The New Competence of the European Union in the Area of Foreign Direct Investment (FDI): A Third Country Perspective

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Introduction

Following the entry into force of the Treaty of Lisbon on 1 November 2009 the European Union (EU) has been able to extend its competence for the Common Commercial Policy (CCP) into the field of Foreign Direct Investment (FDI) (Art. 207 Paragraph 1 of the Treaty on the Functioning of the European Union (TFEU)). While this volume is generally dedicated to the many challenges and open questions relating to this new activity, the present Chapter shall focus on the consequences for third countries, in particular other OECD countries that compete with the European Union and its members for FDI inflows and investment opportunities worldwide. In particular, the view of European neighbours, i.e. members of the European Economic Area (EEA) and the European Free Trade Association (EFTA) shall be analysed more thoroughly. While they do share many of the regulations within the internal market, they are autonomous when it comes to their foreign economic policy although they certainly have a keen interest in obtaining at least similar concessions as the EU from their trading partners and in being attractive for foreign investment.[1] But also the perspective of major trading powers (USA, Japan, Canada etc.) and emerging economies like Brazil, China or India shall be discussed as they

[1] For a detailed analysis see Burgstaller, European Law and Investment Treaties, Journal of International Arbitration 26 (2009) 2, p. 181; Podestà, Bilateral Investment Treaties and the European Union. Recent Developments in Arbitration and Before the ECJ, The Law and Practice of International Courts and Tribunals 8 (2009) 2, p. 225; Herrmann, Die Zukunft der mitgliedstaatlichen Investitionspolitik nach dem Vertrag von Lissabon, Europäische Zeitschrift für Wirtschaftsrecht 21 (2010) 6, p. 207 and Tietje, EU-Investitionsschutz und -förderung zwischen Übergangsregelungen und umfassender europäischer Auslandsinvestitionspolitik, Europäische Zeitschrift für Wirtschaftsrecht 21 (2010) 17, p. 647.

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are competing within the framework of multilateral agreements like the WTO. This Chapter shall not provide a detailed analysis of the various theoretical questions as this seems not necessary in view of the excellent contributions to this book but rather complement them. The main focus is to have a look at possible scenarios in view of the future of the EU's FDI policy.

Political and Economic Signification of the Enhanced Competence

In view of the current importance of FDI flows—and therefore the legal regulations relating to them—for the global economy it seems only normal that the EU aimed to complete the existing competences relating to trade, although the common commercial policy now should rather be called the common foreign economic policy[2] in view of its comprehensiveness. Almost all recent bilateral trade agreements contain also investment-related rules, be it in the form of a comprehensive investment chapter or at least with regard to specific aspects, e.g. in the services chapter or relating to taxation.[3] One of the very early examples of this trend was certainly the inclusion of an investment chapter into the North American Free Trade Agreement (NAFTA) of 1992 between the United States, Canada and Mexico (Chapter 11). While this development was certainly due to the United States' intention to complete exiting trade (in goods) rules with services and investment provisions, now even states that had a cautious approach to investment rules do regularly include such rules in their agreements (see e.g. the China-ASEAN-Free Trade Agreement of 2009[4] or even the very recent Agreement between China and Taiwan[5]). Also the discussions undertaken within the OECD and the WTO made a common position by the EU desirable if the EU members want to speak with one voice in the future shaping of such principles and play a significant and credible role in these institutions.

The EU members had relatively early accepted rules that traditionally are part of FDI, in particular the rules contained in the original EC Treaty on the free flow of capital from third countries, as they continue to be part of the rules relating to the free flow of payments and capital of the TFEU.[6] Furthermore, the EU (or more correctly

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[2] See Herrmann, Grundzüge des europäischen Außenwirtschaftsrechts, Zeitschrift für europarechtliche Studien 11 (2008) 1, p. 81.

[3] See also Bungenberg, Going global?, in: Herrmann/Terhechte (eds.), European Yearbook of International Economic Law, 2010 , p. 123.

[4] See the Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation between the People's Republic of China and the Association of Southeast Asian Nations of 15 August 2009.

[5] The so-called Cross-Strait Investment Agreement signed on 9 August 2012.

[6] In particular, Art. 63 et seqq. TFEU (ex-Art. 56 et seqq. ECT). With regard to their significance for capital inflows from third States see: ECJ, Case C-452/04, *Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht*, [2006] ECR I, 09521.

the EC at that time) had already in the past concluded several agreements with third States, in which specific aspects of FDI (supposedly covered by the existing treaty provision at that time) were addressed. A typical example is the early attempt to do something meaningful in the FTA with Mexico in 1997.[7] In this Agreement, in view of the very limited competence of the EU at the time, the FDI-related provision had to make a strong reference to the terms "movement of payments" and "movement of capitals" contained in the ECT in order to justify the inclusion of some (very limited) provisions relating to FDI. As a result only the admission and limitation of FDI could be addressed while the traditionally more important treatment of investors and investments (including the paramount question of expropriation) and rules relating to dispute settlement were outside the scope of the possible negotiations. Nevertheless, this approach was used in a number of earlier agreements and allowed to signal the willingness to address FDI flows in bilateral agreements despite the limitations due to the existing EU powers of the time.

At the same time, one should not forget the very active role that the EU Commission has played in recent years when FDI was discussed in international fora like the WTO or the OECD (or even earlier the Energy Charter Treaty), even if the existing competence at the time seemed problematic and made that the EU was rather speaking in the common interest of the Member States than as a real player in this field.[8] In this context it will be particularly interesting for the multilateral framework whether improved and strengthened legitimacy of the EU (and thus the European Commission) in FDI will lead to initiatives by the EU within these fora. Although the experience with the Multilateral Agreement on Investment (MAI) within the OECD and the discussion of investment flows as a so-called Singapore Issue within the WTO (in the late 1990s) were rather disappointing it is pretty certain that it is in the interest of many (if not all) states to multilateralise investment in the near future or at least to obtain specific FDI commitments in exchange of more traditional trade concessions.[9] The EU has already in the past played the role of a defender of these interests within the WTO and is certainly now more adequately entitled to do so even if the changed relationship between the weakened EU members and the ever more important BRIC States may have an influence on the EU's interest in addressing specific issues relating to FDI. On one hand, a multilateralisation of specific issues would make the complex situation among the EU Member States less relevant. At the same time it could be that the European Commission's eagerness to negotiate and address FDI in the past was maybe also due to its eagerness to obtain the competence it now has got—and thus there is less

[7] Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and its Member States, of the one part, and the United Mexican States, of the other part, 8 December 1997, OJ L 276 of 28 October 2000, Art. 8 and 9.

[8] See below note 23 for the description of the EU-Mexico Agreement.

[9] See Ziegler, Multilateraler Investitionsschutz im Wirtschaftsrecht, in: Ehlers / Wolffgang (eds.), *Rechtsfragen internationaler Investitionen*, 2009, p. 63.

need now for such a proactive policy on the international level in view of the clarified situation at the EU level.

Existing BITs Between EU Member States

One of the unresolved problems relating to the new competence of the EU for FDI is certainly the existence of approximately 191 BITs between EU Member States.[10] A number of recent arbitral awards and declarations by EU Member States and the European Commission have made it clear that there are various solutions to their role with regard to FDI-related disputes between EU Member States and investors from another EU Member State. In principle, this is a typical problem as it has arisen in other areas where the EU has acquired a competence in an area previously regulated at the national level and through bilateral agreements. Famously, the bilateral air traffic agreements at an earlier period in time caused similar problems among the EU Member States.

It is interesting to recall that most BITs between EU Member States have been negotiated between Central and Easter European Transition Economies and the older EU Member States in the early 1990s. Typical examples of this development are also the BITs negotiated by Switzerland with ten States that now are all EU members.[11] These agreements constituted at that time important tools to develop the economic relations between the States within Europe—and thus an important factor preparing the accession of these countries to the EU.[12] The European Commission has continuously defended the position that after the accession of these countries these agreements should no longer be allowed to play a role regarding FDI flows and their treatment among EU members as they potentially lead to an infringement of EU rules (a position certainly understandable from a EU perspective) was not generally acceptable to investors and it seems even certain EU Member States (often in view of the importance of these agreements for their business community). Generally arbitrators have not accepted the European Commission's position and used these agreements as a basis for the settlement of disputes between EU Member

[10] See de Mestral, Is a model EU BIT possible — or even desirable? Columbia FDI (2010) 21, available at: http://www.vcc.columbia.edu/.

[11] Agreements with Hungary of 5 October 1988, with Poland of 8 November 1989, with the Slovak Republic and the Czech Republic (at the time still as Czechoslovakia) of 5 October 1990, with Romania of 25 October 1993, with Bulgaria of 28 October 1991, with Estonia of 21 December 1992, with Latvia of 22 December 1992, with Lithuania of 23 December 1992, with Slovenia of 9 November 1995. Malta had concluded an agreement with Switzerland as early as 1965, but this agreement was terminated by Malta in preparation for EU membership in 2005. The termination by Malta took effect on 23 February 2005, published in: Amtliche Sammlung des Bundesrechts der Schweiz (AS) 2005, 1163. Cyprus never had negotiated a BIT with Switzerland.

[12] This process is not yet entirely terminated; e.g. there exist BITs between Switzerland and Croatia (30 October 1996), Macedonia (26 September 1996), Montenegro and Serbia (originally as Serbia-Montenegro, 7 December 2005) and Turkey (3 March 1998).

States and investors from other EU Member States.[13] Notably the Czech Republic (due to several lost cases against it) but potentially also Italy, Malta and Slovenia seemed to share the European Commission's position while other EU Member States seemed rather to favour the continued use of these agreements[14]—a situation which makes of course a quick solution less likely.[15] Third States have not had reasons to comment on this problem in view of its internal dimension although potentially their investors could be concerned indirectly, e.g. when making use of an intra-EU BIT through subsidiaries.

Existing BITs Between EU Member States and Third States

The existence of a plethora of BITs between EU Member States and third countries is probably of more direct relevance to the EU's external relations and the discussion of the EU competence in third countries. Already under the old treaty provisions the European Commission had started to show its interest in the issue and challenged the existing BITs of some Member States with third states under the provisions on capital movements. The Commission had argued that the Member States concerned should at least renegotiate their existing agreements (or even terminate them) in order to avoid any discrimination. The European Court of Justice upheld this position in its judgments against Austria, Sweden and Finland.[16] Similar proceedings against Denmark were terminated when Denmark agreed to terminate the respective agreement. Other Member States have also chosen to terminate certain agreements, e.g. Malta with regard to its 1965 Agreement with Switzerland—immediately before joining the EU.[17]

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[13] See the « amicus curiae briefs » by the European Commission and the reaction of the arbitrators in the cases: SCC No. 088/2004, *Eastern Sugar v. Czech Republic* (Partial Award), ICSID Case No. ARB /07/22, *AES v. Hungary* (Award), ICSID Case No. ARB/07/19, *Electrabel v. Hungary* (Award n.y.p.), PCA Case No 2008-13, *Eureko v. Slovakia* (Award n.y.p.) – to mention but a few.

[14] See: « Italy, Slovenia and Malta concur with Czech Republic on lack of necessity for intra-EU BITs; Italy-Czech treaty has been terminated », Investment Arbitration Reporter, 6 August 2009.

[15] See de Mestral, Is a model EU BIT possible — or even desirable? Columbia FDI (2010) 21, available at: http://www.vcc.columbia.edu/, and especially the letter addressed by the Economic and Finance Committee to the Council of the EU of 2009 ('[m]ost member states did not share the Commission's concern regarding arbitration risks and discriminatory treatment of investors and a clear majority of member states preferred to maintain the existing agreements'). See also 'EU Member States Reject the Call to Terminate Intra-EU Bilateral Investment Treaties,' Investment Treaty News, 10 February 2009 and Antell / Carlson / Haworth McCandless , The European Commission and Investment Treaties, The European & Middle Eastern Arbitration Review 2010, online at: http://www.globalarbitrationreview.com.

[16] See, ECJ, Case C-205/06, *Commission v Austria,* [2009] ECR I, 1301, ECJ, Case C-249/06, *Commission v Sweden,* [2009] ECR I, 1335 and EJC, Case C-118/07 *Commission v Finland,* [2009] ECR I, 10889.

[17] The termination by Malta took effect on 23 February 2005, published in: Amtliche Sammlung des Bundesrechts der Schweiz (AS) 2005, 1163.

On the whole it seems understandable that those countries that in the past developed a broad network of BITs with the intention to protecting their investors abroad are rather reluctant to easily abandon these tools. They want to make sure that the EU itself is able and willing to provide an equally comprehensive network and level of protection. This is particularly true for BITs concluded with developing countries (including certain BRICs) while the problem is relevant with regard to OECD countries where normally no BITs exist (even if more recently this trend is no longer clear since certain BRIC countries have joined the OECD—like Korea or Mexico—and some developed states have decided to conclude investment rules, as e.g. in the FTA between Japan and Switzerland or, of course, earlier between Canada and the US through NAFTA). When it comes to negotiations with BRICs which seem particularly interesting for FTAs the question what can and shall be done in the area of investment in view of the existence of many BITs is particularly relevant. In its "Proposal for a regulation of the European Parliament and of the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries" of 7 July 2010 the Commission had made suggestions on how to deal with the existing BITs concluded by EU members. In a nutshell it was accepted that these could stay in force and even be negotiated as long as they did not jeopardize the EU's ability to negotiate its own rules. This left open the option, however, to force Member States to terminate existing agreements or at least to renegotiate them.[18] The question is, however, what impact this will have on future negotiations—so far it seems that EU Member State have been able to continue to negotiate BITs (such as Germany when it renegotiated its BIT with Pakistan in December 2009) and the EU has started to include more detailed provisions in its FTAs (such as in the FTA with Korea of 6 October 2010, Article 7.9 et seqq.)

Future BITs and Investment Chapters in FTAs with Third States

As explained in detail in this volume the exact scope of the EU's competence with regard to FDI remains somewhat unclear.[19] In the Agreement signed with Korea on 6 October 2010 the EU has continued to focus on so-called establishment rules—as it had been the tradition in the past—although in a somewhat more detailed manner (Art. 7.9 et. seqq.) and the existing investment rules between some of its members

[18] "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", 7 July 2010, final As well as "Proposal for a Regulation of the European Parliament and of the Council Establishing Transitional Arrangements for Bilateral Investment Agreements between Member States and Third Countries", 7 July 2010, COM(2010)344 final.

[19] See de Mestral, The Lisbon Treaty and the expansion of EU competence over foreign direct investment and the implications for investor-state arbitration, in: Sauvant (ed.), Yearbook on International Investment Law & Policy 2009–2010, 2010, Ch. 10.

and Korea were declared to stay in force and take precedence over the new FTA (Art. 7.15 Letter b). The door is left open, however, for the future negotiation of a comprehensive BIT between the EU and Korea (Art. 7.16).

In its "Communication from the Commission towards a comprehensive European international investment Policy" published on 7 July 2010, the European Commission advertised its intention to soon start negotiations of comprehensive investment rules in FTAs, e.g. in the envisaged agreements with Canada, India and Mercosur. All these negotiations have been difficult however (not necessarily due to the envisaged investment rules) and thus no texts have been released so far. In the medium term the European Commission would also like to start negotiations of pure investment agreements with important partners such as China and Russia. So far the Commission has declared to want to achieve a high standard of protection—probably the only means to convince traditional capital exporting countries with an extensive network of agreements to accept their lead. It seems that this could include transfer clauses, the protection of IPR, MFN, "full protection and security" as well as "fair and equitable treatment", high levels of protection relating to expropriations and even so-called "umbrella clauses". Knowing all the problems that have arisen with regard even to previously accepted standards this seems already challenging at this point. On the other hand, the Commission has taken up current debates on the enhanced protection of states when it comes to their right to regulate and protection against frivolous claims by investors. Both areas will certainly be subject to considerable debate among the Member States as it is already clear from recent modifications (and the resulting controversies) of model BITs by other States such as the United States or Norway.

An idea of how difficult it can be to negotiate investment rules as a group can be obtained from the experience of the EFTA countries in the past.[20] As Switzerland and Norway were normally not able to overcome their differences regarding the desirable standards to be included in agreements with third States, they were only once able to include a more detailed chapter on investment in such an agreement, namely with Singapore.[21] In all other cases these provisions had to remain very basic (e.g. with Mexico)[22] or the investment rules had to be negotiated in separate bilateral agreements by certain EFTA States and the respective third country

[20] Of particular relevance will certainly be the inclusion of the public interest, namely democracy, human rights, rule of law, the environment in BITs; see, for example, Maes, Reclaiming the public interest in Europe's international investment policy: Will the future EU BITs be any better than the 1'200 existing BITs of EU member states? Investment Treaty News, September 23, 2010, available at: http://www.iisd.org. The new role of the European Parliament in the area of the common commercial policy will enhance this debate, see Kerremans / Orbie, The Social Dimension of European Union Trade Policies, European Foreign Affairs Review 14 (2009) 5, p. 629.

[21] Agreement between the EFTA States and Singapore of 26 June 2002, Articles 37-49. See Ziegler, Dispute Settlement in Bilateral Trade Agreements: the EFTA Experience, in: Bartels / Ortino (eds.), *Regional Trade Agreements and the WTO*, 2007, p. 407.

[22] Essentially using the model developed by the EU with this country, see above. See in general on the EFTA Third Country Agreements: Ziegler, *Wirtschaftsvölkerrecht der Schweiz – (eine Einführung unter Einschluss des Aussenwirtschaftsrechts)*, 2010.

(e.g. Korea).[23] It became normally clear that the absence of agreement between the EFTA States made it impossible to adopt a common negotiating position and to include common language applicable to all parties. It remains to be seen whether the EU Member States can overcome this challenge.

At the same time, the approach chosen by EFTA could show a way how despite the objective of negotiating common rules, separate rules may co-exist with the common agreement. The separate rules could be (renegotiated) BITs where they already exist or even additional BITs by EU Member States that do not yet have them in place with the third country concerned—although this may not be the declared goal of the Commission—at least not in the medium and long run.[24] It is clear that the European Commission must be able to negotiate the traditional investor-State dispute settlement mechanisms contained traditionally in most BITs, even if some states have become more cautious as to their scope. While the use of ad hoc proceedings using UNCITRAL Rules seems less problematic, the use of the ICSID mechanisms remains problematic in view of the fact that the EU is not (and cannot become for the time being) a member of the ICSID-Convention. The ICSID mechanism remains highly popular among certain investors and it would be difficult to convince EU investors that they should completely abandon it. Although there are difficult questions relating to some of its provision (like the definition of investment, the scope of annulment etc.) the fact that ICSID awards are not subject to domestic appeals and are automatically enforceable in ICSID Member States are interesting features. Open questions remain also regarding the payment of damages resulting from an award against the EU due to the behavior of a specific Member State.

BITs as an Instrument to Enhance Competitiveness

The many open questions relating to the exact content and form of future EU investment rules with third States as well as the unclear relationship with the existing agreements of the Member States may lead to considerable uncertainty among investors. If one considers that BITs can increase investment flows and that they are tools that are important for investors when deciding where to invest and how to structure their investments this may have considerable implications for the attractiveness of the EU as a place from where to invest. Many EU companies have a major stake in infrastructure projects, especially in the growing markets in

[23] Free Trade Agreement between the EFTA States and the Republic of Korea of 15 December 2005, Article 1.4 Investment: « Regarding investment, reference is made to the agreement on investment separately concluded between Korea, on the one hand, and Iceland, Liechtenstein and Switzerland, on the other. This agreement shall for these Parties form part of the instruments establishing the free trade area ».

[24] See the Rules contained in the Agreements with Mexico as concluded by the EU and the EFTA-States (see above) and the parallel BITs of certain EFTA- and EU-States with Mexico.

emerging economies and developing countries (transport, energy, housing, telecommunication, production facilities etc.). Recent disputes have shown that the existence of BITs can be of high relevance when it comes to disputes relating to such projects. The existence of a BIT of a high quality can be of considerable importance when it comes to the decision from where the respective investment shall be made in order to benefit from the protection of such a treaty. When it comes to investments in countries such as Canada, Korea, China, India, Singapore or Brazil such agreements could be highly valued.

If the EU does not manage to quickly convince investors that either the existing BITs of its members or the new EU FTAs do provide a good protection, investors might prefer to use vehicles in countries that do satisfy their needs in a less ambiguous way. Although this sometimes labeled as "Treaty-" or "Forum-Shopping" it is acceptable up to a certain degree and especially common for MNEs of a certain size. Normally such a planification of investment flows has also certain tax effects—a topic particularly challenging in times of financial distress.[25]

[25] See the tensions that exist between Switzerland and the EU when it comes to the specific tax privileges for so-called holding companies; see "Antwort des schweizerischen Bundesrates vom 18.2.2009 auf die Interpellation Felix Müri (Steuerstreit. Haltung des Bundesrates)", available at: http://www.parlament.ch/d/suche/seiten/geschaefte.aspx?gesch_id=20083954.