by creating employment and through multiplier effects (e.g. orders from other local industries). By contributing to higher competition, FDI can lead to an improvement of other domestic firms' efficiency and product quality. It may conversely contribute to the 'crowding out' of local firms, i.e. the closure of other uncompetitive production units. FDI acts as a catalyst for domestic investment and technological progress through the transfer of technology to the recipient. Similarly, it may raise management expertise and marketing skills.[22]

The inclusion of FDI in the CCP thus implies that portfolio investments fall outside the competence of the EU and remain an exclusive competence of EUMS. Thus, if the Union wishes to include portfolio investment in its future IIAs, it would be compelled to conclude them in the form of a "mixed agreement". This in application of the principles established in Opinion 1/94. (See, Chapter 2.1.C).

III. The Context in which an EU FDI Policy will occur: the Union's Principles

- Express reference to the principles of the Union within which the CCP must be conducted: Article 205 TFEU and Article 21 TEU
- In general these include: human rights, environmental impact, sustainability, rule of law, respect for international law, attention to environmental, social and economic development of developing countries
- Additional principles that should be included: transparency, independence of arbitral tribunals, coherence and predictability
- The increasing importance of such principles for different actors inside the Union: the European Parliament and DG Relex (human rights and multilateral relations)
- Sustainable Impact Assessments could include human and labour rights assessments. The EP could develop, through legislation, a system through which benefits from FTAs are stopped if grave HR violations are found. This would go beyond HR assessment at the conclusion stage of an international agreement.

7. There have been debates on the relation of investment law with other areas of international

[22] *Id.*, at p. 23.

law such as human rights, environmental protection and with some principles of good governance such as transparency. With the entry into force of the Lisbon Treaty, these issues fall within the EU competences and should be included to some extent in future EU IIAs. The EU and EUMS already include these issues in FTAs they conclude conjointly with third countries.[23] FDI is included in the CCP (and thus external relations) in TFEU Art 206 and 207. Article 207(1) clearly states that the CCP "shall be based on uniform principles" and "shall be conducted in the context of the principles and objectives of the Union's external action." It is the introductory article 205 that refers to those principles, written down in Chapter 1 of Title V of the TEU. Finally, this chapter refers in Article 21 to the principles within which the external action of the Union must be conducted. According with the wording of the Lisbon Treaty, the EU has a real obligation to promote those principles and values, as it is stated in the Preamble, Article 3 and Article 21 of the TEU.

8. The principles go from sustainable development and respect for the environment (Article 21), over good governance (Article 15) to human rights (Article 21). They also provide for support for the rule of law and principles of international law, as well as the aim to foster sustainable economic, social and environmental development of developing countries, with the primary aim of eradicating poverty (Article 21).

9. In addition, other issues that are not explicitly stated in the Treaty but that follow from those principles should also be included. These include the overarching principles of this legal memorandum: transparency, predictability, coherence and independence of investment dispute settlement mechanisms. This would be in line with the practices of other capital exporting states such as Canada and the United States. They too are starting to include some of these issues in their own new free trade agreements (FTA).[24] In the case of the EU, the inclusion of these principles in future agreements seems to go beyond good practice to an actual real obligation.

10. The European Parliament has already proven to be critical towards the inclusion of the

[23] A.Dimopoulos, "EU Free Trade Agreements: An Alternative Model for Addressing Human Rights in Foreign Investment Regulation and Dispute Settlement?.", at p. 567.
[24] See, for example Canada - Colombia Free Trade Agreement, concluded on 21 November 2008, available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=en#free (last visited 2 May 2010).

Union's principles in conducting its external policy.[25] Now the EP has co-decision power because the ordinary legislative procedure has become the standard procedure in the CCP,[26] the Union will have to keep these principles in mind while negotiating its IIAs. It will be for the Commission to find a balance between an effective IIA and those principles so the EP is satisfied. Clearly a future EU IIA will not regulate the aforementioned issues but because the principles are explicitly referred to in the treaty articles on the CCP, and because the European Parliament will/might keep an eye on the matter, the attention to those principles will go beyond mere 'context'. The Commission also understands this increasing importance of issues such as the environment or human rights. This has been reaffirmed on an EU Commission trade conference on EU trade policy towards developing countries on March 16, 2010. Because IIAs are mostly concluded with developing countries, the relevance of the principles is increasing. At the conference Véronique Arnault, director for Multilateral Relations and Human Rights at DG Relex (external relations) and former official of DG Trade, emphasized on the attention that should be given to human rights in EU trade policies, most certainly in free trade agreements.[27] Her unit is still working on the implementation of these principles but does not exclude communication with other industrialized nations such as the USA for a possible streamlined approach towards sensitive issues such as human rights. [28]Also Moreira, the president of the committee on international trade of the European Parliament (INTA), reaffirmed that the EP will closely look to the inclusion of attention to sustainable development within its work.

11. An idea is to conduct assessments before concluding treaties on investments. Right now the EU is already concluding Sustainability Impact Assessments when concluding FTAs (or other agreements such as PCAs). In a draft opinion by MEP David Martin of the EP's Committee on Foreign Affairs for the Committee on International Trade (INTA) of 18 March 2010, it is suggested that all EU trade agreements (investment is not mentioned but as it is under the same provisions on CCP as trade, the result will be the same) should include human rights impact assessments. It also calls on the Commission to develop a system to monitor

[25] *European Commission Final Report on The Use, Scope and Effectiveness of Labour and Social Provisions and Sustainable Development Aspects in Bilateral and Regional Free Trade Agreements*, 15 September 2008, Contract VC/2007/0638, available at http://ec.europa.eu/social (last visited 2 May 2010)

[26] Presentation by J.-F. Brakeland and C. Brown of DG Trade on The Impact of the Lisbon Treaty on Trade Policy at the Civil society Dialogue Meeting of 27 January 2010.

[27] EU Conference on "Trade Policy towards Developing Countries: Challenges and opportunities for the next years", Brussels, 16 March 2010.

[28] Interview with Tobias King, DG Relex – Multilateral Relations and Human Rights, 14 April 2010.

both achievements and setbacks in the development of HR. That the EP is serious about this issue can be deducted from the fact that the draft report further suggests that future EP legislation should include some arrangement so that trade advantages can be stopped temporarily if grave HR or labour rights violations were to be seen. They suggest that the EP, the Commission or even a member state could start such an initiative. Finally, it would of course be the EC that would implement such decision.[29] As existing SIAs have a social component included, it would be wise to include an assessment of human and labour rights in that part. If this would be implemented, attention to human and labour rights would stay, even after the conclusion stage of an international agreement.

[29] Draft opinion of the Committee on Foreign Affairs (rapporteur David Martin) for the Committee on International Trade on human rights and social and environmental standards in international trade agreements, 2009/2219(INI), 18 March 2010, available at http://www.europarl.europa.eu (last visited 2 May 2010).

Chapter 2: EU International Investment Agreements

I. Mixed vs. "Pure" EU Agreements

A. Types of EU Agreements

- The EU has the legal personality and competence to conclude international agreements to exercise its competences
- EUMS are bound by the treaties the EU concludes. If the EU trespasses its competence, its MS can have recourse to the CJEU

12. The EU has legal personality (TEU Article 47) and the capacity to conclude different types of treaties.[30] Among them, it can conclude association agreements[31], co-operation and partnership agreements and interregional co-operation and development agreements. It has the capacity to sign international agreements that fall within its competences. For example for the implementation of its competence on CCP the EU has concluded the WTO agreement and many Free Trade Agreements. TFEU Articles 216 and 217 clearly express the treaty making power of the Union:

> TFEU Article 216: 1. The Union may conclude an agreement with one or more third countries or international organisations where the Treaties so provide or where the conclusion of an agreement is necessary in order to achieve within the framework of the Union's policies, one of the objectives referred to in the Treaties, or is provided for in a legally binding Union act or is likely to affect common rules or alter their scope. 2. Agreements concluded by the Union are binding upon the institutions of the Union and on its Member States.
>
> TFEU Article 217: The Union may conclude with one or more third countries or international organisations agreements establishing an association involving reciprocal rights and obligations, common action and special procedure.

13. These articles indeed show that the Union has the capacity to conclude international agreements and that those agreements can establish rights and obligations not only for Union institutions and the Third party with whom the agreement is concluded, but also for the EUMS which are bound by international EU agreements. Clearly the Union has to be aware not to trespass its competences in concluding the agreement. If the EU would transgress the boundaries of its competences to the detriment of one of its members, that State would have

[30] An updated list of the Agreements concluded by the EU is available at http://ec.europa.eu/world/agreements/default.home.do

[31] This is provided for in TFEU Article 218. The ECJ has ruled that the Association Agreements form part of the Community legal order together with other international agreements.

the right of challenging any unlawful act under TFEU Article 263.[32]

B. "Pure" EU Agreements

- The EU has the possibility to conclude pure EU agreements. This has been done for politically sensitive areas in the CFSP and ESDP where speed is highly necessary. Mostly, there is a distinction between EU and EUMS' competences and the agreements' provisions are specific.
- Some authors suggest a trend towards pure EU agreements, based on *Portugal v Council*. However, this case suggests that the EU can conclude such agreements when they cover more broad and general provisions, rather than specific regulations.

14. The constituting treaties do not refer to mixed or "pure" EU agreements. This difference has evolved in practice and the case law of the ECJ. Even agreements in areas beyond the former first pillar competences, have been concluded as Community agreements with the only signatory being the EU. The TEU provides for that option in the Common Foreign and Security Policy (CFSP) in Article 37.[33] Examples of such cases are agreements between the EU and the NATO which are only concluded by the EU.[34] Even the military agreement with FYROM on EU-led forces was concluded by the EU alone.[35] Three things are remarkable here. First, these EU agreements usually include provisions which distinguish the EU from its MS, in terms of legal personality. Second, these treaties often include a division of competences between EU and MS and are very specific agreements, rather than comprehensive and effective agreements. Third, some of these agreements (e.g. FYROM) require speed and ratification by 27 Member States in such sensitive areas as the ESDP would take too long. Therefore a pure "Union" agreement is preferred, subject to Council oversight.

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[32] TEU Article 263 (ex Article 230 TEC), First two paragraphs provide:
"The Court of Justice of the European Union shall review the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, other than recommendations and opinions, and of acts of the European Parliament and of the European Council intended to produce legal effects vis-à-vis third parties. It shall also review the legality of acts of bodies, offices or agencies of the Union intended to produce legal effects vis-à-vis third parties.
It shall for this purpose have jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers."
[33] TEU Article 37 (ex Article 24 TEU) provides: "The Union may conclude agreements with one or more States or international organisations in areas covered by this Chapter."
[34] P. Eeckhout, *External Relations of the European Union*, Oxford University Press, New York, (2004), 158-160.
[35] Council decision 2001/682 concerning the conclusion of the Agreement between the European Union and the Former Yugoslav Republic of Macedonia (FYROM) on the activities of the European Union Monitoring Mission (EUMM) in FYROM (2001) OJ L242/1.

15. Some authors suggest tendencies towards pure Union agreements based on *Portugal v. Council*.[36] Here the ECJ ruled in favour of a pure Community agreement in the case of a Co-operation Agreement with India. Portugal raised the important question as to which extent the EC could conclude an agreement of which the substance enters the competences of national member states (it referred, among others, to drugs policy in which the EC had virtually nothing to say). The Court ended up rejecting Portugal's objections. However, it sought to decrease the risk of the abuse of the Community's "pure" treaty making power by pointing to the Community's limited competences. Some commentators question whether in this case the Court has not refrained the Community too much from establishing an effective (rather than general) cooperation agreement with India by putting up high conditions for the Community.[37] Rosas argues, referring to *Portugal v Council*, that it is becoming practice for the Union to conclude comprehensive agreements that establish cooperation in different policy areas, on its own.[38] However, it is clear that this medal has another side, being that there are high barriers for the Community to conclude truly effective agreements in areas where the substance of the cooperation agreement goes beyond the competences of the EU.

C. Mixed Agreements

- Mixed agreements are required when competences are split between the EU and its member states (Opinion 1/94)
- Although it is legally not crystal-clear, we argue that mixity is also necessary when 1. specific (as opposed to broad and general) provisions of the treaty come into the EUMS' jurisdiction,
- 2. the mixed agreement could have far reaching consequences for the Union's liability for EUMS' measures. The duty of cooperation which governs mixity has several advantages to guide these agreements.

16. The Court has ruled in favour of mixity in Opinion 1/78. Although it was afterwards criticised by the Commission to accept the participation of the EUMS too fast, the subsequent institutional settlement (PROBA 20 arrangement) also favoured mixity. The most 'famous' decision of the Court, however, came in Opinion 1/94 on the WTO agreement, which according to Craig and De Bùrca marked the end of the expansion of the EC competence

[36] *Portugal v Council*, 1996, C-268/94.
[37] P. Eeckhout, *External Relations of the European Union*, Oxford University Press, New York, (2004), at p.117.
[38] A. Rosas, "The European Union and Mixed Agreements" in Dashwood, A. and Hillion, C. (eds), *The General Law of EC External Relations,* Sweet & Maxwell, 2000, at 218.

under the CCP. However, at the time of the WTO agreement, the competences on TRIPS and GATS were divided in the treaties among the EC and its MS. It is based on that fact that the Court ruled that the agreement needed to be a mixed agreement. However, this is not the case anymore now, neither is it the case for FDI which is in its entirety included in the CCP. Yet, Opinion 1/94 is of relevance because since then the practice of concluding mixed agreements grew, also in the case of comprehensive free trade agreements such as the one with Chile.[39]

17. What now if the EU would formally have the treaty making competence, but when specific provisions of some treaty could enter the jurisdiction of EUMS (think of FDI and expropriation clauses)? In our view there are two strong arguments in favour of mixity. First, mixed agreements respond to such situations where the Union and its MS each retain treaty-making power in a *specific* area.[40] In those agreements both the EU and the MS are contracting parties on the basis that their joint participation is required. It is thus about the specificity of the legal provisions included in the treaties. If they are broad and general, we can go towards a *Portugal v Council* interpretation, but if they are very specific, with consequences within the legal systems of the EUMS, a mixed agreement is required. In this regard, Tomuschad has expressed that "the European Union finds itself under an institutional necessity to conclude mixed agreements whenever the legal regime established by an international third-party agreement falls only partly within its scope of jurisdiction."[41]

18. Second, mixed agreements are governed by the duty of cooperation. This duty has advantages when the agreement could have far reaching legal consequences such as EU liability for MS' measures. The duty of cooperation exists of two principles. In its Ruling 1/78, the Court has emphasized on the principle of loyalty, meaning that all MS will have to implement EU regulations and adopt al national measures which are necessary to ensure that the Union respects the obligations following from a treaty. Also MS need to help the Union to achieve its tasks and, most importantly, they shall abstain from any measures that could

[39] European Commission Trade, Bilateral Relations with India: http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/chile/ (last visited 2 May 2010).

[40] See e.g.: J. Helikoski, *Mixed agreements as a technique for organizing the international relations of the European Community and its member states*, (Hague; Boston 2001), p. 321. E. Nefrani, *Les accords mixtes de la Communauté européenne: aspects communautaires et internationaux*, (Bruxelles 2007), p. 711. N. A. Neuwahl, Mixed Agreements: Analysis of the phenomenon and their legal significance, *Law*, vol. PhD, (Florence 1988), p. 304. D. O'Keeffe and H. G. Schermers (eds.), *Mixed Agreements*, (Deventer, The Netherlands; Boston 1983), p. 248. A. Rosas, The European Union and Mixed Agreements, In A. Dashwood and C. Hillion (eds.), *The general law of E.C. External Relations*, (London 2000), pp. 200-220.

[41] C. Tomuschad, "The International Responsibility of the European Union," in E. Cannizzaro *The European Union as an Actor in International Relations* (The Hague [etc.]: Kluwer Law International, 2002), p. 185.

hinder reaching the objectives of the Treaty. Next to this basic principle, unity in the international representation of the Union is required.

D. Consequences for EU Investment Agreements

- In case the EU and its MS opt for a single EU IIA, it would be most likely to be concluded it in the form of a mixed agreement
- In this way:

  1. portfolio investment could be included in EU IIAs,

  2. there are not just broad and general provisions, but effective investment protection articles that enter EUMS' jurisdiction as well,

  3. the duty of cooperation is used to assure a streamlined implementation of the IIAs,

19. If EU IIAs would include portfolio investment – on which the EU does not have competence (see supra) – Opinion 1/94 clearly shows us that the IIAs would have to be a mixed agreement. The same reasoning accounts for if FTAs were to include investment provisions. EU FTAs cover multiple areas from intellectual property rights and services to government procurement. The latter is seen as an area with great potential for EU exporters. Quite some EU companies have expertise in areas that are normally dealt with by governments. Examples are transport equipment, public works, utilities, etc. As some of these areas fall within the EUMS' competences, the FTA has to be mixed. In addition, the practice of the EU shows that most of the existing FTAs and future ones – for example India, Mercosur and South-Korea – are or will be mixed.[42] The European Commission at the moment prefers the idea of including investment provisions in FTAs, rather than separate BITs. However, the conclusion of BITs in case it is not possible to conclude a FTA with a country, is not excluded.

20. In the case of *Portugal v Council*, the question was about comprehensive cooperation agreements, with rather broad provisions on development cooperation. IIAs (for example BITs) have a different nature with more concrete provisions. IIAs normally include provisions on the definition of investment; the standards of treatment such as, fair and equitable treatment, full protection and security, national treatment, most favoured nation treatment,

[42] Bungenberg, M., *The Common Commercial Policy after Lisbon,* Paper presented at the Hebrew University Jerusalem, on 14.07.2008, available at: http://www.docstoc.com/docs/16984437/The-Common-Commercial-Policy-after-Lisbon/ (last visited 2 May 20109

protection against discrimination, protection against unlawful expropriation; jurisdictional clauses; and on dispute settlement mechanisms, among others. The European Commission has made clear that it will adopt full blown mature IIAs with strong investment protection.[43] A mixed agreement is thus wanted as one cannot define the exact scope of FDI that is now included in the CCP. Concluding two treaties (one EU treaty and one treaty by its Member States) with separate provisions and articles would not consider European integration and will possibly create overlap, forum shopping in dispute settlement, legal uncertainty and especially lack of clarity, and potentially even opposing provisions between the EU and certain member states. This hinders transparency and, especially, coherence in a future FDI policy and dispute settlements. If the new rules on FDI contained in the Lisbon Treaty would lead to the conclusion of two treaties, the provisions on FDI of the Lisbon Treaty would simply lack of *effet utile*.

21. Although some of the questions arisen before international tribunals relate issues that are to some extent regulated by the EU, the conduct of its MS is still the main object to which IIAs would be addressed. Member States can affect foreign investors by their acts and omissions (for example towards its organs and subdivisions) and their measures would still remain the main source of concern for foreign investors. For example, they could produce unlawful expropriations or breach fair and equitable treatment provisions. In addition, the EU does not have competence to regulate on questions of property ownership.[44] For these reasons, states' measures will still be the main concern when negotiating BITs, even if FDI is now an exclusive competence of the Union. A mixed agreement and the duty of cooperation could guide this EU internal respect for the treaty better than if the EU were to conclude a pure EU agreement.

II. Short-term Phasing In

- The EU will authorize the existing BITs under EU Law and empower EUMS to continue concluding BITs in the transitional phase.

22. As the competence on FDI includes investment protection, there are serious doubts about the legality under EU law of the content – or at least part of it – of the existing (about 1300)

[43] Interview with Tomas Baert, Directorate General for Trade, Services and Investment, Graduate Institute Geneva, 27 April 2010.
[44] Cf. TFEU Art. 345. *See* Patricia Nacimiento, "Who's A Respondent In Light of Art. 207 of the Lisbon Treaty?", Kluwer Arbitration Blog, Posted: 30 Apr 2010.

EUMS BITs. Of course they remain legal under international law and therefore the EU will authorize the existing BITs under EU Law with additional legislation.[45] Besides this, the EC is planning to use TFEU Article 2 (1) to empower the MS to keep on concluding their own BITs.[46] This empowerment will be exceptional, *ad hoc* and subject to a heavy procedural framework. It seems impossible for a Member State to be empowered to conclude a BIT with a country with which the EU is concluding an FTA. Apart from this official position of the European Commission – to be released in an EC communication in June 2010 – it is recommended for the EC to take up its competence as soon as possible. The exclusive competence on concluding IIAs lies now within the EU, and a long process of empowerment would not lead to a coherent investment policy which is expected of the FDI transfer, and would remove rules on FDI of any *effet utile.*

III. Long-term Conclusion of EU Investment Agreements

A. Negotiating IIAs

- The EC shall make recommendations, work closely with the Council and report regularly to the EP. It shall also be the sole negotiator in IIAs negotiations with third countries.
- The Council shall authorize negotiations, assist the Commission via the Trade Policy Committee (ex Article 133 Committee) and adopt negotiation directives
- The Commission shall report regularly to the EP. This happen in the INTA committee. Its role is enhanced as the EP now has co-decision making power in the CCP
- The CJEU can rule on the compatibility of the IIA with EU law and can rule on potential excess competence

The European Commission

23. According to Article 207 (3) of the TFEU, the European Commission has the prerogative to make recommendations to the Council to start investment negotiations. Once the opening of negotiations are authorized by the Council, both the Commission and the Council are to make sure that the investment agreements are compatible with internal Union policies and rules. In addition the article states that the Commission will report regularly to the European

[45] The EC does not prefer the word "grandfathering" as the authorization will only be authorization of the existence of these BITs under Article 207, not necessarily the blessing of the entire BIT.
[46] TFEU Article 2 (1) provides: "When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts."

Parliament.[47] It will be Commission officials who perform the actual negotiation with third countries.[48] This strengthens the position of the Union and the flexibility of the Commission to find the common position between itself, the third country and EU member states, as well as among EU member states itself, when coming to complicated details of an agreement. This practice of the commission as a sole negotiator is generally accepted by the other EU institutions and MS.[49] It was the case for the WTO Agreement where the Council stated that "in order to ensure the maximum consistency in the conduct of the negotiations, it was decided that the commission would act as sole negotiator on behalf of the Community and the Member States".[50] The Commission can use then its diplomatic strength in its status as sole negotiator to ensure strong protection for outward investments.[51]

The Council

24. The Council would keep a firm grip on the EU IIAs negotiation process in two ways. First, according to TFEU Art. 207 (3), the Council has to authorize the opening of the negotiations by unanimity (which is required following TFEU Article 207 (4)).[52] Important in this respect is that the obligation to authorize the negotiations does not mean it has the

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[47] TFEU Art. 207 (3) establishes :
*"*Where agreements with one or more third countries or international organizations need to be negotiated and concluded, Article 218 shall apply, subject to the special provisions of this Article.
The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union politics and rules.
The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to *assist* the Commission in this task and within the framework of such directives as the Council may issue to it. The Commission shall *report* regularly to the special committee and to the European Parliament on the progress of negotiations." (Emphasis added).

[48] According to TFEU Art. 207 (3):
*"*Where agreements with one or more third countries or international organizations need to be negotiated and concluded, Article 218 shall apply, subject to the special provisions of this Article.
The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union politics and rules."

[49] Craig and De Búrca, *EU Law*, at p. 199.

[50] Opinion 1/94, of 15 November 1994, Competence of the Community to conclude international agreements concerning services and the protection of intellectual property, *European Court Reports* 1994 Page I-05267

[51] T. Eilmansberger, "Bilateral Investment Treaties and EU Law" (2009) 46 *Common Market Law Review* 390.

[52] TFEU Art. 207 (3) provides:
"Where agreements with one or more third countries or international organizations need to be negotiated and concluded, Article 218 shall apply, subject to the special provisions of this Article.
The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union politics and rules."
TFEU Art. 207 (4), second sentence provides: "For the negotiation and conclusion of agreements in the fields of trade in services and the commercial aspects of intellectual property, as well as *foreign direct investment*, the Council shall act unanimously where such agreements include provisions for which unanimity is required for the adoption of internal rules." (Emphasis added).

obligation to answer positively to the recommendation of the Commission.[53] This means it can cast a negative vote on the recommendation of the Commission which would mean negotiations are prohibited to start. Second, the commission must consult with a special committee that is appointed by the Council to assist the Commission in the negotiations. In practice this will most likely happen in the Trade Policy Committee (the former Art. 133 Committee). This assistance will be more intense than mere consultations, because both the Commission and the Council are responsible to ensure the compatibility of the IIA with internal Union policies and rules.[54] And second, related to the assistance, the Council adopts negotiation directives, which delimit the possibilities of the Commission in the external negotiations.[55] The directives, through which it does so in trade negotiations, are not published and often rather general (giving the Commission some flexibility).[56] This is expected to be the same in investment negotiations. Given the specificity of the new competence on FDI one could wonder whether it would not be necessary to create a specific committee to deal with investment issues.

The European Parliament

25. The role of the EP is extended. The Commission now has the obligation to report regularly to the European Parliament on the progress of the negotiations.[57] The European Parliament does not have the status to assist the Commission in the negotiations as the Council has. This is because it is not explicitly responsible under EU Law to guarantee that BITs will be compatible with internal rules and policies. Of course it follows from the duty of cooperation that it does have to work together to make sure compatibility is achieved. The communication between Commission and Council will take place in the International Trade

[53] P. Eeckhout, *External Relations of the European Union*, Oxford University Press, New York, (2004), at p.171.
[54] TFEU Art. 207 (3) provides:
"Where agreements with one or more third countries or international organizations need to be negotiated and concluded, Article 218 shall apply, subject to the special provisions of this Article.
The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union politics and rules.
The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to *assist* the Commission in this task and within the framework of such directives as the Council may issue to it. The Commission shall *report* regularly to the special committee and to the European Parliament on the progress of negotiations." (Emphasis added).
[55] TFEU Art. 218 (2) establishes: "The Council shall authorise the opening of negotiations, *adopt negotiating directives*, authorise the signing of agreements and conclude them." (Emphasis added).
[56] P. Eeckhout, *External Relations of the European Union*, Oxford University Press, New York, (2004), at p 173.
[57] TFEU Art. 207 (3), third sentence provides: "The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to *assist* the Commission in this task and within the framework of such directives as the Council may issue to it. The Commission shall *report* regularly to the special committee and to the European Parliament on the progress of negotiations." (Emphasis added).

Committee (INTA) of the European Parliament. In practice the Commission has been reporting to the European Parliament on the negotiation of international (trade) agreements for a long time. This practice was even established in an inter-institutional agreement.[58] Therefore this system is actually formalizing the existing practice in Art. 207. However, the role of INTA can evolve in the future. This is because the Parliament now has co-deciding power in the final adoption of the international agreement. Right now the Commissioner for Trade Karel De Gucht is working with Moreira (the President of the EP's INTA Committee) on a new framework agreement.[59] The EP suggests that in the upcoming framework agreement – expected before the 2010 summer break – it should be agreed upon that the EP is part of the official EU delegation in international negotiations for which it has co-decision power, and that it is to receive the same information and the same time as the Trade Policy Committee of the Council receives.[60]

The Court of Justice of the European Union

26. It is possible for any EUMS, the European Parliament, the Commission or the Council to request the opinion of the CJEU on the compatibility of the proposed agreement with the constituent treaties.[61] This can become important in the case of investment treaties as there is now an explicit reference in the articles on the CCP to the principles of the Union as we already analyzed. It is more likely that the European Parliament will especially keep an eye on this, knowing it has co-decision power to conclude the agreement, but still the option before the CJEU remains. If the Court rules the proposed EU IIA is not compatible with the constituent treaties, an international agreement cannot enter into force. It is also possible to request the Court whether the content or what content of an IIA would fall within the scope of the Union's competence. As we have explained before, future EU-IIAs will be hybrid. To deal with this issue, we suggest the treaty will take the form of a mixed agreement.

[58] Framework Agreement on relations between the European Parliament and the Commission (2001) *OCJ* C121/122: see Annex 2.

[59] European Commission MINUTES of the 1896th meeting of the Commission held in Strasbourg on Tuesday 24 November 2009, 02 December 2009, PV(2009)1896 final.

[60] Interview with Arielle Rouby, Advisor Foreign Affairs Unit of the International Trade Committee, 28 May 2010, by phone.

[61] TFEU Art. 218 (11) provides: "A Member State, the European Parliament, the Council or the Commission may obtain the opinion of the Court of Justice as to whether an agreement envisaged is compatible with the Treaties. Where the opinion of the Court is adverse, the agreement envisaged may not enter into force unless it is amended or the Treaties are revised."

B. Ratification of Mixed IIAs

- The difference between ratification, entry into force and signing is customary international law and applies to the EU as well
- There is a double democratic control in the sense that the all 27 EUMS must ratify before the agreement enters into force and that the EP now has co-decision power for the conclusion of IIAs
- The EU can take two temporary measures in awaiting EUMS ratifications: 1. conclude an interim agreement or 2. provide for provisional application
- A possible fast-track system for national parliaments is possible, but potentially unnecessary if there is a provisional application of the treaty or an earlier democratic control on the work of the Council

27. Ratification can follow or accompany the signing of the mixed agreements. VCLT article 11 states that "the consent of a State to be bound by a treaty may be expressed by signature, exchange of instruments constituting a treaty, ratification, acceptance , approval or accession, or by any other means if so agreed".[62] In case there is signing and subsequent ratification it would mean that the MS would express consent to be bound by its executive signing the agreement. However, until final ratification by the national parliaments has taken place, the treaty has not yet entered into force. VCLT Article 18 states in this regard that a state "is obliged to refrain from acts which would defeat the object and purpose of a treaty when it has signed the treaty or has exchanged instruments constituting the treaty subject to ratification, acceptance or approval, until it shall have made its intention clear not to become a party to the treaty".[63] Thus national parliaments can express this intention not to become a party to the treaty by rejecting its ratification. This is customary international law so it applies to the EU as well.

28. First, if IIAs are mixed agreements, all member states' national parliaments will retain the right of non-ratification at the final stage of the conclusion of the IIA. It is practice in the Union that the Council awaits all member states' ratifications before allowing the agreement to enter into force. This will give national parliaments the chance to raise questions to their executive regarding the content of the EU IIA. Although the executive does keep the power to act through the Council and actually sign the agreement, the national parliaments' potential

[62] Article 11, *Vienna Convention on the Law of Treaties*. 1969. Done at Vienna on 23 May 1969, *UNTS*, vol. 1155, p. 331
[63] Article 18, *id.*

control and democratic overview in the ratification stage of mixed agreements is, though, definitely existing. Second, the role of the European Parliament has been enhanced with the entry into force of the Lisbon Treaty. The CCP is now also implemented through the Ordinary Legislative Procedure (OLP), according to TFEU Article 207.1 (ex Article 133 TEC). In more practical terms, this means the EP has to give its consent for the implementation of the CCP. The Parliament has interpreted this provision in a way that it has to give its consent for the conclusions of every international agreement related to the CCP.

29. Fast national ratification of mixed agreements has been seen before, like for example in the case of the WTO where all member states ratified within one month and a half, but is rather exceptional. Most of the times at least some member states take a long(er) time to ratify. We can witness such a thing in most FTAs. Therefore temporary measures are necessary in order to guarantee the effectiveness of the Union's external action.[64] The Union has two possibilities to do so. First, in areas of trade the Community has in the past concluded interim agreements on trade. These were, though, exclusive Community agreements.[65] Such an exclusive Union agreement, even only temporary, seem more difficult in the area of FDI, where the content of a IIAs comes more into member states' competences than trade does. Second Article 25 of the Vienna Convention on the Law of Treaties (VCLT) provides for the provisional application of the treaty when its entry into force is pending. Here the Union would just have to include such a provision or agree upon it in some other manner. The result is that the treaty or part of it would be applicable, pending its entry into force unless a negotiating state expresses their wish not to become party to the treaty. For instance Article 45 of the ECT provides for its provisional application. The EU also uses provisional application in most of its FTAs.

30. It is a political concern that these ratifications could take too long and complicate issues too much. Therefore, one could argue in favour of a fast track system for national parliaments. This would mean that in the end national European parliaments would only be able to accept or reject the whole IIA, without having the possibility to make amendments. It is during the negotiations that national parliaments could and should look after its executives in the Council. For third countries which would negotiate IIAs with the EU this system would be the

[64] Eeckhout, P., *External Relations of the European Union*, Oxford University Press, New York, (2004), at p. 218.
[65] *Id*., at p. 219.

most attractive. The past has thought us that mixed agreements are not always easily ratified but most of the times a simple provisional application clause suffices to implement the agreement already while most EUMS are still ratifying. An example of this was the 1999 sensitive trade, development and cooperation agreement between the EU and South Africa. Also in this politically sensitive case there was a provisional application clause which guided implementation before the entry into force. [66]

IV. The Relevance of New Rules on FDI for Third Countries when Negotiating IIAs

New EU rules on FDI to implement its new competence under the Lisbon Treaty can have remarkable effects on third states, especially when they negotiate IIAs with the EU or EUMS. The knowing and understanding of those rules by third states could be an important asset in ongoing or future negotiations and could contribute to a harmonious development of the EU competence on FDI under the CCP.

First, the understanding of rules on FDI by third countries would be important when they negotiate IIAs with the EU. In this way the third state could be aware of the timing of negotiations, on the proposals it can make, and of what it can expect from any of the EU organs. In addition, third states could demand from the EU negotiators a clarification of the exact meaning of those rules for the negotiated treaty and its implications in the future agreement. Third states could also propose for the active participation of all the EU organs which could play a role in the development of the CCP, in the negotiations of the IIA. This would include the EP and the CJEU. The former is already suggesting its official status in negotiations on the new framework agreement between the Commission and the Parliament. As for the CJEU, third states could demand from EU negotiators that they ask preliminary question on the delimitation of competences or interpretation of EU regulation on FDI if there is any lack of clarity.

Second, third states can take advantage of these new rules when negotiating agreements with EUMS individually. The Lisbon Treaty establishes a range of principles and proceedings applicable to agreements on FDI that also have effect on the conduct of EUMS when they are negotiating IIAs on their own. Third states could invoke these rules in negotiations, for example, by requesting what are the implications of the Lisbon Treaty for the agreement that

[66] Trade Law Centre for South Africa, Legal Aspects of the Negotiation, Ratification and Entry into Force of Economic Partnership Agreements, available at: http://www.tralac.org/unique/tralac/pdf/20070703_LEGAL_ASPECTS_OF_THE_NEGOTIATION.pdf (last visit 2 May 2010)

is being negotiated by the EUMS or by proposing EUMS consultations with EU organs. Thus, it could be possible and advantageous for an EUMS to request the EU organs its view on the content of future IIAs and its legality in light of the EU treaties. This would assure a more coherent policy and would reduce the risk of conflict between EU agreements and EUMS agreements. An in-deep understanding of rules on FDI under the Lisbon Treaty would also allow third states to recall the EUMS of its obligations under that Treaty. For instance, it would be possible for a third state to propose the inclusion of clauses on Human Rights or on transparency in future IIAs to an EUMS based on the fact that the EU is obliged to promote such rules under the Lisbon Treaty.

Such an active participation by third states would allow, indirectly, the development of these new rules on FDI and the search for more predictability in IIAs, in particular because such an active participation would oblige EU organs and EUMS to ask themselves what those rules mean, how they should be implemented, and what would be the interaction between exclusive competence of the EU on FDI and the (remaining or empowered) competence of EUMS. The last ten years of practice has shown that a very important aspect of the promotion and protection of FDI is the perception of fairness of the clauses contained in IIAs. The knowledge and command of rules on FDI contained in the Lisbon Treaty by third states will contribute to the conclusion of more fair IIAs, which ultimately will provoke the promotion of FDI in the EU and in third countries and intensify the parties mutual economic relations.

Chapter 3: EU IIA and International Responsibility

I. Allocation of Competences and International Responsibility

- The exclusive competence of the EU on FDI and the increasing number of competences of the EU should be translated in IIAs covering EU measures
- Two options seem possible when concluding new IIAs: a system that distinguishes between the competences of the EU and the EUMS (ECT like agreement) or a system that does not distinguish between such competences (WTO like agreement)
- In cases involving the EU and EUMS rules of international responsibility of states and International Organizations apply.

31. The increasing number of competences of the EU in the constituent treaties and its exclusive competence on FDI will have its effects in future investment claims. It is probable that foreign investors will consider themselves affected by EU measures. Therefore future investment disputes could involve two kinds of measures: measures of EUMS and measures of EU organs. Thus, for future foreign investors investing in the EU zone, it could be important to cover these EU measures in future IIAs. As Tomuschad expresses "[a]n entity discarding any notion of liability for its conduct could not be taken seriously in international dealings."[67]

32. The question is what kind of international agreement will be best effective in order to cover EU measures in future IIAs, taking into account the interests of the Union, of third states and of investors. Here two options seem possible. The first one is a system that distinguishes between the competences of EU and EUMS – following the ECT model –. The second one is one which does not distinguish the origin of the measure – as it is in the WTO.

33. Selecting one of those options will have effects at the adjudication stage. Once a wrongful act has been committed it is necessary to apply rules on international responsibility in order to determine who is responsible. But in a case involving the EU and its MS, tribunals will have to analyze the measures of two categories of subjects of international law: a regional

[67]C. Tomuschad "The International Responsibility of the European Union," at p. 183. In the same vain Eilmansberger considers that a new agreement "will also have to include relevant protection obligations for the European side." T. Eilmansberger, "Bilateral Investment Treaties and the EU Law," *Common Market Law Review*: 396. Eilmansberger enumerates some EU rules that could be irreconcilables with the common rules included in a BIT. *Id*, at 408.

economic international organization and a sovereign state. In those cases the principles of attribution on state responsibility will converge with those of attribution of international organizations, codified in the ILC Draft articles on responsibility of international organizations.[68]

33. Usually the EU is considered an international organization, thus customary rules of international responsibility of International Organizations are applied to it. Yet, it has been observed that the EU incurs in international responsibility "much like States and under conditions which do not significantly differ" from those which the ILC defines in the draft articles on state responsibility.[69] There is a view that international organizations that have achieved a high degree of integration are a special case, and that certain administrative regulations fall outside the domain of international law.[70] But this debate does not allow the EU to invoke internal EU law in order to justify a failure to perform a treaty. This possibility is forbidden by the 1986 Vienna Convention on the Law of Treaties which provides that "[a]n international organization party to a treaty may not invoke the rules of the organization as justification for its failure to perform the treaty.[71] The same principle was followed by the ILC in its draft articles on responsibility of international organizations.[72]

II. The ECT Option: Allocation of Responsibility in a System that does Distinguish the Origin of the Measure

- These agreements usually contain a division of competences between EU and EUMS
- That division can be made by a declaration of competences or by the option to request the EU/EUMS who is competent of a certain measure
- In the ECT the EU is responsible in accordance with its competences and to know who the respondent will be in a case, a request must be made to the EU

[68] *See, "*International Law Commission, Report on the work of its sixty-first session (4 May to 5 June and 6 July to 7 August 2009)," Chapter IV, available at http://untreaty.un.org/ilc/reports/2009/2009report.htm (last visit 5 May 2010)
[69] C. Tomuschad, "The International Responsibility of the European Union.", at p. 177.
[70] "International Law Commission, Report on the work of its sixty-first session (4 May to 5 June and 6 July to 7 August 2009)," at p.79.
[71] Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations, done at Vienna on 21 March 1986.
[72] *See* Article 31 of the ILC Draft articles on responsibility of international organizations, in "International Law Commission, Report on the work of its sixty-first session (4 May to 5 June and 6 July to 7 August 2009)" cited above.

- In this system the responsibility of two different subjects of international law must be analyzed. The jurisdiction of a tribunal can depend on the attribution of a measure to the EU or a MS.
- Under international law MS are not responsible for acts committed by the IO.
- In order to evade the lack of jurisdiction of international tribunals to review EU measures there have been attempts to make a claim including all the states which conform the IO or to challenge the "implementation" of a EU measure
- If a binding dispute settlement mechanism for EU measures is provided for in a future EU IIA, two options are possible in order to determine who is responsible for a measure: 1. allow the international tribunal to interpret EU law in order to determine who is responsible or 2. allow the claimant to request the EU who the responding party will be.

34. Under the agreements that divide competences there is a distinction of functions between the EU and the EUMS, according to their relevant competences. There are different ways in which this is brought into practice. One option is to conclude mixed agreements that contain a declaration of competences.[73] These kinds of agreements can provide that the EU is party to it only to the extent of its competences. Another option is to establish that at the moment of accession or ratification, the organization shall declare the extent of its competence and inform about any modification in its extent.[74] There are two main problems with such declarations of competences. The first is that it should be changed each time the competences of the international organization are modified.[75] Another problem is that in cases where the alleged violation is a failure to act, the Union could refer to the list to argue that it had no responsibility because it did not have the competence to act. In addition, this could lead to internal finger pointing between the Commission and Member States. This would go against the duty of cooperation, governed by the principles of loyalty and unity in international representation.

[73] This is the case for instance of the UNCLOS Convention and the Ozone Layer Convention (Article 13) of the Ozone Layer Convention, which provides that the regional economic integration organization parties in the convention shall decide on their respective responsibilities for the performance of their obligations and that in their instruments of ratification, acceptance or approval, the organizations shall declare the extent of their competence..

[74] This is the case for instance of the UNCLOS Convention and the Ozone Layer Convention The UNCLOS Convention gives third states the possibility to ask who is responsible. See Article 5.5 of Annex IX of the UNCLOS Convention.

[75] The solution provided in the UNCLOS Treaty is that the state hall notify any changes to the distribution of competences, Article 5, para 4 of Annex IX of the UNCLOS Convention.

35. The ECT is a clear example of a treaty with a division of competences between the EU and the EUMS. The ECT does not explicitly provide for an obligation to declare the extent of the competences of the EU. However, in its Declaration of Transparency, the EC stated that it is "internationally responsible for the fulfilment of the obligations contained [in the ECT], in accordance with their respective competences".[76] Thus, instead of making a list of competences, the declaration redirects to the constituent treaties where those competences are established. In addition, in the same Declaration the EC stated that "upon the request of the Investor" "[t]he Communities and the Member States will, if necessary, determine among them who is the respondent party to arbitration proceedings initiated by an Investor of another Contracting Party." Once a request is made, the EU and its MS have the prerogative to decide who would be the respondent.[77] It is doubtful that an investor would resort to that option since there is no compulsory jurisdiction for EU measures provided for in the ECT.[78]

36. An agreement of divided competences similar to the ECT for future EU IIAs seems possible. If this option is chosen for, an obligatory jurisdiction should be included for cases where the measure at stake is one of the EU. If a system in which a third party must request the Union who is the responsible for the alleged faulty measure, is indeed established, then the Union will have a chance to answer this question through a political process involving the third state, the Union and its MS. The principle guiding this approach would be the aforementioned one of "cooperation", which guides the Union and its MS through all steps of the policy cycle. However, if a political process would not offer an answer on who actually is liable for the measure, the CJEU could judge on who is competent for the measure which is considered contrary to the EU IIA. With this answer, the third party would know who the respondent party is and could start the proceedings via the available dispute settlement mechanisms.

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[76] Contra, M. Burgstaller, "European Law and Investment Treaties" (2009) 26 *Journal of International Arbitration* 181-216, C. Tiejte, "The applicability of the Energy Charter Treaty in ICSID Arbitration of EU Nationals vs. EU Member States*"* (2009) 6 *Transnational Dispute Management* 5 - 18.

[77] J. Helikoski, *Mixed Agreements as a Technique for Organizing the International Relations of the European Community and its Member States*, (The Hague; Boston 2001), p. 321.

[78] The Declaration of the EU is clear in this respect when it states "[g]iven that the Communities' legal system provides for means of such action, the European Communities have not given their unconditional consent to the submission of a dispute to international arbitration." "Statement submitted by the European Communities to the Secretariat of the Energy Charter Treaty pursuant to Article 26. (3) (b) (ii) of the Energy Charter Treaty", *OJ L* 336, 23.12.1994, at p.115.

37. In a system of divided competence as that of the ECT two different subjects of international law could be responsible for the commission of international wrongful acts. Thus, it is essential to distinguish whether a measure is attributable to either the EU or the MS because the jurisdiction of the tribunal will depend on this answer.

38. A possibility one could imagine to skip the lack of binding jurisdiction for the EU is making the EUMS responsible for the acts of the EU. This option however does not appear very convincing. Under international law, international organizations are responsible for the international wrongful acts attributed to its organs.[79] In addition, Member States are not responsible for acts committed by the international organization.[80] Yet, as stated before, the TEU clearly distinguishes the responsibility of the EU from that of its MS.[81] An attempt to challenge a measure of an international organization, even if there was no binding jurisdiction, has been to make a claim including all the states which conform the international organization.[82] This practice has been followed before the European Court of Human Rights (ECtHR) where all the EUMS appear as a respondent when a claimant wants to challenge an EC/EU measure.[83] Craig and De Búrca observe that in most cases the ECtHR rejected the admissibility of the applications brought against different EU acts, but in none of the cases it did so on the ground that it lacked jurisdiction to examine violations committed by the EC/EU.[84] In some cases the ECtHR appears to have recognised that review would be possible when the EU act gives room for implementation choices by the Member States.[85]

39. In the framework of the ECT investors have tried to challenge EU measures before an investment arbitral tribunal by challenging the "implementation" of this measure in order to

[79] *See* Article 3, of the ILC Draft articles on responsibility of international organizations, "International Law Commission, Report on the work of its sixty-first session (4 May to 5 June and 6 July to 7 August 2009)".
[80] "International Law Commission, Report on the work of its sixty-first session (4 May to 5 June and 6 July to 7 August 2009)" at p. 179 According to the ILC, it is "implied" that -except on those cases expressly provided in the Draft articles- "responsibility is not considered to arise for a State in connection with the act of an international organization" and that "membership does not as such entail for member States International responsibility when the organization commits an internationally wrongful act." *Id.*, p. 167.
[81] Article 340 of the TFEU (ex Article 288 TEC) establishes that: "The contractual liability of the Union shall be governed by the law applicable to the contract in question. In the case of non-contractual liability, the Union shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by its institutions or by its servants in the performance of their duties."
[82] *See* Article 47 of the ILC Draft articles on responsibility of international organizations, "International Law Commission, Report on the work of its sixty-first session" (4 May to 5 June and 6 July to 7 August 2009)
[83] Craig and De Búrca, EU Law, 421.
[84] *Id.*, p. 422.
[85] *Id.,* p. 224.

evade the lack of jurisdiction of investment tribunals to review EU measures.[86] But, this option still gives a small margin of appreciation to those tribunals. However, now that the EU has the exclusive jurisdiction on FDI, it is expected that a binding dispute settlement system covering the EU will be developed.

40. If a system of divided competence is established and there is a binding jurisdiction covering the EU there would be two mechanisms in order to determine to whom the wrongful act is attributed. The first is to allow the international tribunal to apply rules on international responsibility and EU law – the constituting treaties – in order to determine who is responsible. According to the TEU EUMS are not allowed to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided in the TEU. The EU however has such a power.[87] Nevertheless it seems highly unlikely that it would choose this option. The second and more probable option would be to allow the claimant to request who should be the responding party, as it happens in the ECT.

III. The WTO Option: Allocation of Responsibility in a system that does not Distinguish the Origin of the Measure

- In these agreements, there is no distinction between the rights and obligations of the EU and its MS and therefore there can be joint responsibility in case of an international wrongful act
- In such mixed agreements it is not necessary to distinguish under whose competence a specific measure falls. This could be done at the EU internal level if it would appear necessary to arrange affairs between the EU and the MS to know where the wrongful measure originated
- WTO Members can bring claims against an individual EUMS but in all cases the EU takes up the defense for its EUMS. If the EU is then condemned, there is joint liability. For this reason there has not been a lot of discussion regarding the allocation of responsibility between the EU and MS in the WTO
- This appears to be the best option in future EU IIAs, because once a wrongful act is determined, it is not necessary to determine whether the act was attributable to the EU or to a MS. This would be a novelty in international investment law.

[86] *AES Summit Generation Limited and AES-Tisza Erőmű Kft. v. Republic of Hungary*, ICSID Case No.ARB/07/22, and *Electrabel S.A. v. Republic of Hungary*, ICSID Case No.ARB/07/19.
[87] TEU Article 344 (ex Article 292 TEC).

41. Under this type of agreements both the EU and its MS have rights and obligations and those of the EU are not distinguished from those of its EUMS. Thus, it can be said that there is a joint responsibility in the performance of the obligation contained in the treaty. This combination was acknowledged by the ECJ in one of the cases *Parliament v. Council*, concerning a treaty establishing cooperation that was concluded by the EC and its MS, on the one side, and several non-member States, on the other side. In that case Court found that:

> "In those circumstances, in the absence of derogations expressly laid down in the Convention, the Community and its Member States as partners of the ACP States are *jointly liable to those latter States for the fulfillment of every obligation* arising from the commitments undertaken, including those relating to financial assistance."[88] (Emphasis added).

42. The WTO Agreement falls within this category, since both the EU and its MS are parties to the treaty and there is no allocation of competences. In the *Hermès* case the Court found that in the WTO agreement, which is a mixed agreement, there was no specific allocation of competences and obligations towards third country WTO members. Thus, under the WTO Treaty both are jointly responsible and supposed to comply with the obligations included therein. This does not imply that sometimes the measures at stake are those of individual MS. In the WTO some cases against the EC/EU refer to measures undertaken by EUMS. An example of this situation was *EC-Asbestos*, in which the European Communities was the responding party, although the measure at issue was being maintained by one Member State, France.[89] A similar situation has arisen in the panel proceedings concerning *EC - Measures Affecting the Approval and Marketing of Biotech Products*, where the panel stated:

> Concerning the third category - the member State safeguard measures - we note that this category consists of nine distinct measures taken by six different EC member States, namely, Austria, France, Germany, Greece, Italy and Luxembourg… It is important to note that even though the member State safeguard measures were introduced by the relevant member States and are applicable only in the territory of the member States concerned, the European Communities as a whole is the responding party in respect of the member State safeguard measures. This is a direct consequence of the fact that the Complaining Parties have directed their complaints against the European Communities, and not individual EC member States. [90]

43. It is possible for WTO Members to bring claims individually against EUMS, as it has

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[88] Case C-316/91. Judgment of 2 March 1994, *European Court of Justice Reports*, 1994, p. I-625 at pp. I-660-661.

[89] *EC - Measures Affecting Asbestos and Asbestos-Containing Products* - Report of the Panel, 18/09/2000, WT/DS135/R, paras. 2.3 and 3.4.

[90] *EC - Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R and WT/DS293/R, adopted on 29 September 2006, para. 7.101

happened in a number of cases. [91] But in all such cases the EC decided to take up the defense for the MS. Perhaps because of this situation in the WTO, there has not been a lot of discussion regarding the allocation of responsibility between the EU and MS. Nevertheless, by its practice the EU appears to acknowledge and adopt a conduct which would not be attributable to them under international law.[92] In any statement made on behalf of the EC in an oral pleading before a WTO panel the EC declared that it was:

> "ready to assume the entire international responsibility for all measures in the area of tariff concessions, whether the measure complained about has been taken at the EC level or at the level of Member States".[93]

44. The necessity to distinguish the competences of the EU from that of its MS could resort in a later stage at the EU internal level: e.g. if a MS enacted some legislation that provoked a ruling against the EU, it can be expected that its effects have to be analyzed inside the EU, for instance, to see if there is any responsibility towards the Union. Here community legislation would apply.

45. This system of joint liability seems to be the most appropriate for future IIAs. Externally it guarantees states and investors that they have the possibility to bring a claim against any IIA-inconsistent measure without fearing an internal battle within the EU on who is liable. And internally it leaves the EU and its MS the freedom to work out a mechanism in which responsibility can be allocated to MS who would have to pay for the award if they were responsible for the wrongful measure. Because in mixed agreements it can be unclear for third states or investors who is actually liable, full joint external liability is the most appropriate way to counter this problem. The European Commission realises this and following the EU's positive experience in the WTO, they are envisaging such a system for future IIAs.[94] The problem with this option is that, as this system would be completely new in international investment law, the existing investment dispute settlement systems and enforcement

[91] MS of the EC/EU acted as respondent before the DSB in the following cases: France, (*France — Certain Income Tax Measures Constituting Subsidies*, DS131, *France — Measures Relating to the Development of a Flight Management System* DS173 (this complaint is identical to the one addressed to the EC (WT/DS172)), Greece: *Greece — Enforcement of Intellectual Property Rights for Motion Pictures and Television Programs*, DS125, *Greece — Certain Income Tax Measures Constituting Subsidies*, DS129; Ireland : (*Ireland — Customs Classification of Certain Computer Equipment* DS68, DS82, DS130), Netherlands: case DS128, Portugal: case DS37, Sweden: case DS86, United Kingdom: case DS67..

[92] See Article 8 of the ILC Draft articles on responsibility of international organizations, "International Law Commission, Report on the work of its sixty-first session" (4 May to 5 June and 6 July to 7 August 2009)

[93] Unpublished document, quoted in "International Law Commission, Report on the work of its sixty-first session" (4 May to 5 June and 6 July to 7 August 2009), p. 75.

[94] Interview with Tomas Baert, Directorate General for Trade, Services and Investment, Graduate Institute Geneva, 27 April 2010.

mechanisms would not be able to apply.

Chapter 4 : Dispute Settlement in Future EU IIAs

I. The Role of Internal Dispute Settlement Mechanisms

A. Recourse to MS tribunals

- IIAs normally give the option to investors to resort to the tribunals of the host state or to resort to international arbitration to settle a dispute. In this line, the ECT gives the investor the choice between the tribunals of the host state, international arbitration, or other mechanisms previously agreed upon.
- Nevertheless, foreign investors usually prefer to resort to international mechanisms
- In the case of EUMS, national tribunals do not have jurisdiction to analyze the legality of EU measures

46. Disputes involving foreign investors can normally be resolved by recourse to the local tribunals of the state in which the investment was made or under the mechanisms provided for in international law. Customary international law provides for the possibility of a state to resort to diplomatic protection in favour of its nationals. In addition, investment treaties normally recognise the possibility for investors to initiate proceedings directly against host countries in two ways: they give the choice to either opt for the local courts of the host state or to resort to international arbitration.[95] Following the example of most BITs, the Energy Charter Treaty provides that if a dispute was not settled amicably during a period of three months the investor may choose to submit the dispute to: i) the tribunals of the State party in the dispute, ii) any previously agreed dispute settlement procedure; iii) the dispute settlement mechanism provided for in the treaty.[96] If an investor in the ECT chooses one of the dispute settlement mechanisms, this does not preclude it from resorting to the other mechanisms,

[95] For example, the Argentina-United States BIT provides that in case of investor-state disputes which cannot be resolved by consultations or negotiations, investors can submit the dispute to: i) the tribunals of the State party in the dispute, ii) any previously agreed dispute settlement procedure; or 3) the dispute settlement mechanisms provided for in the treaty (ICSID, ICSID Additional Facility Rules, UNICTRAL Arbitral Rules, or to any other arbitral mechanism agreed upon between the parties).*Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment*, done in Washington the 14 of November 1991, Article VII, 2. It is understood that once the investors chooses one mechanism the others are precluded. This is commonly known as the fork in the road principle. *C. Schreuer*, Travelling the Bit Route—Of Waiting Periods, Umbrella Clauses and. *Forks in the Road*, 5 *The Journal of World Investment and Trade* 231 (2004),

[96] Energy Charter Treaty, Article 26. Those mechanisms are arbitration under the ICSID Convention, in accordance to the ICISID additional facility rules, under the UNCITRAL Arbitration Rules, arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.

unless the contracting party expressly opposed such a possibility.[97]

47. Nevertheless, foreign investors usually prefer to resort to international mechanisms, arguing that it is cheaper for them to litigate before international tribunals than before local ones, or because it is believed that local tribunals are both a sort of judge and party in the proceedings. Host states on the other hand, prefer these kinds of disputes to be resolved by local tribunals because they consider those tribunals are best placed to analyse the facts of investment disputes and that the principle of separation of powers would guarantee the independence of its judicial branch.

48. In the particular case of EUMS, the major limitation we can find is that MS national tribunals do not have jurisdiction to analyze the legality of EU acts or legislation. According to TEU Article 19 (3)(b), the only possibility local courts or tribunals of the MS have, is to request the CJEU for a preliminary ruling "on the interpretation of Union law or the validity of acts adopted by the institutions".[98] The TFEU establishes a system of review of measures of the EU. Article 267 (ex Article 234 TEC) provides that the CJEU has jurisdiction to give preliminary rulings "on the interpretation of the Treaties" and "on the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union." The article also states that if those questions are raised before a court or tribunal of a MS, that court or tribunal may request the Court to give a ruling thereon. Under this mechanism, individuals have the right to challenge the validity of measures on disputes being dealt with at the domestic level. One of the difficulties is that individuals are obliged to convince the national court to send a question of validity to the CJEU.[99] Types of EU rules that can be subject to judicial review include Regulations, Directives and Decisions. But private applicants are not entitled to instigate a direct challenge to relevant Union measures once promulgated. Instead they are required to wait until a decision is made by a national implementing authority.[100]

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[97] Contracting parties listed in Annex ID of the ECT do not give such unconditional consent. Is it interesting to see that 24 contraction parties (including the EC) plus the United States and Canada are included in such list, but not all the EU members are included in the list.

[98] TEU Art. 19 (3) provides:
"The Court of Justice of the European Union shall, in accordance with the Treaties:
(a) rule on actions brought by a Member State, an institution or a natural or legal person;
(b) give preliminary rulings, at the request of courts or tribunals of the Member States, on the interpretation of Union law or the validity of acts adopted by the institutions;
(c) rule in other cases provided for in the Treaties."

[99] *See* A. Ward, *Judicial Review and the Rights of Private Parties in EU Law*, 2nd ed. (Oxford: Oxford University Press, 2007), 262.

[100] *Id.*, 286.

B. Recourse to the CJEU

- Under EU law only the CJEU can analyse the legality of EU measures, both in light of the constituent treaties of the EU and of international agreements concluded by the EU
- Under EU law individuals can resort to the CJEU to challenge EU measures. The TFEU provides actions for annulment and damages
- However, there is a presumption that a prejudice to an individual is caused by the implementing measure of the EUMS and not by the EU measure
- It is an open question whether the CJEU will give direct effect to IIAs
- It is expected that if a future IIA recognises the possibility of an investor to resort to internal tribunals it is implicitly empowering such tribunals to give direct effect to the investment treaties
- It would be insufficient for foreign investors if the only possibility for challenging EU measures would be recourse to the CJEU. A new system should be developed.

49. Under EU law only the CJEU can analyse the legality of EU acts or legislation.[101] The CJEU has jurisdiction to analyze whether or not EU measures are in accordance with the constituent treaties, e.g. TEU and TFEU (referred to in the Lisbon Treaty as "the Treaties"). The CJEU is also the only tribunal that can analyze the legality of EU acts or legislation in light of other agreements concluded by the EU, including mixed agreements (as stated in the Declaration for the ECT).

50. The CJEU already in the *Haegeman* case has ruled that once an agreement enters into force, its provisions form an "integral part" of the community law.[102] The CJEU has recognised its jurisdiction to judge the alleged violation of mixed agreements (*Cases Demirel*[103]*, Hermès*[104]*,* and *Christian Dior,*[105]). Thus if a future IIA is concluded in the form of a mixed agreement, it would be possible to resort to the CJEU to judge its violation.

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[101] Pursuant to Art. 344 TFEU (ex Art. 292 TEC) all other methods of judicial settlement are excluded: "Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein." Opinion 1/00 on the establishment of a European common Aviation area []2002] ECR I-3493. See also the *Sellafield*, Case C-459/03; *Commission v. Ireland* [2006] ECR I-4635.

[102] *R. & V. Haegeman v Belgian State*, Case 181-73, Judgment of the Court of 30 April 1974,

[103] *Meryem Demirel v Stadt Schwäbisch Gmünd*, Case 12/86, Judgment of the Court of 30 September 1987. -

[104] *Hermès International v FHT Marketing Choice BV*, Case C-53/96, Judgment of the Court of 16 June 1998, European Court reports 1998 Page I-03603.

[105] *Parfums Christian Dior SA v TUK Consultancy BV and Assco Gerüste GmbH and Rob van Dijk v Wilhelm Layher GmbH & Co. KG and Layher BV*, Judgment of the Court of 14 December 2000, European Court reports 2000 Page I-11307.

51. Under EU law individuals can resort to the CJEU when they consider that an EU measure is not in accordance with the Treaties. TEU Art. 19.3 (a) provides that the CJEU in accordance with the Treaties shall rule on actions brought by a Member State, an institution or a natural or legal person.[106] Nevertheless, it must be taken into account that the CJEU departs from the principle that when individuals believe that they suffered a prejudice by virtue of an EU measure, the responsibility of MS by their implementation of Union measures must be analyzed first (*Francovich et Boonifaci c. Italie*,[107] *Factortame,*[108]).

52. TFEU Article 263 (ex Article 230 TEC) regulates the action for annulment, empowering the CJEU with the possibility of reviewing the different acts of EU institutions and MS. The grounds for annulment are "lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers".[109] This article allows natural or legal persons to institute these proceedings if the measures are "addressed to that person" or whether they satisfy the requirement of "direct and individual concern", something that is not easy to fulfil.[110]

53. A future EU IIA could be the basis for a claim of damages before the CJEU. Craig and De Búrca consider that "[s]ince international agreements concluded by the community are binding upon it, a violation of their provisions may, in principle, form the basis for an action in damages under [the TFEU Article 340 (ex Article 288 TEC)]." [111] However, those authors recognise that so far no such action has been successful, because most of the cases brought have been based on the alleged violation of the WTO Treaty and the ECJ has consistently held that the provisions of the WTO agreements do not form part of the rules by which the ECJ can review the legality of acts adopted by the community institutions.[112] The CJEU thus does not

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[106] TEU Art. 19 (3) provides:
"The Cour t of Justice of the European Union shall, in accordance with the Treaties:
(a) rule on actions brought by a Member State, an institution or a natural or legal person;
(b) give preliminary rulings, at the request of cour ts or tribunals of the Member States, on the interpretation of Union law or the validity of acts adopted by the institutions;
(c) rule in other cases provided for in the Treaties."
[107] *Andrea Francovich and Danila Bonifaci and others v Italian Republic*, Joined cases C-6/90 and C-9/90, Judgment of the Court of 19 November 1991, European Court reports 1991 Page I-05357.
[108] *Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport,* 1996/03/05, C-46/93.
[109] *See* TFEU Article 263.
[110] *See* Ward, *Judicial Review and the Rights of Private Parties in EU Law*, 254.
[111] Craig and De Búrca, *EU Law*, 215.
[112] *Ibid.*

give direct effect to WTO Law.

54. It is a mystery whether the CJEU would take a similar reasoning regarding a future EU IIA. This uncertainty would also support the necessity of an extra EU binding dispute settlement system for investment disputes. However it is expected that if a future IIA recognises the possibility of an investor to resort to internal tribunals, it is implicitly empowering such tribunals to give direct effect to the investment treaties. In the case of the ECT, the EC expressly recognised the jurisdiction of the ECJ on disputes regarding the application and interpretation of the constituent treaties or acts adopted thereunder.[113]

55. The aforementioned rules could be used by investors when claiming the violation of a standard in a future EU IIA. However, if a new system is developed with a binding jurisdiction to judge EU measures it is doubtful that investors would prefer to resort to the CJEU.[114]

II. The Role of Existing Investor-State International Dispute Settlement Mechanisms

- If there is a distinction between EU and EUMS responsibility (ECT) in future mixed agreements, existing investor-state dispute settlement systems can still play an important role
- The EU could not be a party to the ICSID Convention without its amendment
- The ICSID Additional Facility Rules are reserved to disputes between states and nationals of other states

[113] It is stated in the Declaration:
"The Court of Justice of the European Communities, as the judicial institution of the Communities, is competent to examine any question relating to the application and interpretation of the constituent treaties and acts adopted thereunder, including international agreements concluded by the Communities, which under certain conditions may be invoked before the Court of Justice.
Any case brought before the Court of Justice of the European Communities by an investor of another Contracting Party in application of the forms of action provided by the constituent treaties of the Communities falls under Article 26(2)(a) of the Energy Charter Treaty. Given that the Communities' legal system provides for means of such action, the European Communities have not given their unconditional consent to the submission of a dispute to international arbitration or conciliation."
" Statement submitted by the European Communities to the Secretariat of the Energy Charter Treaty pursuant to Article 26. (3) (b) (ii) of the Energy Charter Treaty", *OJ L* 336, 23.12.1994, p.115

[114] Referring to international disputes where third States allege the responsibility of the EU on account of an international wrongful act, Tomuschad considers that third States will be dissatisfied if the sole remedy is resorting to the ECJ, since the EU would throughout its court become *judex in re sua*, notwithstanding the fact that the Court is an independent institution. *See*, "The International Responsibility of the European Union," at p. 190.

- Other arbitration mechanisms such as UNCITRAL Rules and arbitration before the ICC were designed to apply to commercial arbitrations and do not cover the public interests attached to State arbitrations (involving a State as a disputing party), such as requirements regarding public notice of proceedings, access to documents, open hearings, and amicus curiae briefs only to State arbitrations.
- Those mechanisms, however, are more flexible and would allow adapting the procedure in order to allow the EU to be a party in a proceeding,
- In addition the rules on transparency of the existing dispute settlement mechanisms are not in accordance with the requirements of the TEU

56. In the case the EU opts for a mixed IIA which creates a system that distinguishes the origin of the measure – similar to the system of the ECT – two situations should be distinguished: (i) where the targeted measure is one of an EUMS, the classic dispute settlement mechanisms could be applied, and (ii) when the targeted measure is one of the EU, the creation of new mechanisms or the adaptation of old ones is required.

57. Arbitration under the ICSID Convention is one of the most used mechanisms to solve investor-state disputes. The ICSID Convention provides an institutional mechanism with a secretariat with the power to administer each *ad hoc* arbitration. The main advantage for investors is that the arbitral awards are final and directly enforced before the national courts. One of the main disadvantages of the Convention is that there is no system of appeal in order to harmonize the case-law, only a system of annulment is provided.[115] In addition, it has no rules on transparency and the arbitration selection process and the process for the challenge of arbitrators is very disadvantageous. The Convention is conceived to settle legal disputes arising "between a Contracting State ... and a national of another Contracting State."[116] This means that it would not be possible for the Union to become a party to the ICISID Convention without the amendment of the Treaty. Thus, measures adopted by the European Union would

[115] Article 52(1) ICSID Convention provides: "Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds: (a) that the Tribunal was not properly constituted; (b) that the Tribunal has manifestly exceeded its powers; (c) that there was corruption on the part of a member of the Tribunal;
(d) that there has been a serious departure from a fundamental rule of procedure; or (e) that the award has failed to state the reasons on which it is based."

[116] Article 25(1) of the ICSID Convention provides: "The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally."

be outside the jurisdiction of the Centre (this is without prejudice of the possible option that an EU organ would decide that the respondent in a particular case would be a MS or the option that the "implementation" of an EU measure that could fall within the ICISID jurisdiction).

58. Something similar arises with the ICSID Additional Facility Rules. These rules were adopted by the Administrative Council of the Centre in order to allow the Secretariat of ICSID to administer certain categories of proceedings between States and nationals of other States that are not party to the ICSID Convention. However, the EU could not be a party in the proceedings because they are reserved to States and nationals of other States.[117] In the ECT, the EC made clear that in cases of a claim against the EC/EU nor the ICISID Convention neither the ICSID Additional Facility Rules would be applicable.[118] However, it would be possible for the Administrative Council to modify those rules or to create a new set of rules including a REIO (Regional Economic Integration Organization) clause.

59. IIAs normally include other arbitration mechanisms such as UNCITRAL Rules, arbitration before the International Chamber of Commerce and before the Stockholm Chamber of Commerce. These mechanisms, unlike the ICSID Convention, do not provide a specialised institution on investor-state disputes. They were initially designed to apply to commercial arbitrations and sometimes it is difficult to adapt them to requirements where one of the parties is a state. The most used of these other mechanisms is arbitration under the 1976 Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). The main problem with that system – that could be extended to the rest of these mechanisms – is that it does not cover the public interests attached to State arbitrations (involving a State as a disputing party), such as requirements regarding public notice of proceedings, access to documents, open hearings, and *amicus curiae* briefs only to State arbitrations.[119] In addition, under these mechanisms the awards will be enforced applying the New York Convention. Thus unlike the ICSID, the possible judicial review will be in charge of local tribunals, either in the jurisdiction where the award is rendered or the jurisdiction

[117] *See*, for instance, Article 2 (a) of the ICSID Additional Facility Rules.
[118] "As far as international arbitration is concerned, it should be stated that the provisions of the ICSID Convention do not allow the European Communities to become parties to it. The provisions of the ICSID Additional Facility also do not allow the Communities to make use of them." "Statement submitted by the European Communities to the Secretariat of the Energy Charter Treaty pursuant to Article 26. (3) (b) (ii) of the Energy Charter Treaty," *OJ L* 336, 23.12.1994, p.115
[119] *Revising the UNCITRAL Arbitration Rules to Address State Arbitrations*, CIEL and IISD, February 2007, available at http://www.iisd.org/pdf/2007/investment_revising_uncitral_arbitration.pdf (last visited 5 May 2010).

where enforcement is sought.

60. However, those rules are more flexible and would allow the possibility of adapting the procedure in order to allow the EU to become a party in the proceedings. This seems to have been the opinion of the EC in its unilateral Declaration on the ECT, which only include the ICSID Convention and the ICSID Additional Facility Rules as not applicable to it.

61. Another option would be the amendment of the ICSID Convention. This option is certainly possible; otherwise the Conventions are in danger of becoming out of touch with the reality of international investment relations. The experience in the accession of the EC to the FAO Convention shows that when all other member states are convinced of the importance and usefulness of including a REIO clause in the treaty, even a multilateral treaty can be amended. Whether adopting the ICSID mechanism is desirable is another question. Experience tells us that when negotiations for amending a multilateral treaty are opened, many countries push for their desired modifications. In the case of the ICSID Convention, this could imply opening a Pandora's Box.

III. Is a new hybrid system possible? The WTO DSU as an example

- It would be possible to create a new dispute settlement system based on the WTO DSU
- This new system could be completed with some of the characteristics of existing investor-state dispute settlement systems
- In this new system the EU could be challenged either for its measures or for measures of EUMS . The new system should offer a mechanism of appeal.
- Some issues to keep from existing investment disputes include: the possibility of investors-state claims, the value of awards as a final judgment of an internal court, and the "judicial" component of investor-state arbitrations
- Rules on transparency, public hearings, access to documents, and submission of *amicus curiae* brief should be more developed in a new system

62. It is argued that instead of adapting the existing investment dispute settlement mechanisms, the EU can develop a completely new system taking the WTO Dispute Settlement Understanding (DSU) as a model and completing it with some of the characteristics of existing investment dispute settlement systems. Even if there are many

differences in the rationale and structure of trade law and investment law systems[120], it would be possible to envisage a future dispute settlement mechanism inspired by the WTO DSU.

63. That would imply the design of a new system where the EU can be challenged both for measures of its MS or for measures of the EU. In a system that does not distinguish the origin of the measure, the respondent may always be the EU as is the practice in the WTO. Some of the advantages of choosing this option are that the EU could use the experience gained in the WTO. The main characteristics that could be taken from the WTO DSU and applied in a future EU IIA would include: the option of making a claim to an EUMS or directly to the EU, state-state dispute settlement mechanisms as an additional option to investor-state arbitration, third state intervention in the proceedings and the system of double review.[121]

64. The experience of the WTO in this domain could be very important for the development of a system with panel and appeal for investment cases. It would be possible to establish a first instance with arbitral tribunals similar to those appearing in the traditional investment dispute settlement systems and then allowing recourse to a permanent Appellate Body (similar to that of the WTO) with jurisdiction to review or to annul the arbitral decisions. By installing a system of Panel and Appeal it would be possible to establish a more coherent and predictable investment dispute settlement system and develop a real case-law. There are already examples of States envisaging a system with appeal. For instance the United States in its 2004 model BIT provides for the possibility of establishing a system of appeals. [122] The Central American Free Trade Agreement (CAFTA) expressly mentions the possibility of developing a future appeal system.[123] Similar language was included in US Free Trade Agreements with Chile, Singapore and Morocco.[124] It would also be very important to have the participation of EUMS representatives in the written and oral stages of the proceedings.

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[120] For an in deep analysis of the differences of the trade and investment treaties, see Nicholas DiMascio and Joost Pauwelyn, "Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?" 102 *AJIL* 48, (2008).

[121] For an analysis of the advantages of a system of appeal for investment arbitrations *see Improving the System of Investor-State Dispute Settlement: An Overview*, OECD Working Papers on International Investment, Number 2006/1, February 2006.

[122] Annex D of the 2004 US model BIT (Possibility of a Bilateral Appellate Mechanism) provides "Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism."

[123] See *Central American Free Trade Agreement,* Chapter 10.

[124] Annex 10-H of the US-Chile Free Trade Agreement, signed on June 6, 2003; US-Singapore Free Trade Agreement, concluded on January 15, 2003, Annex 10-D of the US-Morocco Free Trade agreement, signed on June 15, 2004.

Besides that in the WTO it is the EC/EU who has always acted as the respondent, even when the contested measure was one adopted by a member State. However, sometimes the representatives of the relevant Member States are part of the EC delegations present at the meetings of the Panel with the Parties or the EC submits documents it has obtained from the Member States concerned as part of its defense.[125]

65. At the same time, some characteristics of investment arbitration mechanisms should be included in a future IIA in order to develop an effective and sophisticated system. These are mainly: the possibility of investors-state claims, the causes for annulment contained in the ICSID and New York Conventions, the obligation to recognize and enforce the award as if it were a final judgment of the court in that State without the possibility to apply other remedies that are established in the IIAs. Another very important aspect that should be included in future EU IIAs is the "judicial" component of investor-state arbitrations, such as the possibility to invoke jurisdictional and admissibility objections, the way in which hearings are developed, the use of witnesses and experts and the possibility to cross examine them.

66. Together with the insights of the WTO and the investor-state dispute settlement system it would be necessary to develop some rules that are in a state of infancy in both systems. Especially rules on transparency, public hearings, access to documents, and submission of *amicus curiae* should be developed more taking into account that there are now specific rules in the ToL that require for that.

[125] *European Communities - Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R and WT/DS293/R, report adopted on 29 September 2006,.

Proposed main characteristics of a hybrid system of investment protection involving the EU

Aspects from the WTO Treaty	Aspects from current IIAs	Aspects to develop
• Challenge the EU for measures of the EUMS (joint liability) • Binding jurisdiction for the EU • Period of consultations • State-state dispute settlement • System of double review • Permanent appellate body? • Standards of review (DSU 17.6) • Third-state intervention • Follow up of the compliance whit the award	• Option to resort to local courts • Rules on jurisdiction • Rules on applicable law • Preliminary objections • Investor-state dispute settlement • Causes of annulment • Enforcement of the award	• Rules on transparency • public hearings • access to documents • and submission of amicus curiae briefs

IV. State-state Dispute Settlement Mechanisms as an Option for Investment Disputes?

- Most of the attempts to establish state-state dispute settlement mechanism in IIAs have failed
- IIAs usually provide for state-state dispute settlement mechanism only for disputes regarding the interpretation and application of the treaty
- Even though state-state DS could be included as an option available to states in a future EU IIA, it is unlikely that this system could substitute investor-state arbitration

67. State-state dispute settlement mechanisms are normally used when states decide to exercise diplomatic protection. This is also the system through which disputes involving the WTO agreement are resolved. However, this system has had a secondary role in investment treaties.[126] The experience in this domain of state-state arbitration in order to protect the rights of investors, is very poor.[127] According to Zachary Douglas, "[t]he only example of a state/state arbitration to date has arisen under the Peru/Chile BIT."[128]

[126] This mechanism is usually included in investment treaties in order to resolve disputes concerning the interpretation or application of the treaty between the contracting parties. This has been the situation until now in most BITs which contain clauses in this sense. The ECT provides a system for disputes concerning the application or interpretation of the Treaty towards an *ad hoc* tribunal where the EU can be party. *See* ECT Article 27.

[127] Jamal Seifi, *Investor-State Arbitration v State-State Arbitration in Bilateral Investment Treaties*, *TDM* Vol. 1, Issue #02 - May 2004.

[128] Here an investor from Chile alleged a violation of the Peru-Chile BIT against Peru. As a reaction, Peru started the state/state dispute mechanism to retrieve an interpretation of the BIT which would favour it in the invester-

68. In addition most of the attempts to establish this type of proceedings have failed. State-state arbitration was analysed by the Negotiating Group on the Multilateral Agreement on Investment (MAI)[129], a failed attempt of establishing a multilateral investment treaty. However, in a later version of the draft agreement, the option of state-state arbitration did not remain.[130] The option of state-state arbitration for resolving investment disputes was also considered by Canada during the NAFTA negotiations in the early 1990s. However, that state changed its view during the negotiations.[131] In addition, state-state arbitration in investment disputes is not possible in the framework of the ICSID Convention. Article 27 (1) provides:

> No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

69. As Schreuer explains bringing an international claim is "a typical element of diplomatic protection" and the reason for the phrase "international claim" in Article 27 "is the existence of arbitration clauses in many bilateral investment treaties (BITs) for the settlement of disputes between the States parties to the treaties. This opens the possibility of two different arbitration procedures arising from the same claim: one under ICSID between the investor and the host State, the other between the two States based on the alleged violation of the investment treaty."[132] Besides that, state-state arbitration was included in some agreements, such as the Olivos Protocol for the Settlement of Disputes in MERCOSUR of 2002.[133]

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state case. This succeeded and eventually the claim of the Chilean investor failed. Zachary Douglas, p.xxx. *See*: *Lucchetti v Peru* (Preliminary Objections) 12 *ICSID* Rep 219, 221/ paragraph7.

[129] Unclassified DAFFE/MAI/EG1(96)9/REV1, *Organisation for Economic Co-operation and Development* 11 October 1996, available at http://www1.oecd.org/daf/mai/pdf/eg1/eg1969r1e.pdf (last visited 2 May 2010).

[130] *See*, The Multilateral Agreement on Investment, Commentary to the Consolidadted Text, OECD, DAFFE/MAI(98)8/REV1, 22 April 1998, available at http://www1.oecd.org/daf/mai/pdf/ng/ng988r1e.pdf, (last visited 2 May 2010).

[131] R. Pacquing, *Investor-state arbitration: Canada's experience in NAFTA and the case for its inclusion in the Australia-US FTA*, Issues Paper No. 25, 2003. In the case of NAFTA state-state arbitration is reserved only to the case in which government fails to abide by an award. *See* Article 1136.5 of the NAFTA Treaty.

[132] Christoph Schreuer, *The ICSID Convention: A Commentary: A Commentary on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 2nd ed. (Cambridge: Cambridge University Press, 2009), 322.

[133] In chapter XI, articles 39 to 44 of the agreement, dealing with claims by private persons, a two-step approach is introduced, requiring a first stage of consultations and reviews that may already put an end to the dispute. If this is not successful, then State-State procedures will be initiated as a second step. See Olivos Protocol for the Settlement of Disputes in Mercosur of 2002, art. 44.

70. Perhaps the main obstacle of state-state arbitration is the existing practice of investor-state arbitration. The main advantage of investor-state arbitration for investors is that they do not need to depend on political considerations which a state will always take when deciding whether or not to initiate an investment claim on behalf of a national. The main advantage for states is that they will not need to use its resources to pursue the claim of a private investor and that they do not risk potential political conflict with the host state. [134]

71. In our view, a state-state system is highly unlikely to substitute the system of investor-state arbitration provided for in most BITs. This would be seen as a backward step that neither investors nor the international community would profit of and thus be able to accept. However, the option for a state to resort to state-state dispute settlement should be included in a future EU IIA.

[134] Rafael Pacquing, *Investor-state arbitration: Canada's experience in NAFTA and the case for its inclusion in the Australia-US FTA*, Issues Paper No. 25, 2003, p. 35.

Chapter 5: Enforcement of Awards after the ToL

I. Enforcement of Awards under the New York Convention

- Enforcement of awards in the context of new EU IIAs will be possible under the New York Convention
- However the amendment of the treaty would be desirable in order to better deal with awards against the EU
- Member States disregarding EU law could be a ground to set aside the award when it is being enforced before local courts
- Awards against the EU may be implemented by the Union's institutions as it happens under the ECT
- It would be necessary to establish EU regulation to deal with this situation

72. The enforcement of awards according to the NY Convention is applied when investors resort to UNCITRAL Rules, ICSID Additional Facility Rules, arbitration in the framework of the ICC or that of the Stockholm Chamber of Commerce, among other mechanisms. Under the New York Convention, awards are subject to judicial review before the national tribunals of the jurisdiction where the award is rendered or of the jurisdiction where enforcement is sought. [135] The NY Convention would be still applicable in a new context where arbitral awards are rendered according to a future EU IIA. However, it is probable that respondents will invoke the *EcoSwiss* doctrine in order to challenge the award before local courts when there is a link between the award and the public policy of the Union.

73. In the *EcoSwiss* case (which involved a commercial arbitral award), the respondent wanted to set aside an arbitral award before the tribunals of Netherlands according to Article V.2(b) of the New York Convention (an award contrary to the public policy of the country). The ECJ considered that competition law contained in the TEC (now Article 101 of the TFEU) "constituted a fundamental provision which was essential for the accomplishment of the tasks entrusted to the Community and…the functioning of the internal market."[136] The Court concluded that "a national court to which application is made for annulment of an arbitration award must grant that application if it considers that the award in question is in fact

[135] Article V of the New York Convention provides the causes under which and award can be challenged before the local courts of a contracting party.
[136] *Eco Swiss China Time Ltd v Benetton International NV* (Case C-126/97) - [1999] All ER (D) 574, para. 36

contrary to [Article 101], where its domestic rules of procedure require it to grant an application for annulment founded on failure to observe national rules of public policy."[137] Thus, under this doctrine, an arbitral award disregarding EU law is unenforceable under public policy exceptions recognized by either national law or international law.[138] This would become an obstacle if an investor wants to enforce an award which dealt with EU law since having applied EU law not correctly by a member state could become a cause of annulment of the award.

74. If a system is established where the EU can be found responsible for an international wrongful act affecting an investor, then it would be the EU who would have to pay. However, there are no special mechanisms provided for in these cases. It is not clear how the recourse to the New York Convention could be implemented in those cases. It is presumed that for these reasons the contracting parties in the ECT included a particular clause dealing with the enforcement of awards. Article 26(8) of the Energy Charter Treaty provides:

> The awards of arbitration, which may include an award of interest, shall be final and binding upon the parties to the dispute. An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted. Each Contracting Party shall carry out without delay any such award and shall make provision for the effective enforcement in its Area of such awards.

The position of the EC in the ECT has been that an investment award against the EC would be implemented by the Communities' institutions:

> Any arbitral award against the European Communities will be implemented by the Communities' institutions, in accordance with their obligation under Article 26(8) of the Energy Charter Treaty.[139]

It could be expected that the EU will have a similar position regarding awards against it in a future EU IIAs. However, a more sophisticated enforcement system could be expected, since the EU measures will increasingly be the concern of foreign investors.

II. The Enforcement of Awards Under the ICSID Convention

- The enforcement of awards according to the ICSID Convention is only applicable to ICSID awards
- It would be applicable in a scenario where an EU IIA contemplates awards against EUMS

[137] *Id.*, Operative part.
[138] Eilmansberger, "Bilateral Investment Treaties and the EU Law," 427.
[139] "Statement submitted by the European Communities to the Secretariat of the Energy Charter Treaty pursuant to Article 26. (3) (b) (ii) of the Energy Charter Treaty", *OJ L* 336, 23.12.1994, p.115.

- However, there could arise some difficulties in implementing this enforcement system
- Yet, the recognition of an award as it were a final judgment of an internal court and its the review by international tribunals could be kept it in future IIAs

75. The enforcement of awards under the ICSID Convention is applicable only to arbitral awards rendered according to the Convention. In addition the Convention provides a self-contained system of annulment and there is no possibility of challenging the award before the local courts.[140] The Convention provides that each Contracting State shall recognize an award rendered pursuant to the Convention as binding and as if it were a final judgment of a court in that State.[141] A party seeking recognition or enforcement in a Contracting State shall resort to the competent court or authority and the execution of the award shall be governed by the laws concerning the execution of judgments of the State where execution is sought.[142]

76. The enforcement according to the ICISID Convention could be applicable in a scenario of a future EU IIA where the investor keeps the possibility of making a claim against an EUMS. However, the implementation of those articles could bring some problems. They do not envisage what would happen when regional economic international organizations like the EU are involved. For instance Article 54(1) provides that an award must be enforced "as if it were final judgment of a court in that State". This article does not cover the relationship between CJEU judgements which technically speaking are not a final judgement of the court of that state. So, what would happen if there is a contradiction between the arbitral award and a judgement of the CJEU? Which one would prevail? Should an arbitral award be considered as being a final judgement of the CJEU? These are problems that could arise if an investor wants to enforce an arbitral award against an EUMS.

77. A possibility would be to establish a new system of enforcement in a future EU IIA or to enact some measure (for example a regulation, declaration or any other) at the EU level which could clarify the relationship between national and EU tribunals for the effects of the ICSID Convention. Perhaps the simplest solution would be to include *mutatis mutandis* the wording of articles 53 and 54 of the ICISID Convention in a future EU IIAs together with a system of

[140] Article 53(1) of the Convention provides: "The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention."
[141] Article 54(1) of the ICSID Convention.
[142] Article 54(2) and (3) of the ICSID Convention.

appeal or a system of annulment.

III. What if an EUMS Refuses to Pay for an Award

- The TFEU provides remedies in case an EUMS refuses to comply with an arbitral award
- The Commission, other EUMS and investors could resort to these mechanisms

78. Situations where an EUMS refuses to pay an award against it could arise in case of future EU IIAs where international responsibility is allocated either to the EU or to a EUMS (an ECT like system). The state could for example argue that it does not have the funds to pay the award because of a financial crisis, or that the award is unfair.

79. One possibility would be to use the existing EU mechanisms. In those situations the Commission may initiate an infringement procedure under TFEU Article 258 (ex Article 226 TEC) -and other MS may do so under Article 259 (ex Article 227 TEC)- when it considers that one of the States has failed to respect the obligations contained in an international agreement of the Union. This is also true with regards to the WTO agreements even though, in *Portugal v. Council*, the ECJ considered that they are not among the rules which Member States may invoke to claim the illegality of the Community acts.[143] If one would wonder why the EU would have to intervene when international responsibility has been allocated to a Member State and this Member State is thus the legally responsible, the system follows from the duty of cooperation and the principles underlying this duty. Investors would also have the option to resort to the CJEU if a MS refuses to pay an award by alleging that a MS does not comply with a "mixed agreement" trough the mechanism of preliminary rulings (see supra, Chapter IV).

II. The Origin of Funds if the EU were to Pay for an Award

- The situation may arise in a system where EU can be condemned for measures of the EU organs or for measures of EUMS
- In case of awards against EU measures, it will be possible readapt the proceedings for claims of damages before the CJEU or to establish a new system
- For awards against the EU for EUMS measures a new system should be established at the EU level to make the faulty Member State end up paying

[143] Craig and De Búrca, *EU Law*, 284.

80. In case of awards against measures of EU organs, it will be possible to follow the standard proceeding used when the EU is condemned by the CJEU to pay damages.[144] Another possibility will be to establish a specific system to deal with this situation, for instance by simply taking the financial need to pay the award from the own resources of the Union. On average it holds 1613.0 million EUR from agricultural and sugar levies and 10749.9 million EUR from customs duties. This is respectively 1.5 and 10.1% of its budget.[145] However, a budget line to deal with the payment of "unexpected" internal or international awards should be added to the Union's budget. Only this would give it the flexibility it needs for the independent payment of investment awards.

81. In case of an award against the EU for measures adopted by an EUMS, the duty to pay the award would also lie with the Union in a WTO like system. But then there should be a process available to make the faulty Member State end up paying. This sort of compensation process should be designed at the internal level of the EU. One option could be to simply add the financial compensation the Union will have to pay for an award against a Member State measure to the contributions this Member State has to pay to the Union for the budget of the following year. This system should be ideally translated into EU legislation. This would give the Commission legal certainty it would receive back the financial burden it will have to carry when paying the award and ensures the possibility of recourse to the CJEU if a Member State would not pay. However, this last seems very unlikely, as the faulty Member State knows that all other Member States would not accept the situation in which each of them has to pay for the award via their contributions to the EU budget. The EU could also take the example of some federal states in which there are no specific arrangements for when a measure of a subdivision of that state (for example provinces in Canada) was challenged in a proceeding. When an award is rendered, the EU could just request the Member State that enacted the wrongful measure to pay for the award.

[144] See TEU Article 340 (ex Article 288 TEC) and TEU Article 268 (ex Article 235 TEC) and, second sentence
[145] Nicolaides, P. and Talsma, F., *Financing the Union: Options for reform,* EIPASCOPE 2005/2, 27-34, available at: http://aei.pitt.edu/5948/01/SCOPE2005-2_4.pdf, (last visited 2 May 2010).

Conclusion

Future EU IIAs will contain both liberalization and protection provisions. We believe it is in the interest of the Union and its Member States to conclude IIAs, including the full scope of standards of treatment and possibly also portfolio investments. These investment provisions can be included in FTAs. However, in developing its external FDI policy, the EU should keep in mind that also BITs might be necessary in case the possible negotiation of an FTA lies somewhat more difficult at the time (e.g. China). The conclusion of IIAs should be subject to an enhanced sustainable impact assessment (SIA), which includes human rights among other values. Benefits from IIAs should be blocked if grave violations of SIA provisions are found. If IIAs include portfolio investment or investment provisions are included in FTAs the agreement should be mixed. If not, the necessity for mixity will depend on the nature and extent of protection clauses. In our view, there are strong arguments for the conclusion of an IIAs as a mixed agreement when the full scope of standards provided for in current BITs would want to be included.

For the allocation of international responsibility a WTO like system seems the best option. The EU and its Member States have experience with this system and it has proven to be effective. Also for third states it is attractive because this implies joint external liability without internal battles on who is responsible or competent in case of proceedings. Foreign investors could challenge both EU measures and MS measures. A system of joint responsibility would be a novelty in international investment law and would offer a major opportunity to improve the system. The EU cannot be party to the ICSID Convention and the existing flexible mechanisms (UNCITRAL, ICC, SCC) are not adequate for state/EU proceedings or fit with the principles of the Union (e.g. transparency). Therefore a new system should be developed which allows foreign investors to challenge EU measures and allows the EU to be a respondent. We argue strongly in favour of a system with *ad hoc* arbitration panels and a permanent appellate body. This would make international investment law more coherent and predictable. Automatic enforcement before internal courts would be guaranteed by providing an international review mechanism by the appellate body. Recourse to internal courts (MS for MS measures and CJEU for EU measures) remains possible for foreign investors. IIAs would thus be given direct effect in the legal order of the EU. We encourage the EU not to be over pragmatic and use this opportunity to develop a coherent, predictable and transparent investment dispute settlement system with panel and appeal.

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