M. Jeżewski, The EU law and BITs clash: impact on the Polish practice

SUMMARY OUTLINE

1. The EU law constitutes a special regime of international law which enjoys supremacy over national laws of its Member States as well as over most of their international obligations. The alleged clash between EU law and Bilateral Investment Treaties (BITs) concluded by Member States can be therefore perceived from three perspectives. First, there is an issue of the relationship between the Accession Treaties and the so-called intra-EU BITs, that is BITs concluded between Member State. Second, the paper touches upon the question of the obligations of Member States under Article 307 of the EC Treaty with regard to BITs concluded with third countries. Finally, the question of the current attempts by the Commission to expand EC powers to cover the investment protection has to be dealt with due to the impact that EC treaty making practice has on the attitude of Member States in this field.

I. Intra-EU BITs

2. To obtain the full picture of the legal situation in respect to intra-EU BITs it is necessary to take into consideration two perspectives. On the one hand, the issue can be perceived from the point of view of the Law of Treaties as codified in the Vienna Convention of the Law of Treaties. On the other hand, one has to take the proper account of the internal rules of the European Union with particular focus on the principle of solidarity and loyal co-operation established by the Article 10 of the EC Treaty.

Article 59 of the VCLT

3. From the perspective of Poland and other new Member States there are strong arguments in favor of the termination of pre-accession intra-EU BITs. Those arguments are based on the Article 59 of VCLT, which provides for the termination of the Treaty „*if all the parties to it conclude a later treaty relating to the same subject matter and: a) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty*(...)". It is therefore necessary to fulfill three conditions for the application of that provision, i.e. there must be an identity between parties to both treaties, the treaties have to

deal with the same subject matter and the parties have to intend the termination. The first condition is uncontroversial, so the paper focuses on the remaining two.

4. As regards the condition that the treaties **relate** to the same subject matter it is not required, as suggested by J. Pauwelyn, that the provisions of the two treaties are in conflict with each other. What counts is the situation in which two treaties can be applied to the same set of facts. It is only after establishing that this is the case, that one has to look at the circumstances which could justify the conclusion about the parties' intention to terminate the former treaty (or to compare provisions of both treaties in order to find inconsistency in accordance with Article 59(1)(b)).

5. Comparing provisions of Intra-EU BITs with EC Treaty it is necessary to take into account the basic *rationale* of both regimes. The basic reason for concluding intra-EU BITs has been to provide investors from the Fifteen for the protection of their economic activities and their capital in the host States which now consitute parts of the Common Market. From the point of view of the nature of capital movements, before accession, such investments could have been classfied as external capital flows, whereas in terms of Common Market such flows are of internal character. Moreover, the aim of the Community is to „*promote throughout the Community a harmonious, balanced and sustainable development*", which has to be attained „*by establishing a common market*". The latter notion is not explained as such, but it is possible to conclude, on the basis of the provisions of the Treaty, that it means a single economic entity, based both on unified and harmonized rules determining the economic activities.

6. Concerning the question of the intent to terminate the former Treaty, according to VCLT such an intent need not to be explicit. It can also by implied from the provisions of the later treaty. Such an intent can be derived from the EC Member States' will to establish Internal Market. Such an approach does not leave too much space for truly international economic relations between Member States as was confirmed by the ECJ in *Commission v. Italy* (Case no 10/61), where ECC Treaty was given precedence over GATT obligations as between Member States.

7. Taking into account the abovementioned arguments one has to reject the approach adopted by the Arbitral Tribunal in *Eastern Sugar v. Czech Republic* (Partial Award of 27 March 2007), especially taking into account the lack of the comprehensive analysis by the Tribunal of the meaning of Article 59.

Article 54(b) of the VCLT

8. From the perspective of new Member States, the best option to deal with the intra-EU BITs would be to terminate them by the mutual consent of the parties. Article 54 of the VCLT allows for the so-called *actus contrarius*, providing that „*the termination of a treaty or the withdrawal of a party may take place (...) at any time by consent of all the parties after consultation with the other contracting States*".

9. In the context of intra-EU BITs the real issue is therefore not whether termination by mutual consent is consistent with VCLT, but whether such option is acceptable for the parties to those treaties. It is also necessary to take into consideration the position of the Economic and Financial Committee presented in its 2006 and 2007 annual reports to the Commission. In these reports the EcoFin has suggested that the Member States should pursue a review of their BITs with each other and reflect on the necessity of keeping them in force.

10. Most intra-EU BITs were concluded between old Member States and acceding countries before the accession. It is therefore not surprising that most of the first group do not find any good reasons to agree for the termination by mutual consent. The only known example, as regards Poland, is the Italy which sent a note in 2007 informing the Ministry of Foreign Affairs that it treats the Polish-Italian BIT as terminated. Other old Member States emphasize the need to protect their investment, especially by the investor-to-state dispute settlement provisions.

11. Notwithstanding the legal arguments, there are political advantages of using the path of mutual termination. Such an act would be an example of the good will on the side of the old Member States showing their confidence in the legal system of the host States. To achieve the proper result some coordination by the Commission could be considered.

Article 54(a) of the VCLT

12. The termination clause is a typical part of most BITs which are usually concluded for a certain duration with the possibility of extention if no action is taken by either of the parties. Such move would be undoubtedly effective in the sense of the succesfull termination of the BIT. However, from the point of view of new Member States, there is no much sense in using this mechanism as the termination clauses extend the protection of the BITs for even up to 15 years after the

unilateral termination. Moreover, such a step could be considered as hostile and create unfavorable atmosphere for foreign investments.That is the main reason why the Polish government ultimately decided not to use its right under those clauses, eventhough it considered it in 2006.

Article 30 of the VCLT

13. Article 30(3) of the VCLT, concerning the application of the succesive treaties relating to the same subject matter is applicable once it has been stated that the former treaty was not terminated by using Article 59 of the VCLT. Hence, the arguments presented in this part of the presenation are of alternative character. As the condition that all parties to the earlier party are parties also to the later treaty and the implied condition of the same subject matter have been presented before, the main focus will be on the issue of the compatibility of the provisions of pre-accession intra-EU BITs with the provisions of EU Treaties.

14. As mentioned previously, there is an inherent inconsistency with regard to the very foundations of both legal regimes. BITs deal with foreign investments and grant them protection based on most-favored nation clause or national treatment. They also protect investors from illegal expropriation and usually lay some objective standards, such as fair and equitable treatment or full protection and security. The EU law establishes much more comprehensive set of rules regarding economic activities on the internal market. At the foundation of the internal market lies the abolishion of bounderies for the movement of the economic factors, so the goods, services, capital and enterprises from Member States circulate freely and are treated equally at the whole territory of the EU.

15. The clash of *rationale* relates also to the provisions for dispute settlement under both regimes. The main advantage of BITs is the possibility for an investor to raise a claim directly against the host State before an arbitral tribunal. Neither EU nor EC Treaty allow the private party to sue the host State before the ECJ or CFI. That does not mean, however, that an investor does not have a remedy against the State which infringes its individual rights under EU law. First, national courts are treated as community courts which are obliged to apply directly effective EC norms and interpret national rules in accordance with EC law. Second, the individual has a right to draw the Commission's attention to the breach of Member State's obligations, so it can pursue the claim under Article 226 and 228 of the EC Treaty. Third, if before the national court

the issue of EC law arised, the court would be either entitled (lower instance) or obliged to ask the ECJ for a preliminary ruling. The investor is therefore not left without remedies, notwithstanding some voices to the contrary.

II. BITs with third countries

16. Under Article 307 (2) of the EC Treaty, *„To the extent that (...) agreements* (concluded before the accession) *are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude"*. This obligation requires Member States to ensure that their obligations under, e.g. BITs will be comaptible with their obligations under EC Treaty or acts of institutions.

17. The area of possible conflict has been presented above. The remarks made are also applicable to BITs with third countries. However, there is a different perspective here, as one has to focus on Member States' obligations towards the Community. That is why the Commission decided to sue Austria and Sweden by virtue of Article 226 of the EC Treaty, claiming that their BITs render the measures available for the Council under Article 57(2), 59 and 60(1) of the EC Treaty uneffecive (as not applicable immediately) towards the investors from other Contracting Parties to those BITs. The ECJ confirmed that the current BITs of the Member States concerned do not allow for the immediate action in accordance with the possible measures adopted by the Council. Although Austria introduced the proper clause (which would reserve certain powers to regional organisations) into their model BIT and commited itself to do so in case of the future renegotiations, the Court found that Austria failed to fulfill its obligations under Article 307 with regard to the BITs at issue in the proceedings. The same conclusion was made in respect of Sweden, so both Member States have to take appropriate measures to enable the execution of the Council's measures restricting the free movement of capital.

18. The ECJ's decisions have a substantial impact on the Polish practice in the field of treaty making. Even before the final resolution by the ECJ, the Commission has taken some steps to ensure that new Member States will comply with their obligations under Article 307(2). Those steps led to the renegotiation process with United States and Canada. In the first case the process have already been finilized by the adoption in 2004 of the Additional Protocol to the Treaty on Businees and Economic Cooperation allowing for the application of the Community's

measures. As regards Canada, since the problem concerned not only Poland but also some other new Member States, the Commission took over the burden of talks with Canadian partners which effected in the adoption of the Memorandum of Understanding in 2007. The Memorandum has been concluded in order to pave the way for the renegotiation of the Canadian FIPAs. The renegotiation of the Polish-Canadian FIPA is yet to be finilized. In both cases, however, the adoption of the so-called EU clause was traded off by the concessions for the other Contracting Party.

19. The ECJ rulings affected also the policy with regard to the new BITs. The Polish government established a special Interdepartmental Committee on BITs issues. The first couple of meetings focused on the EU clause in future treaties. At the same time the same issue is being dealt with in connection with the ongoing negotiations with the Saudi Arabia. The Committee found two possible options to deal with that matter.

20. First, whenever it would be possible, Polish BITs should cover the EU clause. The Committee proposed that every provision, the application of which could be limited by the EU action, should be formulated without prejudice to the measures adopted by the EU. The Committee considered also whether it would be better to form the clause in more general terms as applicable to the whole BIT.

21. Second, in case the other side does not accept the previous option, the Committee finds it appropriate to consider the possibility of forming the clause without mentioning the source of the measure. Such a clause would be available for both sides and would be used only after fulfilment of the objective criteria. This option was chosen in case of the FIPA with Canada. If neither of the options were accepted, the Committee would sugest suspending the negotiations. The proposal to disregard the Commission's position was rejected after the final resolution of the issue by the ECJ. However, one has to draw the attention to the fact, that the alleged obligation to include the EU clause into the new BITs does not flow from the Article 307 but rather from the Article 10 of the EC Treaty, which makes this obligation even stronger due to the formulation of the both provisions.

III. The investment agreements concluded by EC

22. The current regime of the EC Law does not touch upon the issue of the protection of investment. However, under Article 133 the Community has the power to conclude trade agreements with third countries within the scope of the common commercial policy. Moreover, according to the ECJ, the power to conclude treaties with third countries or other international organizations extends to areas in which the Community has exclusive competence in the internal sphere (implied external competences). On that basis, the Community has concluded several comprehensive Free Trade Agreements (FTAs) or Partnership and Cooperation Agreements (PCAs) that cover such issues as trade in services or freedom of establishment.

23. In some recent FTAs and PCAs the Commission included also the chapter on investment dealing mostly with the pre-establishment stage, i.e. with the market access issues. However, those chapters in their most-favored nation clause refer also to the maintanance of the investment which clearly exemplifies the expansion by the Commission of the Communities' comptence in the direction of the post-establishment protection. The problem of the relationship between Member States' BITs with agreements concluded by the EC came therefore to the light.

24. The new approach towards the chapters on investment in FTAs and PCAs has been confirmed in the so-called „Template for investment provisions in free-trade agreements – Relationship with bilateral investment treaties". The Council's Legal Service found some of the issues concerning the protection of the investment as being within the exclusive competence of the Community. According to the template such transformation is due to the „ERTA effect", which turns internal powers into the exclusive external comptence of the Community. As far as I know, most old Member States have opposed the template, however they have accepted the introduction of the chapters on investment into certain FTAs (e.g. with Chile). New Member States, including Poland, acknowledged that by extending the provisions of FTAs and PCAs on the protection of investment already established, the Community went beyond its powers so it violated Article 5 of the EC Treaty.

25. This constatation does not affect the general view of the new Member States that it would be better if the Commission negotiate and apply norms regarding the protection of EC investors. This is, however, the postulate *de lege ferenda* which finds no basis in the current division of

powers between EC and Member States. At the same time, one has to notice that the so-called Lisbon Treaty establishes explicit legal basis for the EC's powers in the field of the foreign direct investment. Due to the uncertainties as to the ratification process, Polish government decided to to abolish its BITs negotiations with third countries.

IV. Conclusions

26. The accession to the EU changed the legal situation of Poland immensly. Poland has become a part of the more or less unified economic entity which regulates, sometimes in a very detailed manner, most aspects of the economic activities. Moreover, the EU constitutes a legal system with its own rules on responsibility and mechanisms to make them effective. All these factors affected the Polish position with regard to BITs.

27. First, there is a strong feeling that with the accession BITs between Member States have lost their meaning. Investors from all Member States enjoy either unified or harmonized protection on the EU's territory and are subject to obligations flowing from the EU legislation. In legal terms, there are strong arguments in support of the view that the so-called intra-EU BITs terminated by virtue of Article 59 of the VCLT. Even if one accepts, *arguendo*, that this is not the case, the EC rules would prevail over BITs in case of incompatibility according to Article 30(3) of the VCLT. It is also possible to terminate BITs by some action taken by the Contracting Parties, but arguments favoring such moves are mostly of political rather than legal character.

28. Second, with the accession new Member States have to adjust their BITs to the new situation, in which their territory became part of the internal market. Such an obligation requires, according to the ECJ's rulings in cases against Austria and Sweden, renegotiation of the binding agreements to enable EC measures to be immediately effective. Poland, if it wants to avoid the same repercusions, have to try to convince its partners to include the so-called EU clause into the existing BITs. As regards future BITs, the obligation to guarantee the application of EC measures is based on Article 10 of the EC Treaty.

29. Third, when it comes to the EC treaty-making in the field of the investment protection, it is necessary to distinguish the situation *de lege lata* and *de lege ferenda.* In the first case, the attempts to expand Community's powers on the post-establishement protection have no legal basis. The Lisbon Treaty grants the Community the competence to conclude international

agreements concerning Foreign Direct Investments, so the issue of the relationship between Member States' obligations under BITs and the Community's obligations under future FTAs and PCAs will have to be resolved according to the principle of loyal cooperation.