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The Role of EU Law in 'intra EU' ISDS under the ECT

Some Thoughts on the Electrabel v. Hungary Award

As of today, there are several investor state arbitration procedures pending between an investor from an EU member State and another EU member State. These procedures are called sometimes 'intra-EU' disputes. In some of these disputes, EU investors relied on Bilateral Investment Treaties between their home State and another EU member State while in approximately 10 pending procedures,[1] the legal basis of the investor's claim is the Energy Charter Treaty[2] (ECT). Both BIT and ECT-based intra-EU disputes raise some intriguing questions in connection with the role of EU law in such procedures. The *Electrabel S.A v. Hungary*[3] case is an example of such an intra-EU dispute under the ECT where the Tribunal has already taken a position on some of these questions.

In this brief paper, I shall review three findings of the award that seem relevant in the context of so-called intra-EU arbitration, namely:

– EU law is a part of the applicable public international law in an ECT arbitration;
– EU law takes precedence over the ECT in the event of a conflict;
– EU law does not bar the jurisdiction of the tribunal in an intra-EU ECT arbitration.

I shall briefly present the factual and legal background of the case, then continue with the presentation of the arguments in support of the above three findings and finish with a few observations relating to these findings.

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[1] An estimate based on the information found on the web-site of the ECT <http://www.encharter.org/index.php?id=213&L=0L%C2%A1%C2%AFid%C3%86%C3%AEe> and the ICSID <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListPending>, last accessed on September 20, 2014.

[2] <http://www.encharter.org/fileadmin/user_upload/document/EN.pdf>.

[3] *Electrabel S.A. v. Hungary* (ICSID Case No. ARB/07/19) Decision on Jurisdiction, Applicable Law and Liability (November 30, 2012).

I Setting the Scene

1 Factual Background

Electrabel S.A.,[4] a Belgian company, invested in a power generator company in Hungary in 1995. Hungarian power generators at that time had concluded so-called long-term power purchase agreements (PPAs) with the state-owned electricity company in order to sell the generated electricity. These contracts created a stable flow of revenues to the generators, protecting them from the emerging free market in the sector.

After the accession of Hungary to the EU, the European Commission established that these PPAs constitute unlawful State Aid under EU rules and ordered their early termination. Hungary then terminated the PPAs by law.[5]

2 Procedural and (Substantive) Legal Background

Electrabel brought several claims before an ICSID tribunal against Hungary for violation of the ECT. One of Electrabel´s claims was that Hungary unlawfully terminated the PPAs – this was a so-called PPA Termination Claim. The PPA Termination Claim gives the most evident example of the interaction between ECT and the EU law.

The legal grounds of the claim in the Electrabel case was the ECT. The ECT, like most if not all BITs, provides for a more or less typical set of standards on how the host State needs to treat the protected investments[6]. It also contains an investor-state dispute resolution clause, offering the consent of the contracting States to submit to arbitration disputes with investors of other contracting States arising out of the violation of the ECT.[7]

The *Electrabel* arbitration is an ICSID (International Center for Settlement of Investment Disputes) arbitration. That means, in the present context, that the 'background rules' of the arbitration, *the lex loci arbitri,* are the ICSID Convention[8] and the rules of public international law and not, as with 'commercial' international arbitration, a municipal law of a State. One of the further differences is that, as an award of an ICSID tribunal, the award of the *Electrabel* tribunal shall be enforceable under the relevant provisions of the ICSID Convention without the possibility of being set aside under the rules of any municipal law[9] or a need for special recognition or enforcement under the New York Convention.

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[4] For the sake of completeness, the initial investor was *Electrabel´s* predecessor, *Tractabel.*

[5] Commission Decision On The State Aid Awarded By Hungary through Power Purchase Agreements. C (2008) 2223 final. http://ec.europa.eu/competition/state_aid/cases/201965/201965_827719_388_1.pdf, last visited September 25, 2014.

[6] See Chapter III of the ECT.

[7] See Article [Article 26. 3. *c)*] of the ECT.

[8] See for example Rudolf Dolzer, Christoph Schreuer, *Principles of international investment law* (2nd edn, Oxford University Press 2012, Oxford) 278.

[9] ICSID Convention, Article 53.1 and 54.

II Analysis of some of the Findings of the Tribunal

For the purposes of this article, it seems convenient to assume the perspective of an arbitral tribunal in the course of the analysis. From this perspective, the Tribunal's tasks start (i) with determining the law or laws applicable to its jurisdiction, (ii) then establishing its jurisdiction relating to the claims presented, (iii) then determining the applicable law or laws to the merits to these claims (iv) after which it is in a position to decide on the merits of the case.

As the Tribunal highlighted, it was an arbitral tribunal constituted under the rules of ECT and the ICSID. Its jurisdiction is based on the consent/the agreement of the parties – as in 'ordinary' or commercial arbitration - which is confirmed by the constant practice of investment tribunals.[10] The offer of the consent of the host State – i.e. Hungary – to arbitration is included in the investor-state dispute resolution clause of the ECT.[11] This consent is given therefore in a public international law instrument and, consequently, public international law shall be applicable to such consent.

Article 26.6 provides that if an investor submits a claim under the ECT, the Tribunal shall apply the ECT itself and the rules and principles of international law. Under the constant arbitral practice, such a treaty provision qualifies as a choice of law provision under the relevant arbitration rules[12]. As a result, a tribunal constituted under the ECT should apply the ECT itself and public international law to the merits of the dispute.

To have a complete picture of the legal context of such dispute, it worth noting that municipal laws also come into play in investment treaty arbitration, in particular *a)* to certain issues defined by international law[13] *b)* as fact in the dispute[14].

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[10] Just some example of the large number of scholarly works: Dolzer, Schreuer (n 8) 259. Hege E Kjos, *Applicable law in investor-state arbitration: The interplay between national and international law (Oxford monographs in international law* (1st edn, Oxford University Press 2013, Oxford) 20, and early arbitral decisions: *AAPL v. Sri Lanka* ICSID Arb no. 87/03 Award June 27, 1990 para 2., <http://www.italaw.com/sites/default/files/case-documents/ita1034.pdf>; *Salini Construttori Spa v.Morocco* para 27. <http://www.italaw.com/sites/default/files/case-documents/ita0738.pdf>.

[11] See (n 6).

[12] In case of an ICSID procedure, Article 42.1 of the ICSID Convention is applicable providing that the agreement of the parties shall determine the law applicable to the merits of the dispute It is not necessary here to discuss in details that, when deciding applicable law in this context, the Tribunal defines applicable law with reference to the choice of law provision providing for the application of the law choosen by the Parties and/or by applying the 'law of the claim' the *lex causae.*

[13] For example, 'The law applicable to an issue relating to the existence or scope of property rights comprising the investment is the municipal law of the host state.' Zachary Douglas, *The international law of investment claims* (Cambridge University Press 2009) 52.

[14] See the frequently cited authority in *Certain German Interests in Polish Upper Silesia* No. 11 Interpretation of judgments nos. 7 and 8 (the Chorzow Factory). Publications of the Permanent Court of International Justice. Series a.-No. 13 December 16th, 1927 <http://www.icj-cij.org/pcij/serie_A/A_13/43_Interpretation_des_Arrets_No_7_et_8_Usine_de_Chorzow_Arret.pdf>.

1 Is EU Law a Part of Public International Law?

The first question the Tribunal needed to determine is the role of the EU law in the above context and in particular, whether EU law is to be considered as a part of public international law, as claimed by Hungary, or it needs to be taken account as a part of the municipal law of Hungary as argued by the Claimant.[15]

It was not disputed that the accession of Hungary to the EU was implemented by the entry into force of a treaty under public international law and that both Hungary and the home state of Electrabel, Belgium, were parties to this instrument.[16] The arbitrators were to decide whether EU law was part of the legal norms that are applicable as public international law and whether only the whole body of the EU is to be considered as international law or only a part of it, namely the founding treaties.

The Tribunal held that EU law has a multiple nature. Depending upon the perspective from which it is regarded, it can be considered

a) as international law, as it is created by international instruments,
b) part of the legal order of Hungary, one of its member states,
c) from the perspective of EU institutions, a distinct legal order.[17]

In the view of the tribunal – which was a tribunal constituted under public international law – it should regard EU law as part of international law. And not only the founding treaties[18] but EU law as a whole has the character of public international law. In support of this last finding, the Tribunal argued that 'all EU legal rules are part of a regional system of international law and therefore have an international legal character.'[19]

2 How to Resolve Conflicts between ECT and EU Law?

If EU law is a part of public international law and there is a conflict between the applicable norms, this conflict should be resolved in accordance with the rules of public international law. Such a conflict may emerge in two respects, in connection with the jurisdiction of the tribunal and with the merits of the case.

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[15] The Claimant, at some point in the arbitration, conceded that the founding treaties of the EU may be considered as public international law.

[16] TREATY concerning the accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union, signed on April 16 2003 <http://www.europarl.europa.eu/enlargement_new/treaty/default_en.htm>.

[17] *Electrabel* para 4.118.

[18] I use the term founding treaties because the case was plead partly prior to the entry into force of the Lisbon Treaty, which change the names of the relevant treaties and the numbering of their articles. However, in order to be 'up to date' I shall refer to the articles as numbered by the Treaty on the Functioning of the European Union.

[19] *Electrabel* para 4.122 citing the famous *Van Gend & Loos* (Case 26/62) decision of the ECJ. 'The Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights.'

The *Electrabel* tribunal found that no conflict or inconsistency exists between EU law and the ECT. The Tribunal has also concluded that if there were any material inconsistency between the ECT and EU law, the ECT and EU law should, if possible, be read in harmony.[20] Though *Electrabel* tribunal discusses the two issues in Chapter IV titled 'Applicable law', issues relating to jurisdiction of the Tribunal shall be discussed under next point.

The findings on *'no inconsistency'* and need for 'harmonious interpretation' were founded, inter alia, on the historical role that the EC played in the ECT, i.e. that the ECT was the 'brainchild' of the EU. On the other hand, it found that ECT and EU law share some common policy objectives, in particular in both condemning anti-competitive behaviour.[21]

The Tribunal, however, went further and addressed the issue of how to resolve a potential conflict between the two set of norms of public international law. In the course of this obiter dicta analysis, it examined, as part of the rules on conflicts of public international law, the 'rule of conflict' provisions of the ECT and the Founding Treaties of the EU. The conclusion was that, if there is a conflict, EU law takes precedence over the rules of ECT.[22] The 'conflict provision' in the ECT, Article 16, provides that if there is a conflict between preceding or subsequent treaties and the ECT which have the same subject matter then the provision that is more favourable to investment or investors shall apply.

According to the Tribunal, the EC Treaty and the ECT do not relate to the same subject matter. And even if it were applicable, Article 16 has been replaced by the 'rules of conflict' of the EU Founding Treaties, i.e. what is now Article 351.1 of the TFEU[23].

Article 351.1 provides that earlier international agreements between Member States and third states shall not be effected by the EU Treaty.[24] As no rights or obligations vis á vis third states are at issue here, only those of EU Member States, this provision does not seem to be applicable. Moreover, the practice of the ECJ held that, in multilateral treaties, Article 351 shall not protect the *inter se* reciprocal obligations between Member States.

Finally, the Tribunal rejected the idea that Article 351 may be extended to the rights of investors under the anterior treaties. It held that one cannot disconnect the rights of individuals from the rights of their home states.

3 Jurisdiction and EU Law

In the *Electrabel* case, the jurisdictional objection was not raised by one of the Parties but the EU, which suggested in its *amicus brief* that the Tribunal lacks jurisdiction to hear the PPA Termination Claim.[25]

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[20] *Electrabel* para 4. 166.
[21] *Electrabel* para 4. 130–142.
[22] *Electrabel* para 4.173–4.191.
[23] This the former Article 307 of the Treaty on the European Communities (TEC).
[24] Article 351.1 of the TFEU provides 'that rights and obligations of the Member States – arising from agreements with one or more third states – concluded before [their accession to the EC/EU] shall not be affected by the Treaty.'
[25] Most of the issues addressed here were discussed by the Tribunal in chapter IV. of the award dealing with applicable law; however, for practical reasons I shall discuss it here under the section 'Jurisdiction'

If – as the Tribunal established – EU law is part of public international law and supersedes the ECT, it may alter the scope of the consent of Hungary included in the ECT or render the arbitration agreement between the parties invalid or inapplicable. This would be the case, for example, if EU law had barred investor-state arbitration between EU nationals and Member States. According to the tribunal, this is not the case.

The summary of the reasoning is the following:

There is no provision in EU law barring investor-state arbitration. In the TFEU, the only provisions concerning external dispute resolution explicitly are in Section 344, that excludes any dispute resolution mechanism *between Member States* in connection with the interpretation and application of EU law other than under the one provided for in the TFEU. This is applicable only in state-to-state relations and not to investor-state dispute resolution. No similar general interdiction exists in EU law in the latter field.[26]

Investor-state arbitration does not violate the ECJ´s role in the EU legal system. First, the Tribunal noted that, with regard to the PPA Termination Claim, the Tribunal does not need to review the validity of any act of an EU institution which can be a competence reserved to the ECJ. Moreover, the possibility of investor-state arbitration does not jeopardise the role of the ECJ as a court authorised to give final interpretation of EU law in the framework of a preliminary ruling procedure. The tribunal argued that foreign courts and arbitration tribunals that apply or may apply EU law do not have recourse to the ECJ and a tribunal in an investment treaty arbitration applying EU law shall not be in a different position. Also, the enforcement of decisions of an arbitral tribunal by the courts of the member states is reviewed by the ECJ because these courts refer to the ECJ any question of interpretation of EU law if it occurs in the enforcement procedure–see the *Eco Swiss* case as an example.[27]

The tribunal recognised that reference for preliminary ruling is not applicable with regard to an ICSID award. It found however that there remains a possibility to ensure the uniform application of EU law by the ECJ, even for an ICSID award, mainly in the framework of an infringement procedure.

The dispute on the PPA Termination is not an intra-EU dispute. The Commission argued that the PPA Termination Claim is, in substance, related to the lawfulness of an EU measure (the Commission's State Aid decision). It is thus an intra-EU dispute that is not covered by the ECT dispute resolution provision because it is an investor from the EU, an EU national, that contests the validity of an act of its 'home state'[28]. The Tribunal rejected this argument, noting that the Claim is directed against Hungary. The EU also argued that the tribunal should treat the relationship between ECT and EU law in such a way that, to the extent that a measure is in compliance with EU law, it should be presumed that it complies with the ECT.

In sum, the Tribunal has jurisdiction to hear the claims of Electrabel SA, including the PPA Termination Claim. It was even highlighted that the EU itself accepted, by signing the ECT, the

[26] *Electrabel* para 4.147.
[27] *Electrabel* para 4.148–4.152.
[28] *Electrabel* 5.20 and ss.

possibility of investment arbitration with private parties, including EU nationals (See under point III. below.).

Briefly, on the law applicable to the merits, it results from the above theories, as established by the Tribunal, that EU law is applicable to the merits of the case.

III Observations

The *Electrabel* tribunal was not reluctant to take a firm position concerning the role of EU law in an intra-EU investor state arbitration procedure.

On one hand, the award clearly confirmed that EU law is a part of the applicable law, as public international law in an ECT arbitration. This position was not accepted without critiques. Some argued that EU law cannot be seen as international law and even added that EU law excluded itself from international law.[29] EU law can thus only play a role as a part of the municipal law of the host state when and where the latter is applicable. It is noticeable that both the *Electrabel* tribunal and its critics refer – among others – to the *Van Gend en Loos* decision[30] of the ECJ when trying to determine the nature of EU law.

This criticism can definitely be sound if someone approaches the ECT or international investment law as if it were a stand-alone or self-contained system or if someone simply argues that complex phenomena, such as the regulation of the globalised world economy (including foreign investment), is provided for in various different set of legal norms that cannot be reconciled in one single dispute resolution procedure.

On the other hand, the Tribunal recognised that one aspect of the *Electrabel* case was to ascertain the correct balance between the competing values behind, on one hand, the ECT – i.e. the substantive and procedural rights granted to foreign investors – and EU law – i.e. the economic integration of EU member states.[31] As a procedural aspect of this balancing exercise, the Tribunal firmly confirmed, like other tribunals dealing with 'intra-EU' disputes, the availability of an investor-state dispute resolution mechanism for EU investors against EU member states under the ECT. That means the rejection of the broad policy argument according to which the EU Member States were willing to substitute the procedural and substantive standards granted by the investment treaties with the more complex institutional, substantive and procedural rules of EU law.

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[29] See Christian Tietje, *Bilateral Investment Treaties Between EU Member States (Intra-EU-BITs) – Challenges In The Multilevel System Of Law TDM March 2013.* The author argued in this article that EU law cannot be regarded as a part of public international law because, amongst others, that it posits the founding treaties as superior to other rules of public international law.

[30] See (n 18) and Tietje (n 29) 7, referring to the same citation in *Van Gend & Loos.* Even Professor Klabbers whose work the 'Treaty conflict and European Law' was cited approvingly several times in Chapter III of the award remarks with some irony in connection with *Van Gend & Loos* that EU law 'perhaps even so unique as to no longer qualify as a part of international law'. See Jan Klabbers, *Treaty conflict and the European Union* (Cambridge University Press 2009, Cambridge, UK, New York) 196.

[31] *Electrabel* 4.113.

A further highlight made by the Tribunal was that the EU itself agreed to international arbitration in the ECT, not only with non-EU nationals but with EU nationals.[32] This statement is, the least to say, not undisputed in the light of the Commission's arguments in its *amicus* brief, claiming that a dispute between a national of an EU member state (that is a national of the EU) and the EU relating to an EU measure is the same as a dispute between an investor and its home state[33] and therefore not covered by the investor-state dispute resolution clause of the ECT.

Finally, to what extent can the relevant findings of the Tribunal be 'extended' to intra-EU BIT arbitrations? The jurisdictional findings of the Tribunal can definitely serve as a reference outside ECT-based investor-state treaty arbitration. As to the findings in connection with substantive issues (including that of the applicable law and the hierarchy between ECT and EU law), the findings of the *Electrabel* tribunal cannot be disregarded either, though the special historical and legal connections between EU law and institutions and the ECT may serve as a 'vehicle' to facilitate the adoption of a contradictory position by another investment arbitration tribunal.

[32] *Electrabel* 4.163.
[33] *Electrabel* 5.20 citing point 60 of the *amicus* submission of the EU Commission.