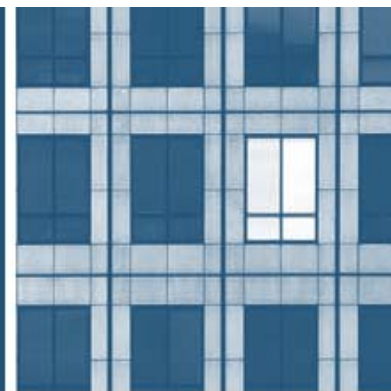


On the Subject



Trial

August 17, 2010

Under the European Commission's proposed regulation, individual Member States will lose the capacity to initiate and control BIT arbitration.

Transitional Arrangements for Bilateral Investment Treaties between EU Member States and Third Countries after the Lisbon Treaty

In July 2010, the European Commission released a draft regulation establishing transitional arrangements for Bilateral Investment Treaties (BITs) between EU Member States and third countries. The draft regulation addresses the status of BITs of Member States following the removal by the Lisbon Treaty of their normative competence to make and administer these treaties.

The Lisbon Treaty amended the treaties that govern the European Union. As part of these amendments, the Lisbon Treaty expands the common commercial policy of the European Union to include "foreign direct investment". One of the amended governing treaties (the Treaty on the Functioning of the European Union (TFEU)) grants the European Union exclusive competence for certain areas, which includes the common commercial policy. It also provides that where the European Union has exclusive competence, only it can legislate or adopt legally binding acts; Member States may only do these things if authorised to do so by the European Union or for the purpose of implementing EU acts. BITs between Member States and third countries fall within "foreign direct investment". The TFEU thus transfers the power to make BITs from Member States to the European Union.

There are currently over 1,000 BITs between Member States and third countries, which retain force under public international law. The Commission's proposal seeks to establish a transitional regime for the harmonisation of the existing international legal norms with the centralisation of investment treaty-making power in the European Union resulting from the Lisbon Treaty. The

primary aim of the regulation is to retain certainty for investors without undermining EU constitutional authority. This is achieved by conditionally authorising all BITs currently on foot (and even providing for the negotiation of existing, and entry into new, BITs), but re-establishing them within the ambit of EU power.

The Proposed New Framework

Under the proposed regulation, Member States will notify the Commission of existing BITs that they wish to maintain in force (Article 2). Article 3 then provides for the authorisation of these BITs' continuing existence. This authorisation is, however, conditional. The Commission will review all notified BITs to determine whether they conflict with EU laws, overlap in any way with EU agreements in force with the third country, or amount to an obstacle to the development and implementation of the European Union's policies on investment, particularly the common commercial policy (Article 5). In the event that any of the issues above is found to exist, Article 6 allows the Commission to revoke the authorisation granted under Article 3.

Article 7 sets out the ways in which Member States may be authorised to enter into negotiations with third countries to amend an existing BIT or to conclude a new BIT. It is clear that the Commission has ultimate control over the entire treaty-making process. The Member State must notify the Commission of the intention to negotiate and provide it with all relevant documentation and information (Article 8). Article 9 provides that the Commission shall authorise the opening of formal negotiations unless it concludes that to do so would conflict with EU law, undermine the objectives of current or intended negotiations between the European Union and the third country, or be an obstacle to EU investment policies. Article 9 empowers the Commission to require Member States to include particular clauses in BITs, and Article 10 provides that the Commission must be kept informed of the progress and results of the negotiations (and may even participate in them). Article 11 requires Member States to give the Commission the texts of the proposed treaty; the Commission then determines whether the treaty conflicts with EU law, undermines current or intended negotiations between the European Union and the third party, amounts to an obstacle for EU investment policy, or fails to

include any clause prescribed by the Commission. If the proposed treaty falls foul of any of the above conditions, the Member State will not be authorised to sign the agreement.

In the event the Commission grants the Member State authorisation, the Commission's involvement does not end: Under Article 13(1), "the Member State concerned shall inform the Commission without undue delay of all meetings which take place under the provisions of the agreement", and the Commission must be provided with an agenda and all relevant information. Crucially, "where an issue to be discussed might affect the implementation of the Union's policies relating to investment, including in particular the common commercial policy, the Commission can require the Member State concerned to take a particular position". Thus, from the need to request permission to open negotiations right through to the operation of the BIT, the Commission ultimately retains total control.

BIT Arbitration Under the Proposed Regulation

Under the proposed regulation, the Commission will control BIT arbitration between Member States and third parties. For all agreements authorised under the auspices of the regulation, the "Member State shall ... immediately inform the Commission of any request for dispute settlement ... as soon as the Member State becomes aware of the request". The regulation requires the Member State to "fully cooperate" with the Commission and "take all necessary measures to ensure an effective defence"; where necessary, it is envisioned that the Commission will participate. The Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions Towards a Comprehensive European International Investment Policy, which accompanies the draft regulation (and, in the main, expands on the European Union's international investment policy) makes clear that it is likely the European Union would be if not the defendant, then at least the co-defendant in any BIT arbitration with a third party.

Member States will also lose the capacity to initiate (or not initiate) arbitrations under BITs: The proposed regulation provides that they "shall seek the agreement of the Commission before activating any relevant mechanisms for dispute settlement ... and shall, where requested by the Commission, activate such mechanisms". This includes informal "consultations" between the BIT counterparties. Again, full cooperation with, and potential Commission participation, is provided for.

The Communication makes clear that a new species of international arbitration will be a part of the proposed regime. Noting that the "current [international dispute resolution] structures are to some extent ill-adapted to the advent of the Union", and that the European Union is not (and not currently

eligible to become) a party to the International Centre for Settlement of Investment Disputes (ICSID) Convention, the Communication states that "the Union should build on Member State practices to arrive at state-of-the-art investor state dispute settlement mechanisms". It seems likely that the European Union will move to employ a standardised dispute resolution provision in any new or renegotiated treaty made by Member States under the draft regulation, if adopted. In this case, two key principles will guide the provisions. The Communication stresses the need for:

- Transparency in investor-state disputes, including open hearings as well as the publication of requests for arbitration, submissions, *amicus curiae* briefs and awards
- The use of quasi-permanent arbitrators and provision for appeals

The alternative suggestion is that the ICSID Convention should be amended to allow EU participation.

Comment

The Lisbon Treaty in several crucial aspects centralises power in a federal structure that contains many of the elements traditionally attributed to the nation state. Specifically, the Treaty, effected by the proposed regulation, moves current and future Member State BITs ultimately under the control of the Commission. If the regulation is adopted, this will of course lead to a game-change in the way third party investors deal with counterparty Member States. Crucially, it will also change the way in which BIT arbitration occurs with Member States: Third states will likely face the European Union as defendants (or, at least, co-defendants). Further, Member States will be unable to institute arbitrations without the Commission's permission, and the Commission may even compel Member States to commence arbitrations. In the event the European Union does not successfully procure the amendment of ICSID, the Communication heralds a standardised dispute resolution procedure at odds with many of the traditional attributes of arbitration: Open hearings and processes, published awards and appellate bodies are anathema to the secrecy, finality and expedition at arbitration's core. On the flip side, these proposed dispute resolution mechanisms (and the requirement for Commission review before proceedings are entered into) will contribute to an international arbitral jurisprudence of greater certainty, which, in an ever-increasingly globalised market, has been long-sought by commentators and government officials.

McDermott's International Arbitration Group will continue to report on the progress of the draft regulation.

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