LUPICINIO
INTERNATIONAL LAW FIRM

NEWSLETTER

INTERNATIONAL ARBITRATION **OCTOBER 2014**

New Advances in Foreign Investments

JOSÉ EUGENIO SORIANO
Of Counsel

NOTICE ON THE RULING (EU) No. 912/2014 OF THE EUROPEAN PARLIAMENT AND COUNCIL of the 23rd of July 2014, which lays out a framework for the management of financial responsibility relating to the Courts that settle disputes between investors and States, established by international agreements to which European Union is a party (entry into force on the 17th of September 2014).

With responsibility comes power. And naturally, with power comes responsibility.

The European Union, following the Treaty of Lisbon (1st December 2009) exclusively assumed the Common Commercial Policy (Art. 3.e. TFEU), covering Foreign Direct Investments (FDIs). It can also be party to international agreements that contain provisions on direct foreign investments.

Thus, on the one hand, the subsistence of the APPRI ("*Acuerdo para la Promoción y Protección Recíproca de Inversiones*", or "*Agreement for the Reciprocal Promotion and Protection of Investments*") is laid out (see Fernández Rozas, "La Ley" ("The Law") nº 18/ September 2014) with an incredibly complex interpretation based on achieving an equal position for all Member States, avoiding the inevitable preferences caused unilaterally by each State signing an APPRI on their behalf, many of which raise issues of compatibility with EU law, particularly on the infringement of the free transfer of capital. This led to Regulation 1218/2012 of Parliament and Council which determined the gradual phasing out of the APPRIs signed by Member States with third party countries, without directly affecting APPRIs within the EC. And it is specified that, as the EU assumes exclusive responsibility on matters of FDIs, it is in a monopoly to conclude such treaties with third party States on the areas covered by old APPRIs. Once the EU establishes a treaty with a third party country, the APPRIs that the Member States had with that country will be abolished in favour of the existence of a sole agreement on direct investments (FDIs), although APPRIs referring to portfolio investments may be maintained, with the prior approval of the Commission. The principle of loyal cooperation (to level the playing field) under Article 4.3 of the European Union Treaty (EUT) plays a role throughout all of this.

Note that, in the future, potential Free Trade Agreements or other agreements on matters of

FDI signed by the EU with third party countries will regulate the issues that APPRIs previously addressed, and most notably including the formula for conflict resolution. Thus negotiations are taking place precisely regarding the future Transatlantic Trade and Investment Partnership with the United States, under which the next FTA will substitute the APPRIs that different Member States have signed with the United States; and it expressly provides that a mechanism for conflict resolution between investors and the states will be incorporated, in order to settle conflicts and disputes through arbitration. Thus what is accepted as normal in the order of EU conflict resolution and, by extension, of the member States in relation to direct investments shall be precisely arbitration.

On the other hand, we question the technique and payment of the arbitration covered by such FDIs, which are usually accompanied by clauses of submission to arbitration. Because if the EU signs a FDI agreement it, logically it has to be responsible in the case of an investor from a third party country that signed the relevant agreement with the EU claiming that the Union did not fulfil the conditions of the agreement.

There will equally be problems when whoever it is, be it a Member State, signs this agreement, but enforcing EU legislation, for example, transposing a Directive if then the complaint by the investor from a third party country is based precisely on the failing of such a Directive in the context of the investment. Because of course, the remainder of the Member States will not be willing in any way to undertake the heavy expenditure that arbitration of the defaulting State may incur, even for the imposition of EU regulations.

The basis for resolving financial burdens derived from the award or settlement agreements that overrule prior arbitral proceedings are as follows: a) recognition and demonstration of the legal personality of the EU; b) continued cooperation between the EU and the Member State that provoked the negotiations; c) institutional loyalty amongst the Member States and the Commission; and d) continued legal flexibility in order to resolve and fix the issues submitted to arbitration.

All this, assuming that international liability for a contract which is the subject of a conflict resolution procedure of resolution is determined by the division of powers between the Union and the Member States. Therefore, the Union will be primarily responsible for defending any claim based on a breach of rules included in an agreement that is the exclusive responsibility of the Union, regardless of whether the agreement in question is issued by the Union itself or by a member State.

This is of paramount importance, as Member States are not free to apply or not apply EU law. If, therefore, in execution they incur a contract or agreement with an investor from a third party country and, as a result, such responsibility is required as a consequence of the proper application of EU regulations, the EU will not be able to avoid the fact that it must defend and assume such responsibility as well as the potential financial burden resulting from the execution of the award, or transactions to avoid it. All this serves to match the foreign investor with the EU investor. The foreign investor must be of an equal quality to his EU counterpart, but should not be treated as privileged or superior, as the basis of legal protection and security to be achieved by the EU must be the same for all Member States.

As well as these substantive rules, this newest Regulation deals particularly with procedure. Specifically, and given the well-established legal personality of the EU, it states that the EU will be the defendant in the arbitration, if the complaint filed implies a breach of the rules established in the contract. And as a consequence, that it will assume the resulting financial responsibilities. Likewise, when it is exclusively a Member State who is responsible, only said State will undertake the financial responsibilities incurred by arbitral proceedings.

Acutely, the Regulation provides that if a Member State decides to trust EU institutions with its defence, it will then be the EU who intervenes procedurally as the defendant, without the risk of the financial responsibility for the Member State's breach of contract falling exclusively upon the former. This dissociation is expected in the case of the States which for various reasons do not have sufficient experience nor legal resources, who request that the EU intervene as a "white knight" in defence of the aforementioned State that breached a direct investment agreement, but in turn it does not have the legal strength that the EU of course does have. However, once again, the defaulting States will be the only ones financially responsible for the result of the verdict.

It could also be that the EU itself has an interest in standing for a particular matter even though the direct investment matter only affects the Member State being defended on behalf of the EU.

These are cases where "community interest" is involved in the matter because the outcome of arbitration with the Member State would undoubtedly affect the EU itself. Hence, when the EU has undersigned a contract almost identical to that which is being vented by the Member State, or when the contract in question undersigned by the State is actually imposed by the Law of the European Union, or when facing the WTO the EU finds itself arguing a matter similar on all points to that which is being litigated by the member State, or if it is necessary to stand for the particular case because it is necessary to ensure the unity of argument before the WTO in a matter in which the EU has an interest. But in any case, and as a duty of loyalty, it is imperative that the EU always takes the interests of the Member State in disputes into account.

And as all this must fall within the EU's set of actions, it states that the Commission will must Parliament and the Council. And when the EU acts as a defendant, so that the interests of a Member State are also at stake, it will provide all documentation, consultation and participation in the proceedings in question. And vice-versa, when the Member State is the defendant, it must inform, consult and solicit the opinion of the Commission on any matter relevant to the Law, including participation in delegation during proceedings.

The EU will ultimately be financially responsible and undertake expenditure when a breach of the direct investment is due to EU actions, whether directly through its entities or indirectly when the Member State does so but due to its obligation to comply with EU Law.
And the Member State will be responsible when it has breached a contract of direct investment with a third party. It is also deemed that if it infringed the agreement with the application of EU law and did not settle the incompatibility of the previous act which caused the State to infringe it, it would need to take responsibility as in similar circumstances, it would have to challenge EU law itself. Of course, if a transactional agreement is reached

prior to the award in order to avoid arbitral proceedings, the State can also take responsibility.

Indeed, within the flexibility necessary in all that is done to arbitral proceedings, both the EU and the Member State may interrupt proceedings, previously ending matters through transactional agreements which, by giving, promising or withholding what is demanded by the content of the arbitral litigation, end with arbitration.

In such cases, if the EU understands that the issue concerns the Union and its own law, and it is in the interests of the EU, without a doubt it can certainly negotiate by taking the financial burden of the consequences of such a proceeding upon itself.

But if in turn this potential negotiation affects a Member State, the EU will only be able to come to an agreement which simultaneously respects the interests of the aforementioned State, who must not take any financial responsibility as a result of the conclusion arrived at by the Commission, and of course, due to the application of the principle of loyal cooperation, there will have to be continued consultation between the EU and the Member State.

In turn, with regard to potential negotiations, if a Member State is the one affected, of course it can come to an agreement that it deems appropriate, but assuming the corresponding financial burden entirely without transferring it in any way onto the EU. It is also required, in such a case, in addition to supporting the financial burden arising from arbitration alone, that the agreement which the Member State concludes in the transaction is compatible with EU law.

It is interesting to note the rule of "prompt payment" assumed by the EU, indicating that when a ruling is passed against the Union, the determined compensation must be paid without delay. And the EU will have the budgetary means and adequate finances in order to pay (excepting the case in which a Member State recognizes that the payment is the responsibility of the State and the State alone).

Quid juris, if the Member State does not recognise its shared responsibility with the EU in the case of an unfavourable ruling or if the Commission determines that it is the Member State which is financially responsible for an unfavourable award? Meanwhile, the EU advances the payment and then recurs against the Member State affecting the financial costs with its interests (naturally without the risk of the State can appeal to the EU Courts if it does not agree with the Commission's decision).

It is interesting to show that the EU has really taken the possibility of submitting to arbitration in cases of FDI seriously. Therefore it will include in its Budgets the estimated quantities resulting from these procedures, thus assuring the third party States and their investors of the EU's full readiness to guarantee the outcome of the awards. And it is also envisaged that the EU will have the appropriate instruments in order to ensure that the Member States also comply with their promises to properly address the application of FDI agreements. To do so, if necessary, the relevant quantities shall be advanced and then recurred against the corresponding State. And in all this, the Commission will be assigned powers of enforcement, an expression that clearly indicates the gravity of the matter and that from now on the States will have both a security measure and protection by the EU in order to meet its commitments to direct investment, as an obligation and a requirement that the Commission cannot avoid whilst being the guarantor of such agreements.

FOR MORE INFORMATION:

JOSÉ EUGENIO SORIANO
Of Counsel
jes@lupicinio.com
+34 91 436 00 90