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Long-Term Power Purchase Agreements (PPAs) and European Legislation

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Table of contents

1. Introduction

The use of long-term contracts for the supply of energy is common among States, whose main objective in energy policy is consistently to reach an optimal supply of power. The building of energy infrastructure is, in fact, burdensome and technically challenging, and requires substantial amounts of money, which is invested by private companies only if they can profit from their investment. States and foreign investors usually resort to Power Purchase Agreements (PPAs), where the investor builds, operates and maintains a power plant, producing energy, and the State purchases the energy.

In order to promote a favourable investment climate, States have long resorted to investment treaties, either in the form of Bilateral Investment Agreements (BITs) or International Investment Agreements (IIAs). Among the latter, particularly relevant in the energy field is the Energy Charter Treaty (ECT), which provides an important legal basis for the creation of an open international energy market. PPAs are usually based on these investment agreements, as they provide a higher degree of protection for investors not only from a substantive point of view, but also from a procedural one, because they provide for the possibility of investors to bring a claim against a State before an arbitral tribunal, avoiding the need to resort to the State's national courts.

In Europe, the existence of the European Communities (EC) first, and then of the European Union (EU), with the consequent interaction between EU law and international investment law, has not raised many questions until recently. The field of international investment has, in fact, long remained steadily in the hands of the Member States. Moreover, BITs between Western European States have always been rare, and almost all the BITs concluded by EU countries were with third countries.

The original framework has changed following two main events. The first event is the EU enlargement that took place between 2004 and 2007, following which 12 new Member States from Central and Eastern Europe acceded to the EU. These countries had concluded several BITs with EU Member States in the years prior to their accession. After their accession, those BITs became agreements between Member States, namely intra-EU BITs. The second event is the entry into force of the Treaty of Lisbon, which gives the EU exclusive competence in the field of Foreign Direct Investments (FDIs). The investment situation has therefore changed substantially.

With regard to extra-EU BITs the investment framework seems quite clear. Since the entry into force of the Lisbon Treaty, the EU enjoys exclusive competence, and secondary legislation providing for a transitional regime has been approved. However, such legislation has not been complied with by the Member States, with the consequence that the Commission has resorted to the European Court of Justice (ECJ) for the termination of existing BITs between Member States and third countries. This is in apparent conflict with the TFEU provisions, which should not affect extra-EU BITs that were in force before the entry into force of the Lisbon Treaty. However, the ECJ has declared such treaties incompatible with EU law, opening the door for further revisions by the Commission.

The investment framework with regard to intra-EU BITs is, on the other hand, more problematic. There is, in fact, no transitional regime in the accession procedure dealing with treaties of this kind, and therefore they remain in force also after the accession of the State to the EU. These treaties introduce an element of uncertainty as they can contain different provisions from those regulating the internal market. States party to intra-EU BITs find themselves bound by both EU law and BITs, with the risk of choosing to apply one instrument in violation of the other. The Commission has strongly opposed such BITs, arguing that they should be terminated because they are incompatible with EU law. Accordingly, it has rejected the jurisdiction of arbitral tribunals to pronounce on the topic. States have adopted a more cautious, and in the end incongruous, approach. Arbitral tribunals, on the other hand, have considered that intra-EU BITs are still applicable and have held that they are competent to rule on the issue. Although not specifically focused on the energy field, the problem of intra-EU BITs has obvious implications for it. Long-term contracts still find their legal bases in pre-accession BITs, and the issue of the validity of these treaties directly affects the possibility of resorting to the protection mechanisms contained therein.

An additional problem in the energy sector stems from the existence of the ECT. Not only are all Member States party to the treaty, but also the EU itself. It therefore qualifies not only as an intra-EU treaty, but also as an extra-EU one. The position of the Commission with regard to the intra-EU effect of the ECT is similar to its position regarding intra-EU BITs, namely that it has been overcome by EU law. Once again, this is not the view of the arbitral tribunals that have ruled on the matter. The cases dealing with the application of the ECT in the context of intra-EU relations are of particular relevance to the purpose of the present thesis: they deal directly with the issue of long-term PPAs, and describe exactly the problems that exist in the current legal regime.

Furthermore, intra-EU arbitral awards on long-term PPAs have been deemed incompatible with the EU State aid legislation, and therefore the Commission has actively opposed their enforcement. This leads to an additional set of problems, which investors may face in the post award phase and which might lead to negative consequences for the investment environment in the EU.

The above-mentioned issues will be dealt with in more depth in the present thesis. While addressing the different issues, the relevant case law, both by the ECJ and by arbitral tribunals, will be recalled and analysed.

2. Overview of the PPAs

Power Purchase Agreements (PPAs) are contracts between a State, or an entity of the State, and a foreign national or legal person[1], that govern the sale and purchase of power. They secure the payment stream for Build-Own Transfers (BOTs) or concession projects for independent power plants[2]. Usually, they are contracts between a privately owned power producer or project company that generates power for sale, and a buyer or off-taker (often a State-owned electricity utility) that seeks to purchase power[3]. PPAs usually acquire the form of long-term contract[4].

The buyer's main obligation is to pay the agreed tariff in due time. PPAs usually provide for the purchaser to pay a monthly tariff for the available capacity and the electrical output produced by the power plant. The most common approach is the so-called "two-part" approach, which separates the capacity charge, designed to recover the plant's fixed costs, and the energy charge, which covers the fuel costs[5]. PPAs can then provide for the possibility for the private investor to sell to third parties, creating more favourable conditions for the investor in case of future changes, such as market deregulation, or in cases where the purchaser's creditworthiness is questionable, although purchasers are usually reluctant to enter agreements with such a clause[6].

The producer's primary obligations encompass the building, operating and maintaining of the power plant in accordance with the provisions of the contract, and the delivery of the agreed amount of power accordingly[7]. The producer takes the risk of operating the system,

[1] UNCTAD, *State Contracts* (2004), available at http://unctad.org/en/Docs/iteiit200411_en.pdf, at 3 (last visited 8 July 2016).
[2] World Bank Group, *Power Purchase Agreements (PPAs) and Energy Purchase Agreements (EPAs)* (16 February 2016), available at http://ppp.worldbank.org/public-private-partnership/sector/energy/energy-power-agreements/power-purchase-agreements (last visited 7 July 2016).
[3] M. Badissy *et al.*, *Understanding Power Purchase Agreements* (November 2014), available at http://cldp.doc.gov/sites/default/files/Understanding_Power_Purchase_Agreements.pdf, at 24 (last visited 7 July 2016).
[4] D. Lowder in L.G. Golding DeSantis *et al.*, *Exploring Power Purchase Agreements – The Basics Part 1* (2011), available at http://energy.gov/eere/wipo/downloads/exploring-power-purchase-agreements-basics-part-1, at 3 (last visited 9 July 2016).
[5] World Bank and Inter-American Development Bank, Concessions for infrastructure A guide to their design and award (1998), available at http://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp_testdumb/documents/concessions_fulltoolkit.pdf, at 160 (last visited 7 July 2016).
[6] World Bank Group, *supra*, note 2.
[7] M. Badissy *et al.*, *supra*, note 3, at 32. See, for instance, Namibia - Power Purchase Agreement for Medium Scale Wind Power Projects, available at http://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp_testdumb/documents/namibiamediumscaleppawind_I4_RNDRD.pdf, at 8 ss. (las visited 8 July 2016).

and the performance risks. Consequently, if the power plant does not produce energy, the purchaser is under no obligation to pay for what has not been delivered[8]. Additional obligations are then related to the primary ones and very much depend on the circumstances of the case. They can relate, for example, to the payment and performance of security, to arrangements with lenders, and to the attainment of permits or licences and insurance. They are often shared by the parties, but can also shift from one party to another depending on the case[9].

Usually present in PPAs is a set of provisions dealing with damages. The most common provisions deal with delay and underperformance. Damages can be payable for delay, in case the power plant fails to pass the performance test by the commercial operation date. The parties can agree on an amount per day of delay, usually up to a cap, and can provide that inordinate delay entitles the purchaser to terminate the PPA[10]. Damages can also be payable for underperformance, although a purchaser might prefer underperformance to the termination of the PPA, which would require the purchaser to buy out the project[11].

PPAs normally set out conditions precedent to the effectiveness of the obligations under the contract. With regard to the investor, they might include, among others, the acquisition of governmental authorisations or clearances, or the execution of project agreements. Conditions precedent for the purchaser might include the receipt of corporate documents, or evidence of the investor's receipt of governmental approvals[12]. PPAs usually contain pre-operation obligations. These may require the investor to obtain the necessary consents and appoint the construction contractor. They then normally require the purchaser to provide reasonable assistance to the investor. As part of the pre-operation obligations, a PPA usually provides that the parties must agree on the operating procedures[13]. These obligations are not present in contracts concluded in respect of the so-called deregulated

[8] D. Lowder, *supra*, note 4.
[9] M. Badissy *et al.*, *supra*, note 3, at 32-33.
[10] World Bank and Inter-American Development Bank, *supra*, note 5, at 161-162.
[11] *Ibid.*, at 162.
[12] *Ibid.*, at 163. See, for instance, Standardised PPA for large renewable energy generators (greater than 10 MW)(Kenia), available at http://www.renewableenergy.go.ke/downloads/policy-docs/Standardized_PPA_for_Large_Scale_Generators_More_than_10MW.pdf, at 8 (last visited 8 July 2016).
[13] *Ibid.*, at 163.

energy market. In these cases, the power plant already exists or is being constructed at the initiative of the private investor[14].

Provisions regarding the term and termination of the contract are always present in PPAs. The term defines the period during which the agreement is effective[15]. Termination of the agreement can be provided for in a wide range of situations[16]. The investor can be entitled to terminate the contract if, among other things, the purchaser fails to comply with payment obligations or repudiates the PPA. The purchaser, on the other hand, usually has the right to terminate the agreement if, for example, the seller fails to achieve commercial operations or abandons the project[17]. Generally, the termination of the agreement leads to a buyout by the purchaser, triggered by one of the parties depending on the termination event[18].

Particularly contentious are the provisions on force majeure and change in law. With regard to force majeure, parties usually insert a list of events that qualify as force majeure in the contract, such as non-political events (e.g.: natural disasters), domestic political events (e.g.: war, revolution, acts of terrorism) or foreign political events. They provide for a duty on the part of the parties to use reasonable efforts to mitigate the effects of force majeure and stipulate that neither party can be considered liable for the non-performance of its obligations under the PPA as a result of the force majeure event[19].

Finally, always present although often overlooked by the parties at the time of the conclusion of the agreement[20], are the provisions on dispute settlement, which provide for arbitration and specify the applicable rules and the technical aspects of this eventual phase. They can either refer to so-called institutional arbitrations, carried out under the auspices

[14] World Bank Group, *supra*, note 2. For an example of PPA in the deregulated energy market, see: Edison Electric Institute Master Power Purchase & Sale Agreement, available at http://www.eei.org/Search/Pages/results.aspx?k=%20Edison%20Electric%20Institute%20Master%20Power%20Purchase%20%26%20Sale%20Agreement (last visited 8 July 2016).
[15] World Bank and Inter-American Development Bank, *supra*, note 5, at 163.
[16] See, for instance, Power Purchase Agreement (PPA) produced for Pakistan, available at http://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp_testdumb/documents/Pakistan%20PPA%20wind_0.pdf, at 88 ss. (last visited 8 July 2016).
[17] World Bank and Inter-American Development Bank, *supra*, note 5, at 164.
[18] *Ibid.*, at 164.
[19] *Ibid.*, at 169.
[20] See, for instance, the short provision provided in Power Purchase Agreement Between Tri-State Generation And Transmission Association, Inc. And Ripe Touch Greenhouse, Llc., available at http://contracts.onecle.com/ripe-touch/tri-state.svc.1995.03.15.shtml, at Article 28 (last visited 8 July 2016) and the long and thorough part on the dispute settlement contained in Power Purchase Agreement (PPA) produced for Pakistan, *supra*, note 16, at 99 ss.

of international institutions, such as ICSID, the Stockholm Chamber of Commerce (SCC) or the Permanent Court of Arbitration (PCA), or refer to the UNCITRAL rules[21]. In addition, although with limited success, the parties can agree to ad-hoc arbitration.

2.1. State contracts

It should be borne in mind that PPAs are agreements between an investor and a State and therefore differ from ordinary commercial contracts[22]. States enjoy an in-built superiority due to their power to interfere with contracts through the exercise of their sovereign legislative powers[23]. In the absence of an agreement to the contrary, Investor-State disputes are settled by the host State's courts. Investors do not find this solution attractive for a number of reasons, such as fear of a lack of impartiality of State courts against their own State, fear of the fact that domestic courts are bound by the State's law even if it conflicts with international legal rules protecting the rights of investors, or of the fact that the executive might ignore domestic courts' decisions[24]. The courts of the investor's home State and of third countries are not a viable alternative[25]. In addition, State immunity constitutes an additional obstacle: host States frequently act in the exercise of their sovereign powers when dealing with foreign investors. Moreover, if the courts of a country follow the doctrine of restricted immunity, they will uphold immunity even if the State entered the relation in its commercial capacity[26].

States create a more favourable investment environment through BITs or IIAs with other States, in which they usually consent to Investor-State arbitration as a dispute settlement system. As a consequence of the "internationalization" of the State contract, disputes are not submitted to the State's courts. In order to achieve this result, the agreement must be covered by international law, as BITs and IIAs do not automatically cover any matter relating to State contracts[27]. The mechanism used in this case is the definition of "investment" contained in the relevant treaty: the object of the contract must fall within this definition. Furthermore, the breach of the agreement must amount to a violation of

[21] R. Dolzer and C. Schreuer, *Principles of International Investment Law* (2012), at 236 ss.
[22] UNCTAD, *supra*, note 1, at 3.
[23] *Ibid.*, at 5.
[24] R. Dolzer and C. Schreuer, *supra*, note 21, at 235.
[25] *Ibid.*, at 235.
[26] *Ibid.*, at 235-236.
[27] UNCTAD, *supra*, note 1, at 9.

international law, so that it will trigger the dispute settlement provisions; not every breach of a contract by a State automatically amounts to a violation of international law[28].

[28] C. Schreuer, "Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road", 5 *Journal of World Investment & Trade* (2004) 231, at 249.

3. European regulatory investment framework in the field of energy

Before the entry into force of the Treaty of Lisbon[29], the field of FDIs was an area of mixed competence shared between the EU and its Member States. The EU has negotiated agreements covering investments in services under the GATS agreement, and aspects of investment liberalisation such as the Trade Related Investment Measures (TRIMs) under the GATT[30]. Competence regarding BITs with third countries, on the contrary, remained in the hands of the Member States, which were free to negotiate such treaties.

This was the background regulating the energy sector: the initial focus of the EU was directed at the achievement of economic integration, namely the creation of a single energy market, also in the field of energy[31], leaving the Member States to act autonomously regarding their external relations. The interaction of EU law and international investment law did not therefore raise many questions, with the two systems growing in parallel[32].

3.1. The Lisbon Treaty

The Lisbon Treaty changed this framework, assigning competence to the EU in the field of energy for the first time. According to Art. 4.2(i) TFEU[33], the EU and its Member States share competence in the field of energy. When the competence in a given area is shared, both the EU and its Member States can adopt legally binding acts in that area due to Art. 2(2) TFEU. This means that the Member States can legislate in a particular field to the extent that the EU has not exercised its competence in that field, or to the extent that the EU has decided to cease exercising its competence[34].

Art. 4(2) TFEU must be read in combination with Art. 194 TFEU[35], namely the general provision in the field of energy, which indicates the general objectives of EU energy policy.

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[29] Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, 13 December 2007, C 306/01.
[30] S. Woolcock, "EU Trade and Investment Policymaking After the Lisbon Treaty" 45(1) *Intereconomics-Review of European Economic Policy* (2010) 22, at 22.
[31] E. Bonafé and G. Mete, "Escalated interactions between EU energy law and the Energy Charter Treaty", 9 *Journal of World Energy Law and Business* (2016) 174, at 175.
[32] D. Moskvan, "The Clash of Intra-EU Bilateral Investment Treaties with EU law: A Bitter Pill to Swallow", 22 *Columbia Journal of European Law* (2015) 101, at 104.
[33] Article 4.2 (i), Consolidated version of the Treaty on the Functioning of the European Union (TFEU), 26 October 2012, OJ L. 326/47-326/390.
[34] M. Krajewski, *Services of General Interest Beyond the Single Market: External and International Law Dimensions* (2015).
[35] B. Mellár, *Energy Policy: General Principles* (May 2016) available at http://www.europarl.europa.eu/ftu/pdf/en/FTU_5.7.1.pdf, at 1 (last visited 6 July 2016).

This article clarifies that the EU shall:

> "(a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union; (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and (d) promote the interconnection of energy networks."[36]

These objectives do not generate an obligation on the part of the EU to adopt specific legislative measures. However, according to the jurisprudence of the ECJ[37] in relation to Art. 3 TEU[38] and 194 TFEU, the EU is under an obligation to develop an EU energy policy and the Union must pursue its objectives by appropriate means[39]. Art. 194.2 TFEU, second part, leaves Member States the right to exploit their natural resources, choose between energy sources and determine the general structure of their energy supply[40].

3.2. Provisions on FDIs

This set of provisions must be harmonised with the provisions on FDIs[41] and trade with third countries. In this regard, Art. 3(1)(e) TFEU[42] assigns exclusive competence to the EU, inserting FDIs in the framework of Common Commercial Policy (CPP)[43]. Arts. 206 and 207 TFEU[44] place foreign direct investment within the CCP framework, and confer on the Union competence regarding the progressive abolition of restrictions on FDIs. Notwithstanding the limitation contained in Art. 207(6) TFEU, the EU maintains that these combined provisions accord the EU itself exclusive competence regarding FDIs[45], while Member States are able to legislate in this field only when empowered to do so by the EU, according to Art. 2(1) TFEU[46].

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36 Article 194.1 TFEU, *supra*, note33.
37 Case 13/83, *European Parliament v. Council of the European Communities* [1985].
38 Article 3, Consolidated version of the Treaty on European Union (TEU), 13 December 2007, C 115/0.
39 Client Earth Legal Briefing, *The impact of the Lisbon Treaty on climate and energy policy - an environmental perspective* (January 2010) available at http://www.clientearth.org/reports/clientearth-briefing-lisbon-treaty-impact-on-climate-and-energy-policy.pdf, at 8 (last visited 6 July 2016).
40 Article 194.2 TFEU, *supra*, note33.
41 A. Stanič in C. Klausegger, P. Klein et al. (eds), *Austrian Yearbook on International Arbitration* (volume 2015) at 31.
42 Article 3.1(e) TFEU, *supra*, note33.
43 A. Reinisch, "The EU on the Investment Path – Quo vadis Europe? The Future of EU BITs and other Investment Agreements" 12(1) *Santa Clara Journal of International Law* (2014) 111, at 114.
44 Article 3.1(e) TFEU, *supra*, note33.
45 A. Stanič, *supra*, note 41.
46 Article 2.1 TFEU, *supra*, note33.

The power of negotiating and concluding BITs is thus no longer in the hands of the Member States, but is rather in the Commission's hands[47]. The Commission defined FDIs as including any "foreign investment which serves to establish lasting and direct links with the undertaking to which capital is made available in order to carry out an economic activity"[48]. In the Commission's view, the power of the EU in the investment field covers both pre-establishment and post-establishment issues, and is therefore not limited to the accession phase, but extends to granting the Commission the power to conclude treaties containing substantive treatment obligations and procedural guarantees, in the form of Investor-State and State-to-State dispute settlement[49].

It is therefore uncontroversial that FDIs in the field of energy now fall within the exclusive competence of the EU. Member States can no longer conclude new BITs without the authorisation of the EU, and existing BITs concluded by Member States will be replaced by agreements concluded by or under the direction of the Union[50].

3.3. Pre-existing BITs and EU legislation

The relationship between pre-existing treaties and EU legislation is addressed by Art. 351 TFEU[51] (formerly, Art. 307 EC Treaty). Art. 351 TFEU, first part, provides that:

> "[t]he rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties."[52]

This provision reflects the principle *pacta sunt servanda*, according to which the obligations assumed by States before their accession to the EU are not affected by EU

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[47] A. Ghouri, *Interaction and Conflict of Treaties in Investment Arbitration* (2015), at 148.
[48] Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Towards a comprehensive European international investment policy, COM (2010) 343, 7 July 2010, at 2.
[49] A. Reinisch, *supra*, note 43, at 118.
[50] J. Kleinheisterkamp, "Investment Protection and EU Law: The Intra- and Extra-EU Dimension of the Energy Charter Treaty", 15(1) *Journal of International Economic Law* (2012) 85, at 86.
[51] Article 351 TFEU, *supra*, note 33.
[52] *Ibid.*, first part.

legislation[53]. The second paragraph of Art. 351 TFEU clarifies the duty of cooperation contained in Art. 10 EC Treaty[54], now substantially replaced by Art. 4.3 TEU[55], providing that:

> "[t]o the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established."[56]

The main aim of Art. 351 TFEU is to strike a balance between rights conferred by pre-accession treaties and the incompatibilities with EU law that may arise from such agreements. However, there is no indication in the TFEU as to how to achieve this result, nor does the TFEU indicate any time limit[57]. It has been mostly the ECJ that elaborated on the specific implications of Art. 351 TFEU. In doing so, the Court has stressed the fact that the EU institutions must not impede the performance of treaty obligations by Member States, which, on the other hand, must renegotiate prior agreements that are incompatible with EU legislation and, where such renegotiation is not possible, must denounce the agreement[58].

[53] P. Koutrakos, "Case C-205/06, commission v. Austria, judgment of the Court (Grand Chamber) of 3 March 2009, not yet reported; Case C-249/06, commission v. Sweden, judgment of the Court (Grand Chamber) of 3 March 2009", 46(6) *Common Market Law Review* (2009) 2059, at 2060.
[54] Article 10, Consolidated Version of the Treaty Establishing the European Community (EC Treaty), 25 March 1957, C 321 E/37.
[55] Article 4.3, *supra*, note 37.
[56] Article 351 TFEU, *supra*, note 33, second part.
[57] P. Koutrakos, *supra*, note 53, at 2060.
[58] *Ibid.*

4. Extra-EU BITs

Since the entry into force of the Lisbon Treaty, the EU has continued its efforts to complete the internal energy market, while, as regards the external dimension, it has focused on the energy security challenge. More than half of the energy that meets the EU's needs comes, in fact, from non-EU countries. For this reason, the need for the EU to establish an external energy policy was considered particularly important[59] and led the Commission to adopt the European Energy Strategy[60] in May 2014 and later to launch the Energy Union, with the aim of making EU external action in the energy sector uniform. This would imply, as will be illustrated below, the need for Member States to communicate to the Commission their future agreements with third countries in the field of energy[61]. The Energy Union relaunched its initiative in 2015, focusing on greater coordination in the internal energy market, to avoid different or contradictory implementation among Member States[62].

At the entry into force of the Lisbon Treaty, more than 1200 BITs between Member States and extra-EU countries were in force[63]. Expanding the EU's competence in the CCP to FDIs with third States, the Treaty created some uncertainty as to the status of these extra-EU BITs. In fact, to the extent that the EU has acquired exclusive competence regarding investments in the field of the CCP, Member States see a corresponding loss of powers[64]. Existing Member States' BITs with third countries become therefore "unconstitutional" from a European perspective, although they maintain their validity under international law[65]. Under EU law, in fact, only the EU can now sign treaties with third countries on matters related to the CCP[66].

In the field of energy, on 4 February 2011, the European Council called for the EU to take action in order to improve the consistency and coherence of the EU's external action in the field of energy[67]. As a consequence, the EU adopted two relevant legislative acts: Decision

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[59] E. Bonafé and G. Mete, *supra*, note 31, at 175.
[60] European Commission, Communication from the Commission to the European Parliament and the Council European Energy Security Strategy' COM (2014) 0330 final.
[61] E. Bonafé and G. Mete, *supra*, note 31, at 175.
[62] *Ibid.*, at 175.
[63] Latham & Watkins International Arbitration Newsletter, *New European Regulation Clarifies the Status of Extra-European Bilateral Investment Treaties* (April 2013), available at file:///C:/Users/Niccol%C3%B2Zugliani/Downloads/international-arbitration-eu-regulation-extra-european-bits.pdf (last visited 28 July 2016).
[64] A. Reinisch, *supra*, note 43, at 119.
[65] *Ibid.*, at 119.
[66] *Ibid.*, at 120.
[67] European Council, Conclusions on Energy, PCE 026/11, 4 February 2011, at para.11.

994/2012/EU and Regulation 1219/2012, that provided investors with some clarity regarding the status of BITs entered into by Member States and non-Member States (extra-EU BITs) following the Lisbon Treaty[68].

4.1. Decision 994/2012/EU

Decision 994/2012/EU[69] granted the EU the power to review existing and future Inter-Governmental Agreements (IGAs) in the energy field. It established a mechanism for the exchange of information between Member States and the Commission with regard to IGAs, with the aim of optimising the internal energy market[70]. To this end, Member States were required to submit to the Commission all existing IGAs by 17 February 2013[71], according to Art. 3(1) of the Decision. This obligation extended to other texts referred to by the IGAs "in so far as they [contained] elements which have an impact on the functioning of the internal energy market or on the security of energy supply in the Union"[72]. These other agreements are typically entered into by Member States in respect of large energy investments[73].

The Decision then provided that the disclosure obligation did not concern agreements between private entities. Furthermore, Art. 3(3) of the Decision required Member States to inform the Commission of the objectives of negotiations with third countries regarding new IGAs or of the amendment of existing IGAs, and to keep the Commission regularly informed[74]. Member States are not required to notify the Commission of the commencement of negotiations for new IGAs with third countries, although in this case there is the risk that the final agreement will be considered by the Commission to be incompatible with EU law. When Member States are unable to reach a conclusion on the compatibility of the agreement being negotiated with EU law, they can resort to the Commission to dispel their doubts: in fact, they can obtain an opinion from the Commission about the compatibility of an IGA with EU law as the negotiations are ongoing, according to Art. 6 of the Decision[75].

[68] Latham & Watkins, *supra*, note 63.
[69] European Parliament and Council of the European Union, Decision 994/2012/EU, 25 October 2012.
[70] *Ibid.*, at Art.1.
[71] *Ibid.*, at Art.3.1.
[72] *Ibid.*, at Art.3.1.
[73] A. Stanič, *supra*, note 41, at 32.
[74] European Parliament and Council of the European Union, *supra*, note 69, at Art.3.3.
[75] *Ibid.*, at Artt.6.1-6.3.

4.2. *Regulation 1219/2012*

Regulation 1219/2012[76], on the other hand, introduced a transitional regime for existing BITs between Member States and third countries, providing some clarity in relation to extra-EU BITs. The Regulation, referring to Art. 3(1)(e) TFEU, confirms that the competence for concluding BITs and free-trade agreements (FTAs) with non-EU countries falls upon the Commission[77]. First, it confirms that extra-EU BITs signed by Member States before 1 December 2009 (or the date of their accession to the EU, if later) remain in force, subject to review by the Commission, until new BITs between the EU and the third country in question enter into force[78]. Second, the Regulation contains a regime for BITs signed between 1 December 2009 and 9 January 2013. BITs that Member States wished to maintain during this period needed to be authorised by the Commission, provided they did not conflict with EU law and policy[79]. Third, it established a framework for future negotiations by Member States. In particular, Member States need an authorisation from the Commission in order to amend BITs with third countries or to conclude new BITs with non-Member States[80]. Member States need to give the Commission five months' notice of their intention to enter into such negotiations[81]. The Commission must then formally authorise the opening of negotiations, unless it concludes that they would be either in conflict with EU law, superfluous because it deals with a matter already negotiated by the Commission, or inconsistent with the EU's principles and objectives for the external action[82]. The Commission can take part in the negotiations[83]. When the latter come to an end, Member States must notify the Commission of the outcome of the negotiations. The Commission then assesses their compatibility with EU law, and only then are Member States allowed to ratify the BIT[84]. Finally, the Regulation also makes clear that BITs entered into by Member States with non-Member States will be assessed by the Commission "with

[76] European Parliament and Council of the European Union, Regulation 1219/2012, 12 December 2012, at (2).
[77] A. Stanič, *supra*, note 41, at 33.
[78] Regulation 1219/2012, *supra*, note 76, Art.3.
[79] *Ibid.*, Art.12.
[80] *Ibid.*, Art.7.
[81] *Ibid.*, Art.8.
[82] *Ibid.*, Art.9.
[83] *Ibid.*, Art.10.
[84] *Ibid.*, Art.11.

a view to the progressive replacement of the bilateral investment agreements notified pursuant to Article 2"[85].

Both the Decision and the Regulation have important implications for energy projects. Pursuant to Art. 8 of the Decision, the EU was required to complete its review of existing IGAs by 1 January 2016. Around one third of the IGAs relating to energy supply or energy infrastructure that were analysed were judged to be of concern[86]. However, to date, no Member State has renegotiated or terminated its IGAs, which are not in compliance with EU law. According to the general rules set out in the Vienna Convention on the Law of Treaties (VCLT), if an agreement does not contain a specific provision dealing with its termination or suspension, a State party cannot terminate it without the consent of the other party[87]. The consent of the third State is necessary also in the case of renegotiation of the agreement. This reflects on the power of the Commission, limiting its enforcement powers, even if an infringement process were to be launched.

Since the entry into force of the Decision, only one IGA has been notified to the Commission[88]. Therefore, the Decision cannot be considered effective. Its provisions have not resulted in the transformation non-compliant IGAs into compliant ones[89].

The very fact that the Commission has reviewed IGAs concluded before the Lisbon Treaty entered into force or before Member States acceded to the EU has undermined the legal certainty and stability of the EU investment framework[90] and further stressed the already existing tension between EU law and international investment law, which will be dealt with below. Moreover, whenever an IGA is found to be incompatible with EU law, Member States will find themselves in the position of either violating the international agreement, that might be a BIT as well as a multilateral agreement such as the ECT, or to violate EU law.

[85] *Ibid.*, Art.5.
[86] European Commission, Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of the Decision 994/2012/EU establishing an information exchange mechanism on intergovernmental agreements between Member States and third countries in the field of energy, 16 February 2016, COM(2016) 54 final, at 3.
[87] Articles 54 and 56 VCLT, Vienna Convention on the Law of Treaties (VCLT) 1969, 1155 UNTS 331.
[88] European Commission, *supra*, note 86, at 4.
[89] *Ibid.*, at 4.
[90] A. Stanič, *supra*, note 41, at 34.

4.3. BITs judgments

The incompatibility of intra-EU BITS with EU law was the subject of so-called BITs judgments instituted by the Commission before the ECJ. These cases were instituted in 2006, before the Lisbon Treaty granted the EU competence regarding extra-EU FDIs, and the subsequent Decision and Regulation. More precisely, contrary to the Decision, the Regulation does not expressly grant the EU power to review Member States' BITs with third countries in order to ensure compatibility with EU law. However, there is little doubt that the Commission will undertake this review, which is expressly allowed by Art. 258 TFEU[91]. Art. 258 TFEU provides that whenever the Commission considers a Member State's BIT incompatible with the *acquis communautaire*, it can bring an infringement proceeding against the Member State before the ECJ.

The BITs judgments were also the first cases in which the ECJ ruled on issues related to investment law[92]. The Commission, in 2006, resorted to the ECJ against Austria[93] and Sweden[94] for failure to adopt appropriate measures to eliminate the incompatibilities present in their pre-accession BITs with EU law, on the basis of Art. 307 EC Treaty (Art. 351 TFEU). In 2007, the same action was brought against Finland[95].

Austria and Sweden had concluded a series of BITs with third countries prior to their accession to the EU. According to the Commission, these BITs, while facilitating the exchange of capital with third countries, at the same time hindered the ability of the Community to impose restrictions on such transfers[96]. The relevant provisions in these cases were Arts. 57(2), 59 and 60(1) EC Treaty. Art. 57(2) EC Treaty provided that the Council might adopt measures on the movement of capital to or from third countries involving, among other things, FDIs[97]. Art. 59 EC Treaty empowered the Council to take safeguard measures in exceptional circumstances, when "movements of capital to or from third countries [caused], or threaten to cause, serious difficulties for the operation of [the] economic and monetary union"[98]. Art. 60.1 EC Treaty allowed the Council to take

[91] A. Stanič, *supra*, note 41, at 33.
[92] P. Eeckhout, *Investment Treaties and EU law* (July 2009), available at http://www.ejiltalk.org/investment-treaties-and-eu-law/ (last visited 13 July 2016).
[93] C-205/06, *Commission v. Republic of Austria*, (Grand Chambers) [2009] ECR I-0000.
[94] C-249/06, *Commission v. Kingdom of Sweden*, (Grand Chambers) [2009] ECR I-0000.
[95] C-118/07, *Commission v. Republic of Finland*, (Second Chambers) [2009] ECR I-10889.
[96] P. Koutrakos, *supra*, note 53, at 2062.
[97] Article 57.2, EC Treaty, *supra*, note 55.
[98] Article 59, EC Treaty, *supra*, note 55.

necessary urgent measures relating to the transfer of capital[99] in the field of the Common Foreign and Security Policy (CFSP).

The Commission argued that the BITs in question violated the secondary legislation based on the aforementioned provisions, and the duty of cooperation contained in Art. 10 EC Treaty[100]. It had notified Austria, Sweden and Finland that their agreements with third States were incompatible with the EC Treaty, Arts. 57(2), 59 and 60(1) of which empowered the Commission to restrict the capital flow[101]. This was despite the fact that no measures had yet been taken, because the BITs could have hindered the application of any compelling economic measure[102]. The Member States, on the other hand, claimed that no violation of Art. 307 EC Treaty had taken place and that the situation described by the Commission was only hypothetical, arising only in the event of an actual adoption of such measures.[103]

The ECJ ruled in 2009, and agreed with the Commission's view in all three cases. It stated that the obligations providing for the free transfer of capital contained in the respective BITs were incompatible with the EC Treaties, as they would preclude the Member States from restricting the transfer of capital when needed in accordance with potential future EU legislation[104]. The urgent and immediately enforceable character of safeguard measures was not deemed compatible with the existence of potentially conflicting future obligations, as waiting for the conflict to arisen would render the EU measures devoid of their effect[105].

Another argument brought by the Member States that was not accepted by the ECJ concerned the clause *rebus sic stantibus* provided by Art. 62 VCLT[106]. According to this principle, in the Member States' view, BIT obligations would not be enforceable against EU rules. This approach was criticised by the Advocate General, who recalled the limited application of the *rebus sic stantibus* principle[107], and by the Court, which considered the

[99] Article 60.1, EC Treaty, *supra*, note 55.
[100] Commission v. Republic of Austria, *supra*, note 93, at para. 16 and Commission v. Kingdom of Sweden, *supra*, note 94, at para. 15.
[101] Commission v. Kingdom of Sweden, *supra*, note 94, at para. 15.
[102] A. Ghouri, *supra*, note 47, at 153.
[103] Commission v. Republic of Austria, *supra*, note 93, at para. 21 and Commission v. Kingdom of Sweden, *supra*, note 94, at para. 18.
[104] Commission v. Kingdom of Sweden, *supra*, note 94, at para. 43.
[105] Commission v. Republic of Austria, *supra*, note 93, at para. 39-40 and Commission v. Kingdom of Sweden, *supra*, note 94, at para. 52.
[106] Article 62, VCLT, *supra*, note 87.
[107] Opinion of Advocate General Poiares Maduro, 10 July 2008, O.J. C 178, at para. 61.

mechanisms provided by international law, like the suspension or termination of treaties, to be too uncertain in their effects to guarantee the effective application of EU law[108]. The ECJ also noted that the incompatibility between extra-EU BITs and the EC Treaty was not limited to the three cases analysed, but had a general value, indicating its line of action, should new cases on the same issue arise. The Court therefore considered the impugned clauses in the pre-accession BITs to be incompatible with the EC Treaty. Member States, under Art. 307 EC Treaty (Art. 351 TFEU), second part, are under an obligation to eliminate these incompatibilities. However, in the above-mentioned cases, the ECJ did not require the Member States concerned to take any action to eliminate the incompatibility, limiting its decision only to declaring its existence[109].

Art. 351 TFEU imposes on Member States the obligation to remove the incompatibilities between agreements they concluded before their accession to the EU and the TFEU. According to some scholars, this not only applies to extra-EU BITs, but also intra-EU BITs, which can also contain provisions that conflict with EU law. As mentioned above, the ECJ in the BITs judgments against Austria, Sweden and Finland already found that BITs provisions on the free transfer of capital were incompatible with EU law and that the Member States had violated Art. 351 TFEU, while not requiring the incompatibility to be removed. It has been argued that the Court's conclusions would be applicable to intra-EU Bits, *mutatis mutandis*. The only difference would be the legal consequences of the incompatibility of the BITs with EU law. In the case of extra-EU BITs, Art. 351 TFEU imposes an obligation on Member States to eliminate the incompatibilities. With regard to intra-EU BITs, on the other hand, any incompatibilities with EU law would lead to the automatic inapplicability of the treaty provisions[110].

4.4. Commission v. Slovakia

A relevant case dealing with the EU internal energy market and the interrelation between EU law and international law is one brought by the Commission against Slovakia[111] in 2009. The Commission, in particular, requested the Court to declare that Slovakia had

[108] Commission v. Kingdom of Sweden, *supra*, note 94, at para. 41.
[109] A. Ghouri, *supra*, note 47, at 154.
[110] F. Weiss and S. Steiner, *supra*, note 206, at 367-368.
[111] C-264/09, *European Commission v. Slovak Republic*, (First Chamber) [2011] ECR I-08065.

failed to fulfil its obligations under Arts. 20(1) and 9(e) of Directive 2003/54/EC concerning the common rules for the internal market[112].

With regard to the facts of the case, in 1997, prior to EU accession by Slovakia, SEPS, the Slovak transmission system operator, granted the Swiss company ATEL a capacity-transmission right of 300 MW between Poland and Hungary, between 1 October 1998 and 30 September 2014[113]. This right was provided in return for the construction by ATEL of the transmission line on which it enjoyed the right[114], bearing 50% of the cost of the investment. The Commission claimed that the preferential right granted to ATEL was to the detriment of other users, creating a privileged position, and in violation of Arts. 9(e) and 20(1) of Directive 2003/54, which require guaranteed, non-discriminatory access to the transmission system[115]. It claimed that Slovakia could not rely on Art. 307 EC Treaty (Art. 351 TFEU) as, contrary to what is required by that provision, there was no incompatibility between the BIT and Community law[116]. These arguments were opposed by Slovakia, which considered the obligations arising out of the BIT to be incompatible with the Directive, but covered by Art .351 TFEU, first part[117]. The contract was not seen as one granting preferential access, but as an investment contract: the deprivation of ATEL's priority access right would amount to expropriation[118] on the basis of the BIT between Slovakia and Switzerland. Slovakia then raised a separate objection based on the ECT: the termination of the contract would amount to violation of Art. 10 ECT, governing direct and indirect expropriation, and Art. 13 ECT, providing fair and equitable treatment[119].

The objections based on the ECT were not dealt with by the ECJ, which focused only on the Directive[120]. The Advocate General considered ATEL's priority access right to be in violation of Directive 2003/54 and EU energy policy[121]. However, he continued, this right was an investment protected under the BIT between Switzerland and Slovakia, giving rise to an obligation which pre-dated Slovakia's EU accession, and which constituted an

[112] European Commission v. Slovak Republic, *supra*, note 111, at para. 1.
[113] *Ibid.*, at para. 11.
[114] *Ibid.*, at para. 12.
[115] European Commission v. Slovak Republic, *supra*, note 111, at para. 16-17.
[116] *Ibid.*, at para. 18.
[117] *Ibid.*, at para. 18.
[118] *Ibid.*, at para. 22.
[119] *Ibid.*, at para. 22 and 24.
[120] A. Ghouri, *supra*, note 47, at 156.
[121] Opinion of Mr Advocate General Jääskinen delivered on 15 March 2011, European Commission v Slovak Republic, Case C-264/09, E.C.R. 2011 I-08065, at para 57.

exception to the third-party access provision of Directive 2003/54/EC, justified under Art. 351 TFEU, first part[122].

The ECJ considered the obligations arising out of the BIT to pre-date Slovakia's accession to the EU, and therefore that they were covered by Art. 351 TFEU. It therefore analysed whether the contract with ATEL fell within the definition of "investment" set out in the BIT and, if so, whether Slovakia could terminate the contract without violating the BIT[123]. In accordance with the Advocate General's line of argument, the Court considered the preferential access granted to ATEL to be an investment according to the definition of that term set out in the Swiss-Slovak BIT, and concluded that "even if it were to be assumed that the preferential access granted to ATEL were not compliant with Directive 2003/54, […] preferential access is protected by the first paragraph of Article 307 EC"[124]. This clarified two points: first, Investor-State contracts are protected by Art. 351 TFEU, first part, when they fall within the definition of "investment" set out in a BIT that pre-dates the Member State's accession to the EU. Second, an Investor-State contract covered by a pre-accession BIT can also be concluded after the relevant Member State's accession[125].

A problem that arose in the case was the jurisdiction of the ECJ to interpret and apply international agreements. In order to come to a decision, the ECJ had to interpret the BIT between Switzerland and Slovakia. The power of the Court to interpret agreements between Member States and third countries is controversial, and the ECJ itself has recognised that it is not within its competence[126], although it has then proceeded with the interpretation of the BIT. This could lead to inconsistencies in the interpretation of BITs by arbitral tribunals and the ECJ. The interpretation given to the BIT by the ECJ differed from the practice of arbitral tribunals and was even in contradiction to customary international law[127]. The problems related to the application of EU law by arbitral tribunals will be dealt with in the next sections.

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[122] Opinion of Mr Advocate General Jääskinen, *supra,* note 121, at para 107 and 108.

[123] European Commission v. Slovak Republic, *supra*, note 111, at para. 33.

[124] *Ibid.*, at para. 52.

[125] A. Ghouri, *supra*, note 47, at 158.

[126] European Commission v. Slovak Republic, *supra*, note 111, at para. 40.

[127] A. Boute, "Case C-264/09, Commission v. Slovakia, Judgment of the Court (First Chamber) of 15 September 2011, Not Yet Reported" 49 *Common Market Law Review (2012)* 1179, at 1184.

4.5. *Further developments*

Given the fact that the Commission brought these successful challenges before the ECJ even before being granted the power to do so by the TFEU, the Decision and the Regulation, it is fair to think that the Commission will make greater use of its powers in the future. Under the powers granted by the Decision, in 2013 the Commission notified several European countries that their IGAs with Russia relating to the South Stream pipeline were incompatible with EU law[128]. This is despite the fact that a number of Member States claimed that they had obtained informal clearance from the EU before the conclusion of the agreements. Nonetheless, the Commission started an infringement proceeding against Bulgaria in June 2014 on the basis that the South Stream IGA was in violation of EU law, which led Bulgaria to abandon the project[129]. More proceedings of this kind are likely to be initiated by the Commission, as there is no reason to consider the action in respect of the South Stream pipeline was a one-off one[130].

The Commission's power to review IGAs concluded before the entry into force of the Lisbon Treaty or before Member States' accession has a detrimental effect on the investment environment. In the BITs judgments, the ECJ determined that the BITs in question were incompatible with the provisions of EU law on the transfer of capital. It is not clear, however, which BITs provisions might be considered incompatible with EU law in the future, it being also possible that the ECJ will consider provisions concerning fair and equitable treatment incompatible with EU law[131]. This uncertainty must be viewed in light of with uncertainty regarding the EU's readiness to comply with its obligations under the ECT, or with its will to allow Member States to comply with their ECT obligations. Not only the ECT, but also compliance with extra-EU BITs and international law are being endangered, with a consequential deterioration of the investment climate and a possible loss of investment.

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[128] A. Stanič̌, *5 EU Energy Law: Increased Regulatory Risk and Ways to Reduce It* (January 2016), available at http://www.iclg.co.uk/practice-areas/oil-and-gas-regulation/oil-and-gas-regulation-2016/5-eu-energy-law-increased-regulatory-risk-and-ways-to-reduce-it (last accessed 28 July 2016).
[129] *Ibid.*
[130] A. Stanič, *supra*, note 41, at 34.
[131] *Ibid.*, at 35.

5. Intra-EU BITs

The problems that arise in the field of intra-EU BITs are of a different kind from those explained above. Art. 351 TFEU is, in fact, not applicable in these cases. Acceding States were required to change their legislation in accordance with EU law, following the so-called *acquis communautaire*. These changes may affect pre-accession BITs to which these States were party, depriving investors of the favourable conditions they were provided with by the BITs[132]. Moreover, such BITs have become treaties between Member States, namely intra-EU BITs. The term "intra-EU BITs" indicates that the investment treaties were concluded between Member States. Before the 2004 enlargement, only two intra-EU BITs were signed; between Germany and, respectively, Greece and Portugal[133]. After the accession of 12 new Member States from Central and Eastern European countries, the BITs signed by Member States with those States during the 1990s, which at the time of signature were simply BITs between Member States and third countries, became intra-EU BITs.

Two main sets of problems arise out of such treaties. First, they grant investors ample protection from a substantive point of view, creating a potential clash with the EU fundamental freedoms. Second, they include Investor-State dispute settlement mechanisms, which allow investors to bypass national courts[134], in possible contradiction to the ECJ's jurisdiction to interpret EU law under Art. 344 TFEU. The compatibility of these intra-EU BITs with EU law, and the issue of whether they need to be terminated or not, has been the subject of debate. In several cases, investors have brought their claims before arbitral tribunals, constituted on the basis of the relevant BITs. These tribunals, contrary to the Commission's position, according to which intra-EU investment issues are now governed by EU law and the BITs have become ineffective, have instead maintained their BIT-based autonomous jurisdiction[135].

5.1. Position of the European Commission

The Commission's position with regard to intra-EU BITS is that they are incompatible with EU law. In arguing for such incompatibility before arbitral tribunals, the Commission has

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132 A. Ghouri, *supra*, note 47, at 159.
133 W. Shan and S. Zhang, "The Treaty of Lisbon: Half Way toward a Common Investment Policy", 21(4) *The European Journal of International Law* (2011) 1049, at 1065.
134 C. Olivet and P. Vervet, *Proposal to expand investors' rights for all intra-EU investment will be the next nail in the coffin of European integration* (May 2016), available at https://www.tni.org/en/publication/proposal-to-expand-investors-rights-for-all-intra-eu-investment-will-be-the-next-nail-in (last visited 16 July 2016).
135 A. Ghouri, *supra*, note 47, at 159.

maintained three main lines of argument, which will be now be outlined. A more detailed view on the single arguments will be dealt with below in the analysis of the single cases before arbitral tribunals.

EU law, in the Commission's view, prevails in the context of accession, and therefore intra-EU BITs should be terminated by Member States, which are under an obligation to take steps to terminate these treaties, insofar as the matters covered by them fall within the competence of the EU[136]. Member States are bound by EU law, and must respect its supremacy. Whenever an intra-EU BIT is in violation of the EU legal order, its State parties violate their obligation to respect the primacy of EU law[137].

Initially, the Commission argued that, in case of a conflict between intra-EU BITs and EU law, the principle *pacta sunt servanda* does not apply, due to EU law's supremacy over national legal systems and BITs between Member States[138]. More recently, however, the Commission has changed its position, claiming that the supremacy of EU law does not rescind the BITs or necessarily prevent the application of their provisions[139], but that it is up to the Member States to take steps to terminate these agreements. The Commission's position has had little effect in persuading Member States to terminate their intra-EU BITs, which have thus remained in force. Recently, however, some Member States that took part as respondents before arbitral tribunals argued that the incompatibility between EU law and intra-EU BITs leads to the latter's automatic termination[140].

Furthermore, since 2004, the Commission has argued that intra-EU BITs are incompatible with the EU single market, based on the fact that such BITs lead to discrimination against investors of Member States that are not party to these BITs, which would be excluded by the BITs' enhanced protection. BITs, in fact, allow investors from the respective States to benefit from special legal protections that cannot be invoked by investors of other Member States. This is deemed to be contrary to EU law, which abolishes impediments to trade based on nationality under Art. 18 TFEU, and sets conditions for the free movement of

[136] SCC, *Eastern Sugar BV v. Czech Republic, Partial Award*, 27 March 2007, SCC Case No. 088/2004, recalled in C. Olivet, *supra*, note 134, at 5.
[137] A. Dimopoulos, "The validity and applicability of international investment agreements between EU Member States under EU and international law" 48(1) *Common Market Law Review* (2011) 63–93.
[138] *Eureko B.V. v. The Slovak Republic*, *infra*, note 159.
[139] *Eastern Sugar BV v. Czech Republic*, *supra*, note 136, at 119.
[140] A. Reinisch, *supra*, note 43, at 149.

persons, services and capital[141]. One example can be found in the provisions of BITs that contain the Fair and Equitable Treatment (FET) standard, often relied upon in investment arbitration proceedings. FET provisions have been considered incompatible with EU law: the conflict, in this case, does not lie in the substantive rights covered by the FET, but in the procedural ones, as this standard can be invoked only by investors from the States that are party to the BIT, which discriminates against investors from other Member State[142].

Another line of argument regards the dispute settlement mechanism provided by the BITs, namely Investor-State arbitration. When dealing with EU law issues, this involves the interpretation of EU law by arbitral tribunals, endangering the uniform application of EU law and the ECJ's exclusive jurisdiction as the sole interpreter of EU law. According to Art. 267 TFEU, national courts can refer a question to the ECJ for a preliminary ruling. This mechanism has been created to preserve the coherence and harmony of the system. Arbitral tribunals, on the contrary, cannot refer questions to the ECJ. For this reason, arbitration and EU proceedings have been deemed incompatible[143].

5.2. Arbitral Tribunals

The Commission has consistently argued for the incompatibility of intra-EU BITs with EU law on the basis of the aforementioned arguments. This view, however, has not been shared by several arbitral tribunals, which have retained jurisdiction and ruled on the cases notwithstanding the Commission's position. Below, the most relevant cases will be discussed.

5.2.1. Eastern Sugar BV v. Czech Republic

A relevant case in this regard is *Eastern Sugar BV v. Czech Republic*[144]. Eastern Sugar BV was a Dutch investor that initiated arbitration against the Czech Republic (which succeeded Czechoslovakia and took on its international obligations) before the Stockholm Chamber of Commerce under the Netherlands-Czechoslovakia BIT for violation of the fair and equitable treatment standard, through the adoption of various regulations relating to the

[141] D. Moskvan, supra, note 32, at 2014.
[142] *Ibid.*, at 2014
[143] S. Miron, "The Last Bite of the BITs—Supremacy of EU Law versus Investment Treaty Arbitration", 3 *European Law Journal* 20 (May 2014) 332-345.
[144] SCC, *Eastern Sugar BV v. Czech Republic, Partial Award*, 27 March 2007, SCC Case No. 088/2004.

sugar industry that enforced discriminatory agricultural quota rules, while adapting its legislation to EU standards[145].

The Czech Republic argued that the tribunal did not have jurisdiction to hear the case, as the BIT was not applicable after its accession to the EU[146]. In doing so, it resorted to Art.59 VCLT, according to which a treaty is deemed to be terminated if the parties conclude a later treaty related to the same subject-matter, and "it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty, or the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time"[147]. The same position was maintained by the Commission, as evidenced by a letter sent to the Czech government in 2006,[148] and submitted by Czech Republic in support of its arguments during the arbitral proceeding. In particular, the Commission maintained that Art. 307 EC Treaty (Art. 351 TFEU) was applicable to intra-EU BITs, which consequently cannot prevail over EU secondary legislation.

In the Commission's view, international agreements that deal with matters within the competence of the EU should be terminated by Member States[149], due to the prevalence of EU law over treaty obligations. According to the Commission, however, "the effective prevalence of the EU *acquis* does not entail, at the same time, the automatic termination of the concerned BITs or, necessarily, the non-application of all their provisions[150]" and it argued that Member States need to terminate the relevant treaty based on the provisions of the VCLT.

Moreover, the Czech Republic claimed that, given the impossibility to apply both the BIT and EU law, the application of the BIT would amount to a violation of the principles of equality of treatment (Art. 12 EC Treaty, now Art. 18 TFEU) and mutual trust[151].

The arbitral tribunal did not accept these arguments, and retained jurisdiction, ruling in favour of the investor[152], although it did not justify its position, simply disagreeing with the

[145] *Ibid.*, at para. 8-12.
[146] *Ibid.*, at para. 97.
[147] Article 59(1)(a)-(b), VCLT, *supra*, note 106.
[148] EC Internal Market and Services, EC Letter to the Czech Deputy Minister of Finance of 13 January 2006.
[149] EC Letter to the Czech Deputy Minister of Finance of 13 January 2006, *supra*, note148.
[150] *Eastern Sugar BV v. Czech Republic*, *supra*, note 144, at para.119.
[151] *Ibid.*, at para. 106-107.
[152] *Ibid.*, at 72.

Commission and the Member States. It further noted that the Commission had not started infringement proceedings against the Netherlands and the Czech Republic for failure to terminate their BIT, nor against other Member States in the same position[153].

Finally, the Czech Republic asked the tribunal to refer the matter to the ECJ under Art. 234 EC Treaty[154]. In doing so, it relied on the *MOX Plant* case[155], where the proceeding was stayed by the arbitral tribunal until the ECJ clarified an EU law issue in a dispute where Member States and the EU were parties. The tribunal rejected this possibility, recalling the well-established jurisprudence of the ECJ since the *Nordsee* case[156], according to which only courts of Member States, and not arbitral tribunals, can refer a question of EU law to the ECJ. On substantive grounds, the tribunal found that the regulations relating to the sugar industry that enforced discriminatory agricultural quota rules were in violation of the BIT, and stated that the principle of non-discrimination expressed in Art. 18 TFEU could not justify a breach of the BIT[157]. Moreover, it did not accept the argument that EU law and the BIT related to the same subject matter, and therefore rejected the application of Art. 59 VCLT[158].

In the *Eastern Sugar* case, the tribunal maintained that a breach of the BIT by a State cannot be justified by the State's other obligations under EU law. Furthermore, the VCLT provisions can only be relied upon when dealing with the same subject matter; however, since the protection afforded by the BIT was missing in EU law, the tribunal found that the two instruments had different subject matters. Finally, a BIT cannot be considered to be terminated merely as a consequence of the State's accession to the EU. In the absence of any express provision for the termination of the treaty contained in the BIT or in the State's accession treaty, the BIT remains in force until formally terminated.

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[153] *Ibid.*, at para.121.
[154] Article 234, EC Treaty, *supra*, note 55.
[155] International Tribunal for the Law of the Sea, *The MOX Plant Case (Ireland v. United Kingdom), Order on Provisional Measures*, 3 December 2001, Case n.10.
[156] Case 102/81, *Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG.* [1982] ECR 1095.
[157] G. A. Bermann, "Navigating EU Law and the Law of International Arbitration", 28(3) *Arbitration International* (2012) 397, at 429.
[158] *Eastern Sugar BV v. Czech Republic, supra*, note 144, at para.159.

5.2.2. Eureko B.V. v. Slovak Republic

In *Eureko B.V. v. Slovak Republic*[159], a case before the PCA, Eureko, a Dutch private company operating in Slovakia in the insurance market through two subsidiaries, claimed that Slovakia, through the adoption of various legislative measures, had indirectly expropriated its investment and denied several standards of protection contained in the BIT between the Netherlands and Czechoslovakia[160].

Slovakia challenged the jurisdiction of the tribunal, among other reasons, on the ground that the State's accession to the EU in 2004 had terminated the BIT, or rendered the arbitration clause inapplicable, under Arts. 59 and 30 VCLT[161]. Since the date of accession, in the Commission's view, the EC Treaty has governed the relationship between the two States as regards the subject matter of the BIT, preventing the BIT and the EC Treaty (now TFEU) from being applied simultaneously, the latter having precedence over the former. As a consequence, the arbitration clause contained in the BIT could not be applied, as the matter fell entirely within the competence of the ECJ[162].

The arbitral tribunal analysed various legal questions in the award. First it dealt with the claims regarding the termination and non-applicability of the BIT under the VCLT. The VCLT had been considered applicable in the case notwithstanding the fact that Czechoslovakia became party to the Convention only after the conclusion of the BIT. Although the VCLT does not apply retrospectively, it is in fact widely regarded as reflecting customary international law, and the parties have brought arguments based on the Convention, without raising the issue of its non-applicability to the BIT[163]. The tribunal rejected the submission that the BIT was terminated under Art. 59 VCLT on the basis of a three-pronged reasoning. First, the procedure for termination, provided by Art. 65 VCLT, was not followed[164]. EU law does not automatically terminate the BIT, and the party seeking its termination must comply with the notifications and the procedures provided for by the VCLT[165]. Second, Art. 59 VCLT requires the later treaty to deal with the same

159 PCA, *Eureko B.V. v. The Slovak Republic, Award on Jurisdiction, Arbitrability and Suspension*, 26 October 2010, PCA Case No. 2008-13.
160 *Ibid.*, at para.7.
161 *Eureko B.V. v. The Slovak Republic*, *supra*, note 159, at para.9.
162 *Ibid.*, at para.59.
163 *Ibid.*, at para.231.
164 *Ibid.*, at para.236.
165 Ghouri, *supra*, note 47, at 166.

subject matter as the earlier one in order to terminate it. In the case of an overlap between the two treaties, it is necessary that:

> "it appears from the later treaty or is otherwise established that the parties intended the later treaty to govern the subject-matter or (b) the provisions of the treaties that relate to the subject-matter are so far incompatible as to preclude the concurrent application of the two treaties."[166]

According to the tribunal, there was no evidence that the intention of the parties was to consider the provisions of the BIT as being terminated by EU law.[167]. Nor was the protection accorded to investors by the BIT deemed to be incompatible with EU law; the only difference being found in the fact that the BIT protection was broader than that provided by EU law[168]. At a minimum, the rights to fair and equitable treatment, to full protection and security, and to protection against expropriation extended beyond the protections afforded by EU law; the tribunal found no reason why those rights should not be fulfilled and upheld in addition to the rights protected by EU law[169]. Third, the right to bring a dispute before an independent arbitral tribunal could not simply be replaced by the possibility of bringing a claim against a State before its courts[170].

The tribunal then addressed the issue of Art. 30 VCLT which, at paragraph 3, provides as follows:

> "[w]hen all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty."[171]

According to the tribunal, there is no incompatibility when the State can fulfil an obligation of the BIT without violating EU law. In this regard, Investor-State arbitration is not prohibited by EU law[172]. Moreover, the tribunal rejected the respondent's argument that

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[166] Article 59(1), VCLT, *supra*, note 106.
[167] *Eureko B.V. v. The Slovak Republic*, *supra*, note 159, at para.244.
[168] *Eureko B.V. v. The Slovak Republic*, *supra*, note 159, at para.245.
[169] *Ibid.*, at para.262-263.
[170] *Ibid.*, at para.264.
[171] Article 30(3), VCLT, *supra*, note 106.
[172] *Eureko B.V. v. The Slovak Republic*, *supra*, note 159, at para.274.

the ECJ has a monopoly on the interpretation of EU law. It clarified that "[c]ourts and arbitration tribunals throughout the EU interpret and apply EU law daily. What the ECJ has is a monopoly on the final and authoritative interpretation of EU law: but that is quite different"[173]. Finally, the tribunal indicated the effects that the Lisbon Treaty had on the BIT: first, it stated that the non-applicability of the Lisbon Treaty to the arbitral proceeding was due to the fact that the arbitration was initiated before the entry into force of the treaty. Second, the tribunal maintained that the Lisbon Treaty had not terminated the intra-EU BIT. Third, the arbitration was not invalidated by the Lisbon Treaty and was therefore considered compatible with the EU legal framework[174].

The arbitral tribunal in the *Eureko* case adopted the same line of reasoning as the *Eastern Sugar* tribunal when dealing with the termination of the BIT. Termination was deemed not to be automatic, but to require that the procedure set out in Art. 65 VCLT be followed, under the condition that the treaties in question deal with the same subject matter. It further found, under Art. 30 VCLT, that the Investor-State arbitration is not incompatible with EU law.

5.2.3. Jan Oostergetel and Theodora Laurentius v. The Slovak Republic

The arbitral tribunal in the case *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*[175] also found that intra-EU BITs are compatible with EU Law, although using different reasoning. The tribunal, constituted in accordance with the UNCITRAL Rules, had to decide on the issue of the compatibility of the Netherlands-Slovakia BIT with EU law, since the BIT had the same subject matter as the EC Treaty[176].

The tribunal did not agree with the argument put forward by Slovakia, according to which the BIT had been terminated in accordance with Art. 59 VCLT, given that the EC Treaty and the BIT had the same subject matter[177]. While the EC Treaty aimed at creating a single market between the Member States, the BIT provided for specific guarantees for investors of one country in another country[178]. The fundamental distinction, however, was found in

[173] *Ibid.*, at para.282.
[174] Ghouri, *supra*, note 47, at 167.
[175] UNCITRAL, *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, Decision on Jurisdiction, 30 April 2010.
[176] Ghouri, *supra*, note 47, at 169.
[177] *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, *supra*, note175, at 79.
[178] *Ibid.*, at 75.

the dispute settlement system provided for in the BIT, which had no equivalent in the EC Treaty[179]. The tribunal did not find it necessary to enter into a thorough analysis of Art. 59 VCLT, rather considering the argument regarding the lack of retroactive effect of the EC Treaty to be decisive[180]. It then went on to state that, since the dispute between the parties arose before Slovakia's accession to the EU, the investor's rights under the BIT remained unchanged, in accordance with Art. 70(1)(b) VCLT[181], according to which the termination of a treaty does not affect any obligation or legal situation that the parties created through the treaty prior to its termination, unless they otherwise agree[182]. This view reflected the position of the Commission, which had not suggested that the accession to the EU by a State would automatically result in the termination of any BIT between the State and other Member States[183]. Finally, the tribunal considered that the protection of investments by BITs and the free movement of capital under the EC Treaty were compatible. The BIT protection was not considered to conflict with any fundamental EU law principles, particularly the principle of prohibition against discrimination[184]. In making this finding, the tribunal recalled the *Eastern Sugar* case[185], according to which the fact that the BIT created unequal rights in favour of the investor did not render it incompatible with the EC Treaty[186].

Arbitral tribunals have therefore not agreed with the Commission's arguments in several respects. They all considered that the BITs, unless formally terminated in accordance with the provisions of the VCLT, remain in force. Furthermore, they found that the BITs were not incompatible with EU law, although for varying reasons: the *Eureko* tribunal determined that the two legal instruments dealt with different subject matters. The *Oostergetel* tribunal found that, although they dealt with the same subject matter, they were incomparable. Both tribunals, moreover, relied on the fact that the disputes pre-dated the respective States' accessions to the EU, although they nevertheless declared the BITS to be compatible with EU law[187]. A breach of the BIT by a State cannot therefore be justified by its other obligations under EU law. The tribunals also stated, in particular in the *Eureko*

[179] *Ibid.*, at 77.
[180] *Ibid.*, at 88.
[181] *Ibid.*, at 90.
[182] Article Art.70(1)(b), VCLT, *supra*, note 106.
[183] *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, *supra*, note175, at 94.
[184] *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, *supra*, note175, at 86.
[185] *Eastern Sugar BV v. Czech Republic*, *supra*, note 144.
[186] *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, *supra*, note175, at 87.
[187] Ghouri, *supra*, note 47, at 169.

case, that the Investor-State dispute settlement system provided by the BITs is not incompatible with the preliminary ruling system presided over by the ECJ. There is therefore a clear conflict of views between arbitral tribunals and the Commission, which does not seem to be reconcilable.

An additional problem stems from the fact that even the termination of intra-EU BITs by Member States would not solve these issues. First, Art. 70(1)(b) VCLT provides that the termination of a treaty "does not affect any right, obligation or legal situation of the parties created through the execution of a treaty prior to its termination"[188]. The termination of a treaty cannot be applied retrospectively, and should not impede either Investor-State disputes already initiated under the BIT, or claims with respect to investments already made during the life of the BIT[189]. However, in the *Oostergetel* case, the tribunal justified its jurisdiction only on the basis that the dispute between the parties had arisen before Slovakia's accession to the EU, and did so in a way that could prevent Investor-States disputes from being determined in accordance with intra-EU BITs if the dispute relates to issues that arose after the State's accession[190].

The picture is then further complicated by the fact that most of the BITs in question contain a "sunset clause", which keeps the rights and obligations arising out of a BIT alive for a number of years after its termination, in order to protect the execution of projects that require long periods to be completed[191].The *Electrabel S.A. v. Hungary* case, which will be analysed below, is an example of this last kind of controversy.

5.3. Future developments: ECJ

As already mentioned, the situation seems to have reached a deadlock, with the Commission and arbitral tribunals holding opposite views on the life and applicability of intra-EU BITs. The ECJ has not yet pronounced on the question of the termination of intra-EU BITs. However, there are cases currently pending before it, and it is therefore only a matter of time before the Court clarifies the matter.

[188] Article Art.70(1)(b), VCLT, *supra*, note 106.
[189] A. Ghouri, "Resolving Incompatibilities of Bilateral Investment Treaties of the EU Member States with the EC Treaty: Individual and Collective Options", 16(6) *European Law Journal* (2010) 806, at 826.
[190] Ghouri, *supra*, note 47, at 169.
[191] Ghouri, *supra*, note 189, at 827.

On 18 June 2015, the Commission initiated infringement proceedings against five Member States, namely the Netherlands, Slovakia, Austria, Sweden and Romania, for failure to terminate their intra-EU BITs under the so-called "pilot procedures"[192]. At the same time as it had repeatedly intervened in arbitral proceedings under intra-EU BITs arguing for the incompatibility of such BITs with EU law, the Commission had also initiated pilot procedures against these States. Pilot procedures offer an informal avenue for the solution of problems between the EU and its Member States related to the infringement of EU law by the latter[193]. The Commission has now disclosed that it has opened informal pilot procedures with an additional 21 Member States, which could lead to formal actions against those countries as well[194].

The Commission's arguments in these procedures are in line with its views up to this point: because they provide the parties' investors with a higher degree of protection, BITs discriminate against other EU investors. The Investor-State dispute settlement system is equally discriminatory. In addition, States should give special attention to BITs' sunset clauses, which would allow such treaties to persist even after their termination[195]. States have taken different positions with regard to the Commission's arguments. If Sweden, although in principle ready to terminate its BITs, questioned most of the Commission's positions, Romania and Slovakia appear to be more open to terminating the offending BITs, while Austria and the Netherlands have not made their views public[196]. The ECJ has not yet pronounced on the topic. However, another referral to the ECJ has recently come into play.

The *Eureko v. Slovakia* case has recently been referred to the Court for a preliminary ruling by the German Federal Court of Justice (BGH). After the tribunal rendered the award,

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[192] L. E. Peterson, *Infringement Proceedings Initiated by European Commission Against Five States over Intra-Eu BITs* (June 2015), available at http://www.iareporter.com/articles/infringement-proceedings-initiated-by-european-commission-against-five-states-over-intra-eu-bits-2/ (last visited 3 August 2016).

[193] J. Hepburn and L. E. Peterson, *Stage is Set for Infringement Proceedings over Intra-Eu Bits, as Informal Process Between European Commission and Three Member-States Fail to Resolve EC's Concerns* (June 2015), available at http://www.iareporter.com/articles/stage-is-set-for-infringement-proceedings-over-intra-eu-bits-as-informal-process-between-european-commission-and-three-member-states-fail-to-resolves-ecs-concerns/ (last visited 3 August 2016).

[194] L. E. Peterson, *supra*, note 192.

[195] J. Hepburn and L. E. Peterson, *supra*, note 193.

[196] J. Dahlquist, *Investigation: EU Member-States Table Differing Responses in Face of Commission's Infringement Proceedings Related to Intra-EU Bits* (February 2016), available at http://www.iareporter.com/articles/investigation-eu-member-states-table-differing-responses-in-face-of-commissions-infringement-proceedings/ (last visited 3 August 2016).

condemning the State for breaching the investor's rights under the BIT, Slovakia tried unsuccessfully to set the award aside before the Higher Regional Court of Frankfurt, which is the place where the tribunal, constituted under the UNCITRAL Rules, had its seat[197]. The Higher Regional Court dismissed Slovakia's challenge, and considered the State to be bound by the consent given through the BIT. It did not consider it necessary to request a preliminary ruling from the ECJ, as it maintained that all the questions related to EU law had been sufficiently answered by the previous jurisprudence of the Court[198]. Slovakia therefore appealed to the BGH. In doing so, it argued that the tribunal lacked jurisdiction due to the incompatibility of the BIT's arbitration clause with EU law, in particular with Arts.18, 267 and 344 TFEU. It later argued that the award should be set aside for reasons of public policy.[199]. The BGH, as anticipated, referred the case to the ECJ for a preliminary ruling. Although the request has not yet been published, the main points of the referral are known. The BGH, although reiterating the ECJ's position that in case of a conflict between EU law and an earlier obligation of a Member States under international law the former takes precedence, noted that the ECJ has not yet pronounced on the compatibility of arbitration agreements arising from an intra-EU BIT with EU law, in particular as regards the aforementioned articles[200]. It therefore suspended the proceeding and referred it to the ECJ for a preliminary ruling on whether or not Investor-State arbitration under an intra-EU BIT is compatible with Arts. 18, 267 and 344 TFEU.

The BGH's view on the issue is the following: With regard to Art. 344 TFEU, the Court considered that the fact that Member States must refer all disputes concerning the interpretation of EU law to the ECJ does not preclude private investors from raising claims against Member States on the basis of intra-EU BITs before an arbitral tribunal. In support of this view, it argued that EU law does not provide any Investor-State dispute settlement mechanism in case of the infringement of investors' rights due to the violation of an intra-EU BIT[201]. The Court added that Art. 267 TFEU is not a bar to intra-EU Investor-State

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[197] P. Nacimiento, M. Wittinghofer *et al.*, *Arbitration and intra-EU BITs – German Bundesgerichtshof weighs in on the discussion* (May 2016), available at http://hsfnotes.com/arbitration/2016/05/12/arbitration-and-intra-eu-bits-german-bundesgerichtshof-weighs-in-on-the-discussion/ (last vsited 2 August 2016).

[198] R. Happ and G. Scherpf, *The Door Is Open for the ECJ to Rule on Intra-EU BIT Arbitration* (May 2016), available at http://www.luther-lawfirm.com/en/news/the-door-is-open-for-the-ecj-to-rule-on-intra-eu-bit-arbitration.html (last visited 2 August 2016).

[199] *Ibid.*

[200] P. Nacimiento, M. Wittinghofer *et al*, *supra*, note 197.

[201] *Ibid*.

arbitration. It argued that a coherent application of EU law may be achieved through the national courts, which, if called to determine the validity of an arbitral award, can refer the decision to the ECJ, according to Art. 267 TFEU[202]. In doing so, the Court applied the jurisprudence of the ECJ in the *Eco Swiss* case to intra-EU arbitral awards, provided the question of validity is limited to the issue of public policy. Finally, to the extent that the questions regarding the other provisions are answered in the negative, the BGH relied to Art. 18 TFEU, arguing that the discrimination on the ground of nationality that would follow if the Investor-State dispute settlement system were held to be admissible can be avoided by extending this "privilege" to non-benefitting parties[203]. Two factors regarding the BGH's referral to the ECJ are noteworthy. First, the BGH did not find that the Commission's arguments, put forward in a number of proceedings through numerous *amicus curiae* briefs, were unpersuasive, in particular as regards the incompatibility of Investor-State arbitration with Arts. 344 and 267 TFEU. Second, although the BGH recognised the possibility that the Investor-State arbitration might be in breach of EU law, it drew the opposite conclusion from the Commission: it is not intra-EU BITs that must be eliminated, but the scope of Investor-State arbitration which should be extended, in order that it be made available to all investors from all Member States [204].

The prohibition contained in Art. 344 TFEU has been already been the object of the ECJ's analysis. This prohibition played a fundamental role in the so-called *Mox Plant* case[205], in which the Commission initiated an infringement proceeding against Ireland for having instituted arbitration proceedings under the UN Law of the Sea Convention. The ECJ, upholding the Commission's view, considered the issue at stake to be the competence of the EU, and it therefore regarded the interpretation of EU law to be a matter for the ECJ only, and found that submitting the dispute to a method of settlement other than those indicated by the EC Treaty was a violation of Art. 344 TFEU. This decision implies that,

[202] *Ibid*.
[203] Global Investment Protection, *Intra-EU BITs before the Court of Justice of the EU*, available at http://www.globalinvestmentprotection.com/index.php/intra-eu-bits-before-the-court-of-justice-of-the-eu/ (last visited 4 August 2016).
[204] P. Nacimiento, M. Wittinghofer *et al*, *supra*, note 197.
[205] Case C-459/03, *Commission v. Ireland (Mox Plant)* [2006] E.C.R. 1-4635.

whenever a case requires the interpretation of provisions of EU law, arbitral tribunals are not entitled to decide if or to what extent EU law must be applied[206].

However, the *Mox Plant* case dealt with inter-State disputes, and therefore should not be regarded as relevant to Investor-State arbitration, which would not be incompatible with Art. 344 TFEU, although there is the possibility that the ECJ might rule differently, now that it has been called upon to pronounce on the issue, finding that arbitral tribunals are not competent to rule on matters of EU law[207]. The ECJ's previous jurisprudence does not exclude this possibility. In the Opinion on the European and Community Patents Courts[208], the ECJ warned that enabling the patent court to rule on EU law would deprive the Court of the possibility of making preliminary rulings and would threaten the uniform interpretation of EU law guaranteed by the Court[209]. It thus appears that the ECJ is giving increasing importance to its role as guardian of the interpretation of EU law, which arbitral tribunals might threaten: this might have implications for Investor-State arbitration, which might be considered incompatible with the Court's prerogatives[210].

[206] F. Weiss and S. Steiner, "The investment regime under Article 207 of the TFEU – a legal conundrum: the scope of 'foreign direct investment' and the future of intra-EU BITs" in F. Baetens (eds), *Investment Law within International Law* (2013), at 368.
[207] A. Reinisch, *supra*, note 43, at 153.
[208] European Court of Justice , Opinion 1/09, European and Community Patents Courts [2011] E.C.R. 1-01137.
[209] Opinion 1/09, supra, note 208, at para 89, recalled in A. Reinisch, *supra*, note 43, at 154.
[210] A. Reinisch, *supra*, note 43, at 154.

6. Intra-EU BITs and the Energy Charter Treaty

The legal problems discussed above on the applicability and maintenance of intra-EU BITs find an additional element of complexity in the field of energy due to the ECT[211]. All Member States and the EU itself are in fact party to the treaty, and therefore the obligations arising under the ECT cannot be disregarded solely on the basis of EU law. Among the several Investor-State arbitration proceedings currently pending between Member States and investors from other Member States, approximately ten proceedings find their legal basis in the ECT[212]. These cases deal directly with PPAs and therefore are of particular relevance to the current analysis.

6.1. The Energy Charter Treaty

The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in 1994 and entered into force in 1998[213]. Originally, member States included most of the energy-rich countries from former Soviet Union and Central and Eastern Europe, the Member States and the European Community (EC) itself (now the EU, as successor to the EC, in its own internationally recognised legal personality[214]).

The aim of the ECT is to provide a framework for energy cooperation between Eastern and Western Europe[215] in order to minimise the risks related to international investment and trade in the field of energy[216]. It deals with five main areas, namely investment protection, trade, transit, environmental protection, and dispute settlement. With regard to investment, the fundamental aim of the ECT is the creation of a "level playing field" for energy investment, based on the principle of non-discrimination[217]. In doing so, the ECT does not oblige States to liberalise their energy markets, nor does it mandate a certain inward flow of foreign investment in the field of energy, and it does not oblige parties to provide

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211 Energy Charter Treaty 1994 (ECT), 2080 UNTS 95.
212 J. Katona, "The Role of EU Law in "intra EU" ISDS under the ECT", 1 *ELTE Law Journal* (2015) 57, at 57.
213 Energy Charter Secretariat, *The Energy Charter Treaty and Related Documents* (2004), available at http://www.ena.lt/pdfai/Treaty.pdf (last visited 31 July 2016) at 13.
214 E. Bonafé and G. Mete, *supra*, *supra*, note 31, at 176.
215 R. Leal-Arcasi and A. Filis, "Linking the European Union to the Energy Charter Treaty and the Energy Community", 3 *Energy Charter Knowledge Centre Review* (2014) 16, at 16.
216 Energy Charter Secretariat, *supra*, note 213, at 14.
217 *Ibid.*, at 14.

contracts to all investors from ECT parties on a non-discriminatory basis[218]. It does not, in other words, grant pre-investment protection[219]. Once an investment is made, however, States parties must agree on extending National Treatment and Most-Favoured Nation Treatment to entities from other States parties that have invested in their energy sector[220]. The ECT expressly provides the right to compensation in case of expropriation or of significant undermining of another State party investor's rights[221]. Moreover, it provides that, should a dispute arise, it will be settled through an ICSID or SCC arbitration, or through an arbitration according to the UNCITRAL Rules[222].

From a EU law perspective, the ECT is a "mixed agreement", namely an agreement parts of which fall within the competence of the EU and parts of which fall within the competence of Member States. At the time of its adoption, the competence for FDIs fell within the competence of Member States, but the Treaty of Lisbon, as explained above, placed it within the Union's exclusive competence as part of the CCP. The fact that both the EU and its Member States are parties to the ECT distinguishes the ECT from intra-EU BITs[223]. With regard to the latter, it has been argued that accession to the EU would automatically terminate intra-EU BITs or would oblige the contracting Member States to terminate their agreements[224]. The same cannot be said for the ECT, due to the fact that the EU is also party to the ECT. The ECT, since the beginning, was conceived as an instrument that would bind not only "old" Member States *vis-à-vis* later acceding States, but also those "old" Member States among each other[225].

With regard, on the other hand, to extra-EU BITs, the situation that emerged in the BIT judgments, where the ECJ found that BIT provisions were in violation of the EU rules on the free movement of capital, cannot be found in this case either. It is true that the provisions of Art. 14 ECT on capital transfers are similar to those of the BITs analysed by the ECJ. In

[218] R. Leal-Arcasi and A. Filis, *supra*, note 215, at 16.
[219] Eur-Lex, *Energy Charter Treaty*, available at http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=URISERV:l27028 (last accessed 23 July 2016).
[220] R. Leal-Arcasi and A. Filis, *supra*, note 215, at 16.
[221] Article 13, ECT, *supra*, note 211.
[222] Article 26, ECT, *supra*, note 211.
[223] T. Roe and M. Happold, *Settlement of investment disputes under the Energy Charter Treaty* (2011), at 89.
[224] See *Eastern Sugar BV v. Czech Republic*, *supra*, note 144.
[225] J. Kleinheisterkamp, *supra*, note 50, at 104.

this case, however, the provision must be harmonised, and Art. 14 ECT must be read as having limited its own competence, restricting capital movement in the field of energy[226].

It has been argued that the entry into force of the Lisbon Treaty, which attributes exclusive competence to the Union for FDIs in the field of the CCP, should not really concern the intra-EU element of the ECT, intra-EU investments being, by definition, not foreign investments[227]. There appears, in fact, to be nothing precluding the application of the ECT to intra-EU controversies. There is, in particular, no "disconnection clause". This is a clause according to which certain parties to a multilateral convention, in their relations *inter* se, decide to apply not the rules of the convention but specific rules agreed upon themselves[228]. Member States of the EC and the EC itself began introducing disconnection clauses in multilateral treaties to which Member States alone were to become parties, or in mixed agreements which the EC also joined[229], and their use has now become a common practice by the EU and its Member States[230]. The very first treaty containing a disconnection clause was the Convention on Mutual Administrative Assistance in Tax Matters in 1988, which stated, in its Art. 27(2):

> "Notwithstanding the rules of the present Convention, those Parties which are members of the European Economic Community shall apply in their mutual relations the common rules in force in the Community."[231]

[226] T. Eilmansberger, "Bilateral investment treaties and EU law", 46(2) *Common Market Law Review* (2009) 383, at 411.
[227] J. Kleinheisterkamp, *supra*, note 50, at 105.
[228] UN General Assembly, Official Records. Sixtieth Session: Report of the International Law Commission (ILC). Fiftyseventh session (2 May-3 June and 11 July-5 August 2005). Supplement No. 10 (A/60/10), at para 463.
[229] M. Smrkolj, *The Use of the „Disconnection Clause" in International Treaties: What does it tell us about the EC/EU as an Actor in the Sphere of Public International Law?* (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1133002, (last visited 11 August 2015).
[230] G. Coop, *Energy Dispute Resolution: Investment Protection, Transit and the Energy Charter Treaty* (2011), at 178.
[231] Article 27(2), Convention on Mutual Administrative Assistance in Tax Matters, 25 January 1988, ETS 127.

By resorting to a disconnection clause, Member States can apply EU law in their relations *inter se*, and exceptionally disregard their respective public international law treaty obligations, modifying the binding effects of a treaty [232].

As noted above, the ECT does not contain a disconnection clause, and it therefore has a comprehensive legally-binding effect, also with regard to *inter se* relations of Member States[233]. This conclusion can be drawn, *a contrario*, also from Annex 2 to the Final Act of the European Energy Charter Conference, which declares that, in the case of a conflict between the ECT and the Svalbard Treaty from 1920, the latter will prevail[234]. Since there is no corresponding provision with regard to EU treaties, in relations between the Member States, the ECT is to be considered superior to the EU treaties[235].

The intra-EU element, however, gives rise to several areas of friction between EU law and the ECT. They are evident, in particular, in disputes related to long-term energy contracts, which deal with investment protection under the ECT/BIT and the EU internal market and competition rules[236]. Long-term contracts were initially used as a means of eroding the monopolistic position of States in the initial phase of energy liberalisation, and were in line with States' obligations under, respectively, BITs and the ECT. Since the Lisbon Treaty, as noted above, they have become a matter of concern for the Commission under EU law[237].

6.2. The Commission's opposition to the application of the ECT in intra-EU disputes

The Commission has argued against the application of the ECT in intra-EU disputes. The line of argument followed by the Commission opposes, first, the jurisdiction of arbitral tribunals in disputes of this kind. Art. 26(1) ECT provides that:

> "Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably."[238]

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[232] C. Tietje, *The applicability of the Energy Charter Treaty in ICSID Arbitration of EU Nationals vs. EU Member States* (September 2008), available at http://telc.jura.uni-halle.de/sites/default/files/altbestand/Heft78.pdf (last visited 11 August 2016), at 10.
[233] *Ibid.*, at 11.
[234] Annex 2, ECT, *supra*, note 211, at 107.
[235] C. Tietje, *supra*, note 232, at 11.
[236] E. Bonafé and G. Mete, *supra*, note 31, at 176.
[237] *Ibid.*, at 180.
[238] Article 26(1), ECT, *supra*, note 221.

The Commission focused on the terms "Contracting Party" and "Investor of another Contracting Party". It stated, in particular, that a contracting party can also be a Regional Economic Integration Organization (REIO) that has consented to be bound by the treaty according to Art. 1(2) ECT, and that the EU is such an organization. A claim brought by an investor of a Member State against another Member State cannot be considered to be a claim against "another" contracting party, with the consequence that the tribunal would lack jurisdiction[239]. Another argument advanced by the Commission is that a tribunal constituted under Art. 26 ECT ought to decline to arbitrate disputes between Member States and nationals of other Member States, on the ground that doing so would be contrary to the applicable rules and principles of international law, which bind the tribunal under Art. 26(6) ECT[240]. One last line of argument regards the merits of the disputes. The Commission has held that, in all intra-EU cases, the applicable rules of international law include EU law, and that there is a rebuttable presumption that compliance with EU law satisfies the requirements of the ECT. The position of the Commission with regard to the applicability of the ECT in intra-EU disputes seems in line, *mutatis mutandis*, with that expressed for intra-EU BITs.

The Commission's view has been criticised by scholars. It has been argued that the lack of "another" contracting party seems unsound, as it is based on a reading of the ECT under which any investor based in a Member State must be considered only as an investor of the EU. Such reading would find no legal basis in the TFEU, which, at Art. 20(1), states that citizenship of the EU "shall complement and not replace national citizenship"[241]. Moreover, the definition of "investor" in the ECT makes no mention of REIOs[242]. Also, the alleged necessity for tribunals to decline jurisdiction on the ground that it would be contrary to Art. 26(6) ECT has been criticised. It has been considered that not every principle of EU law would constitute a rule or principle of international law, even though it arises from an international treaty[243].

6.3. *Arbitral Tribunals*

Not only scholars have opposed the view of the Commission, but also arbitral tribunals, which have addressed the relationship between the ECT and EU law. Although they have

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[239] T. Eilmansberger, *supra*, note 226, at 92.
[240] T. Eilmansberger, *supra*, note 226, at 94.
[241] Article 20(1), TFEU, *supra*, note 33.
[242] Article 1(7), ECT, *supra*, note 211.
[243] T. Eilmansberger, *supra*, note 226, at 94.

relied on different legal reasoning, as will be illustrated below, they have considered the ECT applicable to intra-EU disputes.

6.3.1. AES v. Hungary

In the case *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*[244] (AES v. Hungary), AES, a company incorporated under the law of the United Kingdom, filed a request for arbitration with the ICSID against Hungary for violation of its obligations under the ECT. Hungary, after the 2006 Electricity Energy Act Amendment, which permitted the reintroduction of regulated prices after they were abolished in 2004, adopted two decrees, one in in December 2006 and another in February 2007, reintroducing a regime for administrative prices for electricity sold to the Hungarian State-owned entity Magyar Villamos Művek Zrt. (MVM)[245]. These measures were adopted as a consequence of the debate that arose in 2005, which aimed to cap the "luxury profits" of power generators[246].

According to the claimant, the new regime was in violation of the terms of the PPA concluded with the Hungarian State-owned entity in 1996 (before Hungary's accession to the EU in 2006), which guaranteed a fixed pricing regime under which AES sold energy to two State-owned entities, and was in breach of Hungary's obligations under the ECT. More specifically, the measures violated several substantial grounds of protection, namely fair and equitable treatment, national treatment, most-favoured nation treatment, constant protection and security, expropriation, and the prohibition of unreasonable and discriminatory measures[247]. Hungary, on the other hand, maintained that the PPA was in violation of the EU State aid regulation[248]. According to the State, there was no conflict between the provisions of the ECT and EC competition law, which was incorporated in the Hungarian law governing the PPA. As a consequence, Hungary could not ignore EU demands to "minimize or eliminate prohibited State aid"[249]. AES argued that the ECT was the applicable law, and recalled Art. 16 ECT[250], according to which, if there is a conflict

[244] ICSID, *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary* (AES v. Hungary), *Final Award*, 23 September 2010, ICSID Case No. ARB/07/22.
[245] *Ibid.*, at para. 4.20.
[246] *Ibid.*, at para. 4.15.
[247] *Ibid.*, at para.5.1.
[248] E. Bonafé and G. Mete, *supra*, *supra*, note 31, at 181.
[249] *AES v. Hungary*, *supra*, note 244, at para. 7.2.5.
[250] Article 16, ECT, *supra*, note 221.

between the ECT and another treaty that deals with the same subject matter as Part III of the ECT, namely investment promotion and protection, and Part V of the ECT, which deals with dispute settlement, the provisions more favourable to the investor will prevail[251]. In this case, the ECT provisions were considered to be the most favourable to the investor, given that the PPA was in line with them[252]. Hungary argued that the ECT did not need to be interpreted completely independently from EU law and developments[253], claiming that, when a State is subject to different treaties involving overlapping subject matters, treaty obligations should be interpreted in a way that minimises the possible conflicts[254].

The Commission intervened with the submission of an *amicus curiae* brief, maintaining that the tribunal had no jurisdiction[255], and that, in the case of a State measure in accordance with EU law, there is a rebuttable presumption that the measure is compatible with the ECT[256].

The tribunal found that it had jurisdiction, that the ECT was the applicable law to the dispute, and that it should be interpreted in accordance with the provisions of Arts. 31 and 32 VCLT[257]. It stated that the EU competition law regime had a dual nature: on the one hand, it is an international law regime and, on the other hand, it is a national law regime, once it has been introduced into the national legal order. It therefore considered the competition law regime to be a fact, as pleaded by the parties[258]. The tribunal then rejected the relevance of Art. 16 ECT, given that it was not dealing with a conflict between the ECT and EU law, but with the conformity of a measure adopted by Hungary with the ECT[259]. Hungary's obligations under EU law was only one of the elements to consider, but EU law should not be construed as general principles of international law, as required by Art. 26(6) ECT[260]. It then rejected the applicability of Art. 30 EC Treaty, as it applied only to

[251] *AES v. Hungary*, *supra*, note 244, at para. 7.5.5.
[252] E. Bonafé and G. Mete, *supra*, note 31, at 181.
[253] *AES v. Hungary*, *supra*, note 244, at para. 7.2.2.
[254] *Ibid.*, at para. 7.2.3.
[255] European Commission, Written Submission pursuant to article 37 (2) of the ICSID Arbitration rules of 15 January 2009, in the case ARB/07/22, AES v. Hungary, *supra*, note 244.
[256] F. Hoffmeister and G. Ünüvar, *From BITs and Pieces toward European Investment Agreements*, in M. Bungenberg, A. Reinisch, C. Tietje (eds.), *The EU and Investment Agreements: Open Questions and Remaining Challenges* (2013) at 60.
[257] *AES v. Hungary*, *supra*, note 244, at para. 7.6.4-7.6.5.
[258] *Ibid.*, at para. 7.6.6.
[259] *Ibid.*, at para. 7.6.9.
[260] *Ibid.*, at para. 7.6.9.

agreements between Member States and non-Members States, and both Hungary and the United Kingdom are Member States[261].

With regard to the merits of the case, the tribunal found that none of the substantive obligations under the ECT had been violated. It found no breach of Hungary's fair and equitable treatment obligation, due to the fact that the State gave no assurances to the investor that, following the termination of price administration in 2003, a new price administration would not be introduced[262]. Nor, according to the tribunal, was the decision to reintroduce temporary administrative prices in 2006 irrational or unreasonable, and no violation of the ECT could be found in this regard[263].

Finally, the tribunal stated that the introduction of administrative pricing, adopted to avoid generators earning excessive profits and being a burden to consumers, was a valid and rational objective for a government[264]. Even if Hungary's measures aimed at addressing the Commission's State aid concerns, altering the terms of the PPA, this would have been a rational public policy measure, consistent with the State's right to regulate economic activities within its territory[265].

6.3.2. Electrabel S.A. v. Hungary

Electrabel S.A. v. Hungary[266] case concerned a Belgian company, Electrabel, which invested in a power-generator company in Hungary, entering a PPA with the State-owned electricity wholesaler MVM, to which it sold the electricity. The agreement, concluded before Hungary's accession to the EU, provided that Electrabel would preserve capacity available on demand in return for payment at a fixed price[267]. This agreement was deemed by the EU Commission to be incompatible with European law, as it constituted unlawful State aid, and Hungary was ordered to terminate it, with the same legally binding instrument analysed in *AES v. Hungary*[268].

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[261] *Ibid.*, at para. 7.6.11.
[262] *AES v. Hungary*, *supra*, note 244, at para. 9.3.18.
[263] *Ibid.*, at para. 9.3.37.
[264] *Ibid.*, at para. 10.3.34.
[265] E. Bonafé and G. Mete, *supra*, note 31, at 181.
[266] ICSID, *Electrabel S.A. v. Republic of Hungary, Decision on Jurisdiction, Applicable Law and Liability*, 30 November 2012, ICSID Case No. ARB/07/19.
[267] E. Bonafé and G. Mete, *supra*, note 31, at 182.
[268] European Commission, Decision of 4 June 2008 on the State aid C 41/05 awarded by Hungary through Power Purchase Agreements, C(2008) 2223, 4 June 2008.

In 2007, Electrabel initiated an arbitration proceeding before ICSID on the basis of the ECT for unlawful termination of the PPA. Such possibility was contained in the ECT, Art. 26.3(a)[269] of which provides for the contracting State's consent to arbitration. The *Electrabel* tribunal dealt with the jurisdictional objection first: this was not made by the parties but by the Commission in its *amicus curiae* brief[270], which argued that the tribunal lacked jurisdiction to hear the PPA termination claim. The tribunal upheld its jurisdiction on the basis of three main arguments. First, it found no provisions in EU law which would prevent resort to Investor-State arbitration[271]. Art. 344 TFEU is the only explicit provision on external dispute resolution, and it deals only with the interpretation and application of EU law and concerns only State-to-State disputes, rather than Investor-State disputes, like the one at stake[272]. Second, Investor-State arbitration does not violate the role of the ECJ in the EU system. Investor-State arbitration does not, in fact, jeopardise the role of the ECJ in giving preliminary rulings aimed at keeping the interpretation of EU law uniform. The tribunal recalled the fact that foreign courts and arbitral tribunals apply EU law without having the possibility to resort to a preliminary ruling of the ECJ. It acknowledged that this was due to the control that could be exercised by EU domestic courts during the enforcement stage, and that it was not applicable in the case of ICSID awards, but it still found that the uniform application of EU law by the ECJ was made possible even in the case of ICSID awards by means of an infringement procedure[273]. Finally, the tribunal stated that the dispute regarding the termination of the PPA was not an intra-EU dispute. In doing so, it rejected the Commission's argument that the dispute related to the lawfulness of EU measures and could not be covered by the ECT[274]. The arbitral tribunal applied the ECT itself and the principles of international law, as provided by Art. 26.6 ECT[275]. In investment arbitration, domestic law comes into play when dealing with certain issues defined by international law[276], or, as stated in the *Chorzow Factory*[277] case, as facts in the dispute. The first question the tribunal had to address was whether EU law had to be taken into

[269] Article 26.3(a), ECT, *supra*, note 211.
[270] European Commission, Written Submission pursuant to article 37 (2) of the ICSID Arbitration rules of 28 April 2009, in the case ARB/07/19, Electrabel S.A. v. Republic of Hungary.
[271] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 5.32.
[272] J. Katona, *supra*, note 212, at 62.
[273] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 5.33-5.36.
[274] J. Katona, *supra*, note 212, at 62.
[275] Energy Charter Treaty, *supra*, note 269, Article 26.6.
[276] J. Katona, *supra*, note 212, at 59.
[277] PCIJ, *Case Concerning the Factory at Chorzow, Claim for Indemnity, Jurisdiction*, 26 July 1927, Series A.-No.9.

account as part of international law, as claimed by Hungary, or as part of domestic law, as claimed by Electrabel. The tribunal adopted the same approach as the tribunal in the *AES* case, stating that EU law could be seen either as international law or as domestic law. In contrast with the *AES* approach, however, the *Electrabel* tribunal concluded that EU law had to be regarded as international law. Consequently, a conflict of norms had to be solved through the rules of public international law.

First, the tribunal found no conflict between EU law and the ECT, and considered the provisions on Investor-State arbitration contained in Part V of the ECT to be compatible with EU law[278]. In case a conflict arose, according to Art. 30 VCLT[279], the conflicting provisions should be read in harmony, where possible. It also concluded that if there were any inconsistencies, they should be harmonised by the tribunal itself[280]. Moreover, Art. 16 ECT[281] was not considered applicable as EU law and the ECT, although having many provisions in common, were not considered to have the same subject matter, as required by the article. According to Art. 16 ECT, should a conflict arise between the two sources, the provision most favourable to the investor would apply[282]. Not even Art. 351 TFEU was considered applicable, as it covers the case of relations between Member States and non-Member States, and not disputes between Member States[283]. The tribunal, however, found that the provision had not only a "positive" reading, namely the fact that "the rights and obligations arising from an agreement concluded before the date of accession of a Member State between it and a third country are not affected by the provisions of the Treaty"[284], but also a "negative" one. The latter would imply that, taking into account the process of integration of the EU, the rights under the earlier treaty between Member States incompatible with EU law would not survive[285]. The tribunal went further stating that the pre-eminence of EU law applies not only to pre-accession treaties, but also to post-accession ones, as Member States cannot derogate from EU rules in relationships between themselves[286].

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[278] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 4.175.
[279] Artice 30, VCLT, *supra*, note 106.
[280] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 4.166.
[281] Article 16, ECT, *supra*, note 211.
[282] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 4.173-4.191.
[283] *Ibid.*, at 4.180.
[284] European Commission v. Slovak Republic, *supra*, note 111, at para. 41.
[285] *Electrabel S.A. v. Republic of Hungary*, *supra*, note 266, at 4.183.
[286] *Ibid.*, at 4.186.

Therefore, in the tribunal's words, "if any inconsistency existed between the ECT and EU law, the ECT would apply in relations between EU Members and non-EU Members, but […] EU law would prevail over the ECT in relations between EU Members themselves"[287]. It then dismissed Electrabel's argument that investors under the ECT are different from Member States, and that their rights should be treated as analogous to those of a non-EU State[288].

The Electrabel case was not the first case in which the jurisdiction of the tribunal was challenged on the grounds that the ECJ should have exclusive jurisdiction to decide any issues of EU law arising in intra-EU cases[289]. It must be noted in this respect that, in the *Eureko* and *Electrabel* cases, the Commission adopted a different approach from the earlier *Eastern Sugar* case. In the *Eastern Sugar* case, the Commission accepted that Art. 344 TFEU applies only to inter-State arbitration, and acknowledged that Investor-State arbitration could be used in intra-EU cases, only demanding that the tribunal recognise the primacy of EU law[290]. In the *Eureko* and *Electrabel* cases, on the contrary, the Commission argued that Investor-State arbitration violates EU law because it conflicts with the monopoly the ECJ has on the interpretation of EU law under Arts. 267 and 344 TFEU[291]. The reason for this difference in the Commission's approach has been identified as being the realisation that the problem of intra-EU BITs would not be merely temporary, that is for the time required by Member States to terminate their intra-EU BITs[292]. As explained above, States did not in fact follow the Commission's line but rather maintained their intra-EU BITs, at most arguing that they were automatically terminated. Notwithstanding the Commission's monopoly argument, there is no ECJ case law that could support it. The same Commission, in the *Nordsee* case, precluded the possibility for arbitral tribunals to resort to the ECJ for preliminary rulings[293].

At the same time, the *Electrabel* award has been subject to extensive criticism, especially for its possible implications with regard to non-EU investors[294]. First, the tribunal's

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[287] *Ibid.*, at 4.187.
[288] *Ibid.*, at 4.188.
[289] A. Stier, "The jurisdiction of the arbitral tribunal in intra-EU investment treaty disputes after the decision in Electrabel v Hungar", 31 *Arbitration International* (2015) 163, at 166.
[290] *Ibid.*, at 167.
[291] *Ibid.*, at 166.
[292] *Ibid.*, at 168.
[293] *Ibid.*, at 168
[294] A. Stanič, *supra*, note 41, at 44.

consideration of EU law as international law applicable to an ECT dispute has not been accepted without critique[295]. The topic is still hotly debated, and has led to conflicting awards, such as the *AES* and *Electrabel* awards. Second, the tribunal recognised the necessity of establishing the correct balance between the values behind the ECT and EU law. In doing so, the tribunal, like the other tribunals dealing with intra-EU cases, acknowledged the availability of Investor-State arbitration between Member States and investors from other Member States under the ECT[296]. It then went on to admit the possibility of the arbitrability of disputes between the EU and EU nationals, in opposition to the Commission's arguments[297].

6.4. Recent developments

A series of new cases between Member States initiated before arbitral tribunals on the basis of ECT provisions are currently pending against Spain, the Czech Republic and Italy[298]. On 21 January 2016, the Stockholm Chamber of Commerce (SCC) rendered an award in the case *Charanne and Construction v Spain*[299], which deals with important issues regarding investment protection and the right of States to regulate the energy sector[300].

Charanne B.V and Construction Investments S.à.r.l. were a Dutch and a Luxemburg company respectively, which acquired shares in Grupo T-Solar Global S.A. (T-Solar), a Spanish entity operating in the generation and sale of power through solar photovoltaic centres. At the time of the investment, Spanish legislation provided for a feed-in regime for the photovoltaic sector that allowed investors to recover the costs incurred in the creation of power infrastructure[301]. In 2010, Spain enacted two Royal Decrees that introduced a time limit, removing incentives after the 26th year of operation of the installations, capping the amount of operating hours subject to the special regime, and establishing a transmission charge[302].

[295] J. Katona, *The role OF EU law in 'intra EU' ISDS under the ECT – Some thoughts on the Electrabel v. Hungary award* (January 2015), available at http://eltelawjournal.hu/role-eu-law-intra-eu-isds-ect-thoughts-electrabel-v-hungary-award/ (last visited 4 August 2016).
[296] *Ibid*.
[297] *Ibid*.
[298] E. Bonafé and G. Mete, *supra*, note 31, at 174.
[299] SCC, *Charanne B.V. and Construction Investments S.A.R.L. v. Kingdom of Spain* (Charanne v. Spain), 21 January 2016, Arb. No 062/2012.
[300] E. Bonafé and G. Mete, *supra*, note 31, at 174.
[301] *Charanne v. Spain*, *supra*, note 299, at paras.82 ss.
[302] *Ibid.*, at paras.148-168.

The claimants commenced arbitration under Art. 26 ECT, alleging that the changes amounted, among other things, to indirect expropriation and violation of FET obligations. The indirect expropriation was found in the fact that they negatively affected the economic profitability of their investment in a significant manner[303], and therefore were in breach of Art. 13 ECT[304]. The change of the legal framework was then considered to be in violation of the State's FET obligation to maintain a stable and predictable legal framework, under Art. 10(1) ECT[305].

Spain argued that the measures were not in violation of ECT obligations, and challenged the jurisdiction of the arbitral tribunal on three different grounds. Firstly, the claimant had activated the "fork in the road" provision contained in Art. 26(3)(b)(i) ECT, which excludes consent to arbitration if the affected investor has previously submitted the claim to the courts of the Member State[306]. Charanne and Construction had not themselves filed such claims, but T-Solar had challenged the legislation in question before the Spanish Supreme Court and before the European Court of Human Rights (ECtHR) on the basis that Spain had violated their property rights. Secondly, Spain argued that neither corporation fell within the definition of "investor" set out at Art. 1(7) ECT, as they were merely "empty shells" ultimately controlled by Spanish nationals, while the ECT granted protection to investors who are nationals of other States parties[307]. Thirdly, it argued that the tribunal lacked jurisdiction because of the intra-EU nature of the dispute, and the resolution of such disputes is reserved to the judicial system established by EU law[308]. This last argument was also supported by the Commission through an *amicus curiae* brief.

The tribunal rejected Spain's position on jurisdiction on all grounds. It did not consider the fork in the road provision to be applicable to the dispute, as this provision requires the parties, the subject matter and legal basis of the disputes to be identical. The tribunal focused, in particular, on the identity requirement, finding that Charanne and Construction were different subjects to T-Solar, and were therefore not party to any proceeding before the Spanish courts[309]. With regard to the argument that they did not qualify as "investors"

303 *Ibid.*, at para.456.
304 *Ibid.*, at paras.278-290.
305 *Ibid.*, at para.293.
306 *Charanne v. Spain*, *supra*, note 299, at para.398.
307 *Ibid.*, at paras.225-230.
308 *Ibid.*, at para.209.
309 *Ibid.*, at para.408.

according to Art.1 (7) ECT, the tribunal noted that Art. 1(7)(a)(ii) ECT, referring to legal persons, qualifies as investors those "organized in accordance with the law applicable in that Contracting Party"[310]. Netherlands and Luxembourg are contracting parties to the ECT, and the investors were constituted in accordance with the applicable laws of those contracting parties[311]. In relation to the third argument, the tribunal stated that EU States did not lose their position as ECT contracting parties when the EU ratified it as a REIO, and therefore both the EU and its Member States can be parties in proceedings under the ECT[312]. Consequently, the tribunal found that an intra-EU dispute respects Art. 26 ECT, which implicitly requires that an investment by an investor of an ECT contracting party be made in the territory of another ECT contracting party[313]. Both the territory of the REIO and that of Member States are encompassed by the ECT, but only the territory of the Member States was deemed relevant in this case. The tribunal then rejected Spain's argument regarding the existence of an implicit disconnection clause based on Art. 7 ECT on the ground that "[t]he existence of the EU does not imply any contradiction or impediment to the full implementation by EU Member States of their obligations under Article 7 of the ECT"[314]. Finally, with regard to Art. 344 TFEU, the tribunal agreed with the *Electrabel* tribunal while considering the scope of the provision as being limited to external dispute resolution[315], although it found no contradiction between the ECT and EU law in the present case[316].

The tribunal, however, dismissed the case on the merits. It did not consider that there had been any indirect expropriation, as that would have required a loss of value of the investment and a loss of control over it[317]. Instead, the company T-Solar, which was identified as the claimants' investment, continued operating and making profits, with only a reduction of the profitability of the investment. Such decrease in value was not enough to be considered as equivalent to expropriation. The legislative measures were not of "such a significance that it could be considered that the investor has been deprived, in whole or in

310 Article 1(7)(a)(ii), ECT, *supra*,
311 *Charanne v. Spain*, *supra*, note 299, at para.414.
312 E. Bonafé and G. Mete, *supra*, *supra*, note 31, at 175.
313 *Charanne v. Spain*, *supra,* note 299, at para.428.
314 *Ibid.*, at para.436. (Unofficial translation)
315 *Ibid.*, at para.444.
316 *Ibid.*, at para.439.
317 *Ibid.*, at para.464.

part, of its investment"[318]. Also with regard to the fair and equitable treatment standard, the tribunal found no violation. The claimants argued that the measures adopted by Spain constituted an unexpected modification of Spain's regulatory regime, in violation of their legitimate expectations[319]. The tribunal recalled the customary international law principle of good faith, according to which a State cannot induce an investor to make an investment, generating legitimate expectations, and later ignore the commitments that generated such expectation[320]. However, legitimate expectations must derive from specific personal commitments, such a stabilisation clause, or by rules that, although general, are put in place with the specific aim of inducing foreign investment and on which the foreign investor relied[321]. In the present case, no specific commitments towards the claimants were adopted, and the Royal Decrees, although directed at a limited group of investors, were considered to retain their general nature. Converting a regulatory standard into a specific commitment by the State only as a consequence of the limited character of the subjects affected would constitute an excessive limitation on the power of States to regulate the economy in accordance with the public interest[322].

The award has been criticised for its analysis of the merits of the dispute, in particular for failing to address the issue of the retroactivity of changes to the legal system, and therefore for finding no violation of the ECT[323]. On the other hand, the award is particularly relevant for its intra-EU aspects, as it rejects the idea of an implied disconnection clause, argued for by the Commission and by Spain, and it denies the applicability of Art. 344 TFEU to intra-EU disputes. Accordingly, the tribunal found no legal obstacle, either under EU law or under the ECT, which would prevent European investors from bringing ECT claims against Member States[324].

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318 *Ibid.*, at para.465. (Unofficial translation)
319 *Ibid.*, at para.478.
320 *Ibid.*, at para.486.
321 *Charanne v. Spain*, *supra*, note 299, at para.489.
322 *Ibid.*, at para.493.
323 Global Investment Protection, *3 Takeaways from the First Spanish Solar Arbitration Award* (February 2016), available at http://www.globalinvestmentprotection.com/index.php/3-takeaways-from-the-first-spanish-solar-arbitration-award/ (last visited 12 August 2016).
324 *Ibid.*

7. Long-Term contracts as State Aids?

In addition to the problems discussed above, intra-EU disputes give rise to an additional issue, namely the opposition of the Commission to the enforcement of intra-EU awards, on the basis of their incompatibility with EU legislation on State aid. When a Member State is ordered to compensate an investor from another Member State, compliance with the award requires the payment of a sum of money[325]. The issue of State aid will be addressed first, followed by an analysis of the relevant case law. According to Art. 107 TFEU:

> "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."[326]

Member States are required to notify the Commission in advance of planned measures that may constitute State aid unless they fall within the exceptions set out in Art. 107 paras. 2 and 3 TFEU[327]. Aid measures must confer an economic advantage on the recipient in a manner that would overstep the normal course of business[328].

7.1. The doctrine of imputability

According to the Commission and the ECJ, advantages given by States can be categorised as State aid when they are imputable to the State[329]. In most cases, this was found where the aid came from formally independent entities, which were revealed to be a means for channelling State resources[330], as the persons undertaking the decisions were "formally nominated or acting under the control of a State"[331]. A delicate question arises when dealing with awards rendered by arbitral tribunals, namely the question of whether an award issuing compensation to an investor can constitute illegal State aid. It is true that States nominate

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[325] P. Ortolani, "Intra-EU Arbitral Awards vis-a`-vis Article 107 TFEU: State Aid Law as a Limit to Compliance", 6 *Journal of International Dispute Settlement* (2015) 118, at 119.
[326] Article 107 TFEU, *supra*, note33.
[327] Article 107, para. 2 and 3, TFEU, *supra*, note 33.
[328] L. Hancher, "Arbitrating EU State Aid Issues" in G. Blanke and P. Landolt (eds), *EU and US Antitrust Arbitration: A Handbook for Practitioners* (2011) 965, at 972.
[329] Case T-351/02, *Deutsche Bahn AG v. Commission* [2006] ECR II-1047 at para. 101.
[330] T. Kende, "Arbitral Awards Classified as State Aid under European Union Law", 1 *ELTE Law Journal* (2015) 37, at 40.
[331] Case C-482/99, *France v. European Commission (Stardust)* [2002] ECR I-4397 at para 48, cited in T. Kende, *supra*, note 330, at 41.

one of the (usually) three arbitrators, but this does not seem to be enough to qualify the award as imputable to the State, since the rest of the arbitral tribunal is not connected with the State, and the arbitrators do not receive instructions[332].

The Commission, in the context of long-term PPAs, gave some indication as to its position in 2007 and 2008, in its decisions against Hungary and Poland[333]. Both States had, prior to their accession to the EU, privatised their energy sectors and awarded long-term PPAs to foreign investors in order to attract investment and bring their electricity generation plants up to EU safety and environmental standards[334]. In the case of Poland, the Commission opened a proceeding in 2005 and ruled in September 2007 that the PPAs in question were a form of State aid[335]. It then went further stating that neither BITs nor the ECT prohibit the termination of contracts, but they require the payment of appropriate compensation. However, such compensation is compatible with EU law only if the substantive right was legally enforceable[336]. If the contract was found to constitute illegal State aid, any eventual compensation would face the same qualification, and the termination of the agreement without compensation could not be considered to be deprivation of rights[337]. The Commission did not put forward any precedent to support its reasoning. Nor does the TFEU grant the Commission any explicit power to rule on the validity of private contracts[338].

In the case of Hungary, the Commission initiated a proceeding in 2005 and ruled on the Hungarian PPAs in June 2008[339]. In this case, the State had not proposed to terminate the contracts in return for compensation, as was the case for Poland. The Commission analysed only the legality of the PPAs in the context of the EU State aid regime, declaring them to be incompatible with the common market[340]. According to these PPAs, MVM had the obligation to buy a fixed quantity of energy at a fixed price. Granting a return on investment

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332 T. Kende, *supra*, note 330, at 41.
333 *Ibid.*, at 43.
334 L. Hancher, *supra*, note 328, at 1004.
335 European Commission, Commission Decision of 25 September 2007 on State aid awarded by Poland as part of Power Purchase Agreements and the State aid which Poland is planning to award concerning compensation for the voluntary termination of Power Purchase Agreements, C(2007) 4319), 25 September 2007.
336 *Ibid.*, at para.294.
337 L. Hancher, *supra*, note 328, at 1004.
338 *Ibid.*, at 1005.
339 European Commission, Commission Decision of 4 June 2008 on the State aid C 41/05 awarded by Hungary through Power Purchase Agreements, C(2008) 2223), 4 June 2008.
340 L. Hancher, *supra*, note 328, at 1005.

without commercial risk, the PPAs strengthened the position of PPA-bound producers in comparison with other producers, conferring upon them a selective economic advantage[341].

In the field of compensation for expropriation, the Commission, in the *ThyssenKrupp* case[342], stated that "compensation granted by the State for an expropriation of assets does not normally qualify as State aid"[343]. When dealing with the doctrine of imputability, problems regarding the compatibility of the payment awarded as compensation with Art. 107 TFEU should never arise; however, with regard to intra-EU BITs, both the ECJ and arbitral tribunals have analysed the matter.

The ECJ interpretation of Art. 107 TFEU is that State aid must be granted voluntarily by a Member State or through State resources. A contribution is involuntary when the State repays charges that have been improperly levied, when it is obliged to pay damages, and when it compensates expropriation[344]. With regard to the repayment of charges, the ECJ interpreted Art. 107 TFEU in the *Denkavit* case[345], finding that "the duty of the authorities of a Member State to repay to taxpayers who apply for such repayment, in accordance with national law, charges or dues which were not payable because they were incompatible with Community law does not constitute an aid within the meaning of Article 92 of the EEC Treaty"[346].

More interesting, in the optic of the present analysis, is the ECJ position with regard to the payment of damages. In the *Asteris* case[347] the ECJ was asked, among other things, whether any damages that Greece might be ordered to pay should be considered to be illegal State aid under EU law. The Court concluded that State aid is "fundamentally different in [its] legal nature from damages which the competent national authorities may be ordered to pay to individuals in compensation for the damage they have caused to those individuals"[348]. Therefore, a payment by a Member State, if due as the result of an obligation, does not

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[341] *Ibid.*, at 1005.
[342] European Commission Decision of 20 November 2007 on the State aid C 36/A/06 (ex NN 38/06) implemented by Italy in favour of ThyssenKrupp, Cementir and Nuova Térni Industrie Chimiche,OJ EC No. L144/37.
[343] *Ibid.*, at at para.70.
[344] C. Tietje and C. Wackernagel, "Outlawing Compliance? – The Enforcement of intra-EU Investment Awards and EU State Aid Law", 41 *Policy Papers on Transnational Economic Law* (June 2014) 2, at 3.
[345] Case 61/79, *Amministrazione delle Finanze dello Stato v Denkavit* [1980] ECR 1205).
[346] *Amministrazione delle Finanze dello Stato v Denkavit*, *supra*, note 345, at 1205.
[347] Joined cases 106 to 120/87, *Asteris AE and others v Hellenic Republic and European Economic Community* [1988] ECR 5515.
[348] *Asteris AE and others v Hellenic Republic and European Economic Community*, *supra*, note 347, at para.23.

violate EU State aid legislation. The ECJ did not specify, however, if the legal contribution by a State was to be based on a right of compensation under national law or on a court's judgment recognising liability[349].

Further clarification can be found in a decision of the Commission that expressly relied on the *Asteris* case, namely the *Akzo Nobel* case[350]. The Commission was asked to determine whether the payment of a lump sum from the Netherlands to Azko Nobel, in compensation for the revocation of an environmental permit, would constitute illegal State aid under Art. 107 TFEU. The Commission maintained that, irrespective of the origin of the measure, namely whether it has been mandated by a court or not, the payment of compensation is compatible with Art. 107 TFEU if it serves no other purpose than that of simply compensating an undertaking for damages suffered by a private party as a consequence of governmental actions, and the undertaking is provided for by national law, or at least the law applicable to the case[351].

The decision clarifies the difference between compensation and State aid as stated by the ECJ. A government that is legally bound to pay compensation is not favouring an individual undertaking against its competitors, but only remedying a wrongfulness incurred by it. The compensatory character is what renders it compatible with State aid legislation: this, however, does not mean that the compensation could not serve other purposes[352]. The rationale of the decision is that, where a right to compensation is clearly provided by a State's domestic legislation and by the national courts' judicial interpretation, such compensation is not in breach of EU State aid legislation[353].

The transposition of these requirements to intra-EU investment awards might prove problematic where the relevant BITs provide broad standards of protection. For this reason, the *Akzo Nobel* decision has been criticised for establishing criteria that are too restrictive[354]. It is instead generally recognised that the obligation to pay compensation stemming from an international instrument should be treated in the same way as an obligation to pay compensation arising out of domestic provisions: an arbitral tribunal,

[349] P. Ortolani, *supra*, note 325, at 121.
[350] C (2004) 2026 fin, Commission Decision of 16 June 2004, OJ 2005 C 81.
[351] P. Ortolani, *supra*, note 325, at 121.
[352] M. Tjepkema, "Damages Granted by the State and Their Relation to State Aid Law", 3 *European State Aid Law Quartely* (2013) 478, at 485.
[353] P. Ortolani, *supra*, note 325, at 122.
[354] See P. Ortolani, *supra*, note 325 and C. Tietje and C. Wackernagel, *supra*, note 344.

based upon the wording of an investment agreement, must identify which measure violates the right of the investor in the particular case, thus giving rise to an obligation to compensate[355]. Once the award has been rendered, if a State can be obliged to pay compensation under domestic law, then it can be obliged to do so under international law as well[356].

As stated above, Art. 107 TFEU requires a payment to be a governmental measure and to be attributable to the State in order to constitute State aid. The ECJ analysed these requirements in the *Deutsche Bahn* case[357], stating that, insofar as a Member State has no autonomy regarding the implementation of EU law, attribution of the measure to the State, and therefore imputability, is excluded[358]. In this case, a Member State recognising and enforcing an arbitral award must be considered to be respecting its international obligations[359]. The rationale of the *Deutsche Bahn* case is valid as far as the ICSID Convention is concerned. By virtue of Arts. 53 and 54 of the ICSID Convention[360], ICSID member States have no autonomy regarding the recognition and enforcement of ICSID awards[361]. The same conclusion, by contrast, cannot be reached in non-ICSID cases. Under Art. V(1)(b) of the New York Convention[362], recognition and enforcement of foreign arbitral awards can be denied by third States when they conflict with their *ordre public*[363].

What follows is that there are circumstances in which the enforcement of arbitral awards can violate Art. 107 TFEU[364]; consequently, intra-EU awards are entitled to recognition and enforcement under the New York Convention when imputability can be excluded[365]. The core rules of EU competition law have in fact been considered by the ECJ, in the *Eco Swiss* case[366], to have the same relevance as domestic *ordre public* provisions in this context[367]. This problem arises when the obligation to compensate refers to benefits that

355 P. Ortolani, *supra*, note 325, at 123.
356 C. Tietje and C. Wackernagel, *supra*, note 344, at 5.
357 *Deutsche Bahn AG v. Commission*, *supra*, note 329.
358 C. Tietje and C. Wackernagel, *supra*, note 344, at 6.
359 P. Ortolani, *supra*, note 325, at 124.
360 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ICSID Convention), 18 March 1965, 575 UNTS 159.
361 C. Tietje and C. Wackernagel, *supra*, note 344, at 6.
362 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (NY Convention), 10 June 1958, 330 UNTS 38.
363 Article V(2)(b), NY Convention, *supra*, note 362.
364 C. Tietje and C. Wackernagel, *supra*, note 344, at 7.
365 P. Ortolani, *supra*, note 325, at 124.
366 Case C-126/97, *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055.
367 P. Ortolani, *supra*, note 325, at 124.

constituted illegal State aid under Art. 107 TFEU in the first place. The Commission has almost completely evaded the question of whether or not the recognition and enforcement of arbitral awards can be attributable to a State as illegal State aid[368]. In the field of the energy, the relevance of this problem is evident in the *Micula*[369] case.

7.2. ICSID awards: the case of Micula v. Romania

In 1998 and 1999, Romania introduced economic incentives for the development of weak economic regions in the form of tax incentives and customs duties exemptions[370], which were in 2005. A group of Swedish investors brought a claim before an ICSID arbitral tribunal on the basis of the Swedish-Romanian BIT[371], which entered into force in 2003. They claimed that Romania's revocation of incentives was in breach of its obligations under the BIT, in particular the obligation to grant fair and equitable treatment to investors and not to impair their legitimate expectations[372]. Romania's argued, among other, things that the measures were reasonably related to public policy issues, namely its accession to the EU[373].

In the course of the proceeding, the tribunal invited the Commission to file an *amicus curiae* brief dealing with EU law matters[374]. The Commission argued that the payment of any compensation would constitute illegal State aid under EU law. It stated, in particular that "[a]ny ruling reinstating the privileges abolished by Romania, or compensating the claimants for the loss of these privileges, would lead to the granting of new aid which would not be compatible with the EC Treaty"[375]. The arbitral tribunal, however, found that Romania had violated the fair and equitable treatment standard contained in the BIT, and ordered the payment of compensation to the investors[376]. Romania initiated the payment of

[368] T. Kende, *supra*, note 330, at 43.
[369] ICSID, *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania (Micula v. Romania), Final Award*, 11 December 2013, ICSID case no. ARB/05/20.
[370] *Micula v. Romania*, *supra*, note 369, at paras. 130-131.
[371] Agreement between the Government of the Kingdom of Sweden and the Government of Romania on the Promotion and Reciprocal Protection of Investments dated April 1, 2003.
[372] *Micula v. Romania*, *supra*, note 369, at paras.251-263.
[373] *Ibid.*, at para.266.
[374] N. Lavranos, *Interference of the European Commission in the Enforcement of Arbitration Awards: The Micula v Romania case* (November 2014), available at http://www.globalinvestmentprotection.com/index.php/interference-of-the-european-commission-in-the-enforcement-of-arbitration-awards-the-micula-case/ (last accessed 24 July 2016).
[375] European Commission Decision, (EU) 2015/1470 on State aid SA.38517 (2014/C) (ex 2014/NN) implemented by Romania — Arbitral award Micula v Romania of 11 December 2013, 30 March 2015, C(2015) 2112), at para.25.
[376] *Micula v. Romania*, *supra*, note 369, at para

the sum, and appealed the decision before an ICSID ad-hoc committee, requesting a stay of the enforcement of the award, on the basis that its enforcement would violate European law[377]. The ICSID ad-hoc committee granted a provisional stay, conditional upon Romania's ability to file a letter in which the State unconditionally committed itself (including as regards conditions related to the European Union) to effect the full payment of its pecuniary obligation imposed by the award[378]. Romania failed to grant such assurance, and the tribunal revoked the stay of the award.

On the other hand, when Romania started implementing the award, the Commission ordered the State to refrain from executing it with an injunction pursuant to Art. 11(1) of Council Regulation (EC) No 659/1999 until a formal investigation under Art. 108(2) TFEU was completed, in order to determine whether or not such implementation constituted illegal State aid[379]. A few months later the Commission initiated such an investigation procedure[380]. In the decision adopted at the outcome of the investigation[381], the Commission concluded that the award was compensation for the fact that Romania had ceased granting State aid[382]. The Commission therefore ordered Romania to recover all the amounts paid to the investors in accordance with the arbitral award[383]. The investors reacted by taking action to annul the Commission's decision, on the ground that it failed to acknowledge Romania's obligation to enforce ICSID awards, in violation of Art. 351 TFEU and Art. 4(3) TEU[384]. This challenge is currently pending before the ECJ[385].

In February 2016, the ICSID ad-hoc committee confirmed *in toto* the arbitral award[386]. The investors have therefore commenced enforcement proceedings under the ICSID convention in the U.S.A. and Romania. In both cases, the Commission has intervened, and the cases are still pending.

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[377] T. Kende, *supra*, note 330, at 52.
[378] *Ibid.*, at at 52.
[379] European Commission, Letter on State aid SA. State aid SA.38517(2014/C) (ex 2014/NN) – Romania Implementation of Arbitral award Micula v Romania of 11 December 2013, 1 October 2014, 6848 final.
[380] P. Ortolani, *supra*, note 325, at 124.
[381] European Commission Decision, *supra*, note 375, at para.28.
[382] *Ibid.*, at para.26.
[383] *Ibid.*, at para.74.
[384] T. Kende, *supra*, note 330, at 53.
[385] *ICSID ad hoc committee refuses to annul Micula award* (March 2016), available at http://uk.practicallaw.com/5-624-0591 (last accessed 26 July 2016).
[386] ICSID, *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania (Micula v. Romania), Decision on annulment*, 26 February 2016, ICSID Case No. ARB/05/20.

Recognition and enforcement of arbitral awards under the ICSID Convention cannot be denied on the grounds that they are contrary to public policy. Art. 54 of the ICSID Convention does not contain any of the exceptions set out in the New York Convention. However, there is an additional element that comes into play in the *Micula* case: the EU is not a party to the ICSID Convention, and it is in principle not bound by its provisions. Therefore, the Commission not only ordered Romania to suspend the execution of the award pending a formal investigation, but also qualified the sums it had already paid in compliance with the award as State aid and ordered it to recover them.

This case demonstrates the complexity of the interplay between EU law and the ICSID Convention[387]. One could note, for instance, that forcing a Member State to violate an instrument of international law does not seem to be in compliance with Art. 3(5) TEU, according to which the EU must contribute to the strict observance and development of international law[388]. The extent of this provision, however, has been clarified by the ECJ in the *Kadi* case[389], in which it was held that acts adopted in compliance with instruments of international law can be challenged, as long as they violate principles that form the very foundation of the European legal order[390]. Accordingly, if one considered State aid rules as founding elements of the EU legal order, they could take precedence over Member States' obligations to recognise and enforce arbitral awards under Art. 54 of the ICSID Convention[391].

This does not seem to be an acceptable conclusion, although some have argued that this is not a sufficient ground to warrant considering ICSID obligations to be completely irrelevant for the purposes of the EU[392]. This argument finds its basis in the growing competence that the EU enjoys in the field of investment. Art. 207 TFEU confers on the EU exclusive competence with respect to FDIs in the field of the CCP, with the consequence that future IIAs will be negotiated by the EU instead of single Member States. New IIAs are likely to contain dispute settlement mechanisms providing that investment claims are to be submitted to arbitration under, among other instruments, the ICSID

[387] P. Ortolani, *supra*, note 325, at 131.
[388] Article (5), TEU, *supra*, note 55.
[389] ECJ, Joined cases C-402/05 P and C-415/05 P, *Yassin Abdullah Kadi and Al Barakaat International Foundation v. Council of the European Union and Commission of the European Communities* [2008] ECR I-6351.
[390] Joined cases C-402/05 P and C-415/05 P, *supra*, note 389, at para.304.
[391] P. Ortolani, *supra*, note 325, at 132.
[392] *Ibid.*, at 132.

Convention, as in the case of the Comprehensive Economic and Trade Agreement (CETA) with Canada[393]. A similar approach was adopted during the initial stage of the negotiations for the Transatlantic Trade and Investment Partnership (TTIP) between the EU and the United States, although it has been subject to several criticisms[394] and now seems to have been abandoned in favour of a different mechanism. In addition, Art. 26 ECT, to which the EU is a party, also provides for ICSID arbitration. These factors support the view that, even though the EU is not bound by the ICSID Convention, a limited degree of normative power for the Convention should be recognised, rather than it being regarded as devoid of any effect[395]. A precedent here is found in the *International Fruit Company* case[396], where the ECJ stated that, although the EC was not bound by GATT obligations, as all Member States were parties to the GATT and had transferred to the EC exclusive competence in the field of tariff and trade policy, the EC was bound by it[397]. The conclusion is that, in the long run, the EU will not be able to entirely disregard obligations arising out of the ICSID Convention[398].

With regard to the short-term consequences, the situation differs substantially. The Commission's attitude seems to go in the opposite direction, as shown in the *Micula* case. The Commission could resort to other means, such as the implementation of a regulation to block the enforcement on EU soil of arbitral awards based on intra-EU BITs[399]. While regulations of this kind have never been used for international arbitration awards, they are not unprecedented. In 1996, the Commission passed EC Regulation No. 2271/96[400], which prohibited the recognition and enforcement of any judgment of a U.S. court based on the Helms-Burton Act, which created extra-territorial jurisdiction for the U.S. courts[401].

A central characteristic of ICSID arbitral awards is the fact that every party to the ICSID Convention must recognise and enforce them if the winning party seeks enforcement in its

[393] *Ibid.*, at 133.
[394] See, among the others, Center for International Environmental Law (CIEL), *A Compliance Check of the European Parliament's TTIP Resolution: Public health, environment and democracy at risk* (July 2016), available at http://www.ciel.org/wp-content/uploads/2016/07/TTIP-Resolution-Compliance-Check.pdf (last visited 2 August 2016).
[395] P. Ortolani, *supra*, note 325, at 133.
[396] ECJ, Joined cases 21 to 24/72, *International Fruit Company NV and others v Produktschap voor Groenten en Fruit* [19762] ECR 1219.
[397] P. Ortolani, *supra*, note 325, at 133.
[398] *Ibid.*, at 133.
[399] T. Kende, *supra*, note 330, at 54.
[400] EC Commission, Regulation No. 2271/96, 22 November 1996, OJ L309.
[401] T. Kende, *supra*, note 330, at 54.

territory[402]. An investor could then, as occurred in this case, seek recognition outside the territory of the EU. The ICSID Convention, at Art. 54(1), provides that:

> "if a party fails to comply with the award, the other party can seek to have the pecuniary obligations recognized and enforced in the courts of any ICSID Member State as though it were a final judgment of that State's courts."[403]

Therefore, national courts can refuse to enforce an ICSID award if they consider that the award is suspended or is on course to being vacated[404]. In this case, any decision by or regulation of the Commission that is issued to block the enforcement of the award becomes irrelevant. As already mentioned, the Commission intervened in the proceeding before the U.S. court in order to prevent the enforcement of the award.

7.3. Non-ICSID awards

The situation differs for non-ICSID awards. The recognition and enforcement of these awards is regulated by the New York Convention, which, at Art. V, sets out the grounds on which recognition and enforcement can be refused by a State. The most relevant among these grounds is that the award is contrary to public policy under Art. V(2)(b) of the New York Convention. In this regard, it seems clear that the prohibition against State aid contained in Art. 107 TFEU forms part of EU public policy, constituting one of the core principles of EU competition law[405], as stated by the ECJ in the *Eco Swiss* case[406].

The necessary further step is to determine whether the public policy exception is applicable only after the Commission has declared the State aid to be incompatible with the internal market, according to the procedure set forth in Art. 108 TFEU, or in all situations in which a measure should be considered incompatible with EU State aid rules[407]. This question is significant, given the fact that all energy disputes initiated by investors against the Czech Republic concerned measures that might have been incompatible with Art. 107 TFEU, but were spontaneously revoked by the State.

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402 Article 54, ICSID Convention, *supra*, note 360.
403 Article 54(1), ICSID Convention, *supra*, note 360.
404 T. Kende, *supra*, note 330, at 55.
405 P. Ortolani, *supra*, note 325, at 129.
406 *Eco Swiss China Time Ltd v Benetton International NV*, *supra*, note 366.
407 P. Ortolani, *supra*, note 325, at 129.

Several arguments militate in favour of the need for a review by the Commission. First, the public policy exception under the New York Convention should be interpreted restrictively, according to the so-called pro-enforcement bias of the Convention[408]. Second, an extensive application of the public policy exception would lead to the fact that national courts would be called upon to review arbitral awards that grant compensation for the revocation of measures by a State. In the absence of action by the Commission, this could lead to diverging decisions on the recognition and enforcement of the awards, undermining the goal of the uniform application of EU public policy among Member States[409]. Third, in the absence of control by the Commission, national courts would need to scrutinise in depth the nature of the measures, in order to determine whether or not they constitute illegal State aid. Such scrutiny, however, is in contrast with the limited role that the New York Convention assigns to national courts in the recognition of an award[410]. Art. V(2)(b) of the New York Convention should therefore be applied only to those cases where the Commission has reviewed and declared a measure to be illegal State aid according to Art. 108 TFEU.

[408] Court of Justice of Geneva, RSA v. A. Ltd, 15 April 1999, cited in P. Ortolani, *supra*, note 325, at 129.
[409] P. Ortolani, *supra*, note 325, at 130.
[410] *Ibid.*, at 130.

8. Conclusions

The uncertainty that surrounds the debate on investment policy in the EU is undeniable, both from an intra-EU and an extra-EU perspective, although, as displayed above, the internal field is definitely more problematic. Particularly affected in this framework are long-term contracts, concluded before a State's accession to the EU on the basis of BITs that later became intra-EU BITs. The very applicability of these BITs is at stake, and the clash between the different actors seems irreconcilable. On the one hand, the Commission argues for the incompatibility of intra-EU BITs with EU law and the primacy of EU law in these disputes. If this position prevails, Investor-State contracts will no longer be protected by the relevant BITs. On the other hand, arbitral tribunals have repeatedly rejected this view and have upheld their jurisdiction on the basis of the validity of the BITs under scrutiny.

The Commission's position is not only in contrast with intra-EU BITs, but with all forms of extra-EU law in the investment framework. Proof is its opposition to investment disputes based on the ECT, although all Member States and the EU itself are party to it. This does not seem to bother the Commission, which nevertheless upholds the applicability of EU law, although based on different arguments, as mentioned above.

Even with regard to extra-EU BITs, which are regulated by the TFEU and secondary legislation regarding the survival of obligations that pre-exist the TFEU, the Commission has initiated a revision of treaties entered into prior to the Lisbon Treaty, in order to assess their compatibility with EU law.

The position of the Commission is understandable from an EU law point of view: the purpose of removing all incompatibilities with the internal market is to ensure full compliance with the TFEU and to the creation of confidence among European investors, who rely on the equality of conditions in the internal market. However, from an investment law point of view, this position can only have detrimental effects on the investment environment in Europe. If the protections granted by the BITs are lacking, investors will have to resort to national courts for claims relating to contracts that are based on these BITs. The lack of EU legislation on intra-EU investments certainly does not help.

Even if this debate led to the termination of intra-EU BITs, the issue of the applicability of the BITs would still survive. It is in fact true that BITs often contain sunset clauses, where States parties extend the conditions applicable under the BIT for a number of years after the termination of the BIT to the investors of the other State party. This mechanism is intended to protect investors from changes in legislation, and to create a more stable environment. Therefore, for contracts concluded before the conclusion of the BIT, investors could still resort to arbitration. If the termination of the BIT is automatic, as argued by some States, the question would remain unaffected, as the termination would be back-dated to the accession of the relevant States to the EU.

The real problem for long-term PPAs arises not only from the applicability of intra-EU BITs, but also from an additional element, namely EU State aid legislation. Contracts providing favourable conditions to investors for a period of several years are deemed by the Commission to be granting investors State aid, and therefore to be terminated. The opposition of the Commission in this regard is relentless. Not only has it opposed the enforcement of arbitral awards in Europe, but it has also opposed enforcement outside Europe. This leads to another problem for Member States. If the awards are rendered in accordance with the ICSID Rules, States cannot refuse their enforcement. Member States therefore, find themselves in the situation where, if they enforce the award, they will violate EU law, and if they do not, they will violate their international obligations arising out the ICSID Convention.

Recent developments might soon change this situation and finally provide an answer to the questions discussed above. The referral to the ECJ for infringement of the so-called pilot procedures and the preliminary ruling requested by the BGH, however, might only answer the question of whether or not intra-EU BITs are compatible with EU law. Both scenarios have problematic aspects. If the Court confirms the compatibility of intra-EU BITs with EU law, it will take a position in clear conflict with the Commission's view. This could generate more uncertainty. On the other hand, this will mean that the rights attributed to investors by BITs remain in force, which will have a positive effect on the investment environment. Should the Court consider intra-EU BITs as incompatible with EU law, investors would no longer be able to rely on the protection provided by the BITs or their dispute settlement system. The alternative to these mechanisms is, however, uncertain, as the EU has not yet introduced a replacement regime for the internal market. That matters arising out of BITs should be brought before national courts is the least-appealing scenario for investors. Although none of the scenarios is without its problems, the current situation is even worse, and a ruling by the ECJ is therefore welcomed. The present investment framework is in fact not attractive for foreign investors, either from third countries or from Member States. Investment contracts concluded according to existing BITs will face difficulties in being protected through the resort to arbitral tribunals, and, later, through the enforcement of awards. This situation will reflect on new contracts that might be concluded on the basis of such BITs, and especially on contracts providing for long-standing obligations, against which investors are already been advised, given the difficulties they are likely to encounter should problems arise.

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Abstract

In the energy field, the European investment legal framework is characterised by the relationship between EU law and existing Bilateral Investment Treaties (BITs) or International Investment Agreements (IIAs), concluded by European Member States. Two major events have dramatically changed the framework in the last few years. The Treaty of Lisbon has conferred the EU exclusive competence on extra-EU FDIs, which were previously competence of the Member States. Extra-EU BITs concluded before the Lisbon Treaty fell under a transitional regime that should have led to the termination of extra-EU BITs incompatible with EU law. Member States have not complied with the transitional regime, with the consequence that those BITs are still in force. The Commission has initiated infringement proceedings against Member States in order for them to terminate their extra-EU BITs, considered by the ECJ in conflict with EU law. However, the Court has ruled only with regard to the transfer of capital, leaving the question of the compatibility of extra-EU BITs with EU on the other fields law still open. On the intra-EU side, the expansion of the EU between 2004 and 2007, with the inclusion of Central and Eastern European States into the EU, has determined that BITs signed with these States, originally extra-EU BITs, have now become intra-EU BITs. Their existence and efficacy is hotly debated, with the Commission arguing for the necessity of their termination, being contrary to EU law, and arbitral tribunals considering the BITs as valid and therefore retaining jurisdiction on the topic. The ECJ has not yet ruled on the issue, although several cases are now before the Court, that is called to give a clear answer. The fact that both the EU and Member States are party to the Energy Charter Treaty (ECT) further complicates the debate. Many intra-EU Power Purchase Agreements (PPAs) find their basis in the ECT. The EU argues that, even in this case, EU law prevails on Member States' obligations under international law, while arbitral tribunals have, once again, an opposite view. This conflict reflects on the enforcement stage. According to the EU, the enforcement of arbitral awards based on intra-EU BITs would entail the grant of State aid to the winning investors, in discrimination of the other EU investors. The Commission has not only opposed the enforcement of this kind of awards in Europe, but has also filed *amicus curiae* briefs in enforcement proceedings in non-EU countries. The current situation reflects on the investment environment of the EU, whose uncertainty cannot but have detrimental effects.

Zusammenfassung

Im Bereich Energie hängen die rechtlichen Rahmenbedingungen für Investitionen in Europa vom Verhältnis des EU Rechts zu den bestehenden Bilateralen Investitionsabkommen (Bilateral Investment Treaties-BITs), sowie den internationalen Investitionsabkommen (International Investment Agreements -IIAs) ab, die bisher von den Mitgliedsstaaten der EU beschlossen worden sind. In den letzten Jahren haben vor allem zwei Ereignisse die Rahmenbedingungen dramatisch verändert. Mit dem Vertrag von Lissabon wurde die ausschließliche Kompetenz für ausländische Direktinvestitionsabkommen (extra EU FDIs) auf die EU übertragen. Ausländische Direktinvestitionen, die vor dem Vertrag von Lissabon beschlossen worden waren, unterlagen einer Übergangsregelung, die zu einer Beendigung jener ausländischen Abkommen hätte führen sollen, die mit dem EU Recht unvereinbar waren. Die Mitgliedstaaten richteten sich jedoch nicht nach den Übergangsregeln, sodass jene Investitionsabkommen noch immer in Kraft sind. Die EU Kommission hat daher Vertragsverletzungsverfahren gegen Mitgliedsstaaten eingeleitet, um jene Investitionsabkommen zu beenden, die laut Europäischem Gerichtshof nicht dem EU Recht entsprechen. Jedoch hat das Gericht bisher nur in Bezug auf Kapitaltransfer entschieden, wobei die Frage der EU Rechtskompatibilität von Investitionsabkommen in anderen Bereichen noch immer unbeantwortet ist. Auf der intra-EU Seite haben sich durch die EU Erweiterungen zwischen 2004 und 2007 um Zentral- und Osteuropäische Staaten, die Investitionsabkommen, die mit jenen Staaten unterzeichnet worden und ursprünglich als ausländische Direktinvestitionsabkommen (extra EU FDIs) angesehen worden sind, nun in intra-EU BITs umgewandelt. Ihre Existenz und Wirksamkeit wird nun heiss debattiert, wobei die EU Kommission auf die Notwendigkeit ihrer Auflösung besteht, da sie mit EU Recht unvereinbar seien, während die Schiedsgerichte die BITs als gültig erachten und ihre Zuständigkeit bejaht haben. Der Europäische Gerichtshof hat in dieser Angelegenheit noch nichts beschlossen, obwohl mehrere Fälle derzeit bei Gericht vorliegen, und eines Urteils harren. Die Tatsache, dass sowohl die EU als auch ihre Mitgliedstaaten Parteien des Vertrags über die Energiecharta sind, verkompliziert die Debatte. Viele intra-EU Energie Kaufverträge (Power Purchase Agreements -PPAs) basieren auf dem Energie Charta Vertrag. Die EU argumentiert, dass nach dem Völkerrecht das EU Recht auch in diesem Fall für die Mitgliedsstaaten vorzuherrschen hat, während die Schiedsgerichte wieder einmal anderer Ansicht sind. Der Konflikt hat Auswirkungen auf der Durchsetzungsebene.

Laut EU können Schiedssprüche, die sich auf intra-EU BITs beziehen, die Gewährung staatlicher Hilfe für Investoren mit sich ziehen, wobei andere EU Investoren diskriminiert werden würden. Die Kommission opponiert nicht nur gegen diese Art von Schiedsspruch in Europa, sondern hat bereits *amicus curiae* Schriftsätze für Vollstreckungsverfahren in Nicht EU Ländern eingebracht. Diese Situation reflektiert das derzeitige Investitionsumfeld der EU, dessen unsicherer Zustand nachteilige Auswirkungen haben kann.