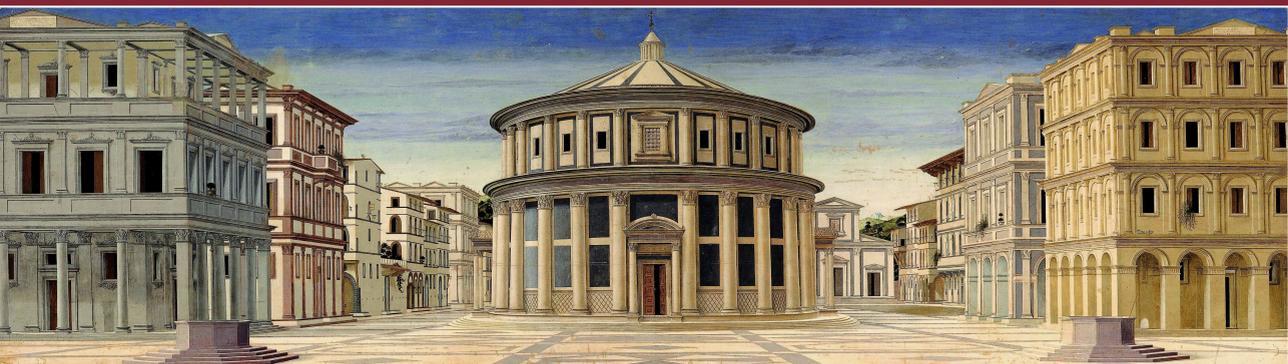


# EUROPEAN PAPERS

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# EUROPEAN PAPERS

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## EDITORIAL

### THE 2019 ELECTIONS AND THE FUTURE ROLE OF THE EUROPEAN PARLIAMENT: UPSETTING THE INSTITUTIONAL BALANCE?

The elections of May 26 have been welcomed with a sense of relief by the inhabitants of the European districts in Brussels and Strasbourg. If, on the eve of the elections' day, the dominant mood was fear of a euro-sceptic landslide, that would have deepened the cleavage between peoples and elites and shaken at its roots the process of integration, this mood has gradually changed as this looming perspective faded away. It turned out to be almost enthusiastic as certainty materialized to have the majority of the Members of the European Parliament's on the "right" side.

In a nutshell, the populist parties increased their shares of the ballots, but less than expected; the *Große Koalition* lost the absolute majority, but, with some adjustment, the Parliament will continue to be controlled by an integrationist majority. A final touch of optimism came from the turnout, which has significantly increased, thus bestowing more legitimacy on the resistance to the populist wave. One may presume that, with a haircut on austerity policies, some more emphasis on social policy, and a crackdown on immigration, business could continue as usual.

Things, however, may be more complex than that. The avoided danger of having the Parliament controlled by nationalist parties should not overshadow the profound implications of this elections day. In particular, two aspects ought to be seriously considered, despite the fact that they are somewhat incoherent.

On the one hand, the elections, unlike their preceding ones, have been dominated by European, not domestic, themes and, in particular, by the fate of the integration project. On the other hand, precisely because of that, the European Parliament is now deeply divided between a pro-integration majority and a euro-sceptic minority, sometimes labeled as sovereigntist. It is this divide that will probably have a major impact on the functioning of the European Parliament and, ultimately, on its role in the decision-making process of the Union.

As a matter of fact, traditionally the European Parliament elections have been dominated by national issues, to the point that they have been perceived not much more than a mid-term test of the respective national parliamentary majorities. A common complaint echoed in the comments on the past elections was precisely the absence of a clear

mandate entrusted by the European constituency as to a political line giving guidance to the Parliament.

However, in spite of this apparent failure, the Parliament has carved out a role – increasingly significant indeed – in the complex EU institutional system. It has presented itself as the only genuine representative of the European citizenry, as opposed to the representatives of the executives of the Member States, symbolized by the two Councils. To fulfil this noble vocation, the Parliament has relied on a vast majority, including Members of the European Parliament and political groups who fiercely oppose each other in the national political arena.

There are, of course, notable examples where this simple scheme did not apply. Noteworthy, this has frequently occurred in recent years, where the rise of euro-sceptic parties has become visible and prompted an unnatural alliance among Institutions that traditionally play different parts in the game. Many an observer was stunned by the unexpected failure of the Parliament to defend its prerogatives in some highly-sensitive political matters, in particular those concerning migration. However, apart from some misguided sense of deference to the Council, the Parliamentary role has been magnified precisely by its capacity to oppose the political direction of the Member States.

It is remarkable that a weak institution, elected by a number of different national constituencies generally uninterested in European affairs, on the basis of national agendas, has become a champion of the integration project. This is probably due to an extraordinary combination of factors: on the one hand, the high majority threshold required, under the founding treaties, for the Parliament to safeguard its prerogatives in the EU decision-making process; on the other hand, the tendency to represent collective or European interest as opposed to groups of interest organized on a national basis, represented within the Council.

Be that as it may, the tendency of the Parliament to act as a unitary actor, could be regarded as a hallmark of the European political system and as a distinctive trait of what is generally referred to as the EU institutional balance. One may wonder whether this can change after the 2019 elections day.

Something has certainly changed in the European political landscape. Although the electoral campaign still remained confined within the national constituencies, “Europe”, its role and its responsibilities, abruptly burst upon the political scene and will not leave it soon.

Not every single aspect of the integration, of course, was duly considered in that campaign. Whereas the EU activities mainly remained in the background, the most visible and symbolic themes dominated the campaign, probably well beyond their real impact of the daily life of citizens. This is part, alas, of the contemporary tendency of the political competitors to overstate symbolical issues, and there is no reason why Europe must remain immune from it.

Nevertheless, the May 26 elections represent a significant turn in the political life of Europe. They have mainstreamed within the European Parliament the classical internal dynamics of parliamentarism, namely the opposition between majority and minority, that had remained largely theoretical in the previous parliamentary terms.

The disappearance of a large majority in Parliament sharing a common vision of the process of integration, and its replacement with a tight majority opposed to a strong and fierce “sovereignist” minority, is an event capable to alter in depth the functioning of the EU political system. To secure this functioning, a more intense, if not organic, link between the majority in the Parliament and the majority in the Councils, may be necessary.

This chain of events may be welcomed by those who believe that consociational mechanisms are the symptoms of teething problems of the European political setting, which will disappear as soon as it matures in an evolved full-fledged political system.

In the view of this writer, such an evolution not only is not auspicious; it is also at odds with the constitutional setting of the EU and with its overarching principle of institutional balance.

This principle, constantly referred to in the case law of the CJEU, is based on the independence of each of the three main political institutions in the decision-making process of the Union. The European model of democracy is fed more from inter-institutional relations than from intra-institutional relations, such as the dialectic between majority and minority within the Parliament. Taking independence seriously entails that the component-parts of each institution share a common conception of the process of integration and of its vocation to fulfil it.

In the case of the European Parliament, independence for decades meant independence of its Members from their national political allegiance and, therefore, from the dynamics of political interests which guide the conduct of the representatives of their respective national state within the Councils. If this premise were to fail, the role of the Parliament would be seriously endangered and, with it, also the principle of institutional balance which constitutes one of the foundations of the EU political system.

To start with, will the new Parliament find the cohesion that proved decisive in its victorious confrontation with the European Council, at the beginning of the last term, concerning the designation of the President of the Commission?

The principle of institutional balance reflects one of the rare cases in history where law creates policy, and not vice versa. By assigning a distinct role to each political institution, and by conferring the powers necessary to discharge it, that principle has forced the political dynamics into the straitjacket of the EU Institutional design. As a result, the European Parliament finally has found its mission as the institution representing the interests of the European constituency, as opposed to those of the Member States, in the process of integration.

The 2019 elections may reverse the direction of the European political tide. Instead of injecting new blood in, and of bestowing additional authority upon, the European Parliament, the Europeanisation of the elections may prompt, paradoxically, the opposite effect: to establish a permanent link between the majorities in the European Parliament and the intergovernmental Institutions, and, by so doing, to undermine the authority of the former to the benefit of the latter. Even more paradoxically, it may expedite the transformation of the European Parliament, from one of the independent branches of the European political system to a verbose Parliamentary house, controlled by the executive and deprived of a real decisional autonomy. If this were the effect of the revolutionary elections of 2019, this would be the beginning of the end of the new model of democracy that has germinated in the European laboratories.

**E.C.**



## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta *and* Juan Santos Vara

#### *ACHMEA* BETWEEN THE ORTHODOXY OF THE COURT OF JUSTICE AND ITS MULTI-FACETED IMPLICATIONS: AN INTRODUCTION

TABLE OF CONTENTS: I. Introduction. – II. *Achmea*, from the perspective of international investment law specialists. – III. An impressive set of consequences inferred from *Achmea*. – IV. *Achmea* and the European integration process.

I. *European Papers* has decided to open a debate on the *Achmea* case, in which the Court of Justice (CJ) found an inconsistency between provisions of a Bilateral Investment Treaty (BIT) containing an agreement to arbitrate and provisions of the TFEU.<sup>1</sup> In its groundbreaking judgment of 6 March 2018, in *Slovakische Republik v. Achmea BV*, the CJ, sitting in Grand Chamber, ruled on the compatibility with Arts 18, 267, 344 TFEU of the arbitration clause contained in Art. 8 of the BIT concluded in 1991 between the Netherlands and Czechoslovakia, and still applicable to Slovakia after the dissolution of Czechoslovakia in 1993 (hereafter NL-SK BIT). The clause enabled an investor from a State Party to bring proceedings before an *ad hoc* arbitral tribunal in the event of a dispute concerning investments in the other State Party. In spite of the opinion given by the AG Mr Wathelet,<sup>2</sup> the Court declared such an Investor-State dispute settlement (ISDS) provided by a BIT between two Member States (so-called *intra*-EU BIT) incompatible with EU law, due to the adverse effect it has on the autonomy of the EU legal system. According to the Court, therefore, the arbitral tribunal lacked jurisdiction in the case.

Scholars from different disciplines have been invited to comment upon this ruling in the present Special Section. They have been asked to examine the judgment, to evaluate its scope and to identify, as much as possible, its potential consequences. In so doing, *European Papers* aims to participate in the understanding of a ruling whose brevity contrasts with the importance of the effects it may have on international investment law and its relationships with EU law. One thus needs to engage in a dialogue with in-

<sup>1</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Slovakische Republik v. Achmea BV*[GC].

<sup>2</sup> Opinion of AG Wathelet delivered on 19 September 2017, case C-284/11, *Slovakische Republik v. Achmea BV*.

ternational law scholarship. The CJ's ruling in *Achmea* has indeed generated remarkably critical comments among international law scholars. The first objective of this Special Section is to understand to what extent the *Achmea* judgment has stretched the differences between the logics of international law and EU law respectively. A second purpose is to tease out *Achmea's* (still) very uncertain consequences. Last, the ambition is to provide a broader analysis of such judgment. As anticipated, strictly speaking *Achmea* is about investment arbitration and the compatibility of an *intra*-EU BIT with EU law. But it should also be viewed through a "law and integration" lens.

II. Not surprisingly, *Achmea* has received numerous and important critiques from both public and private international law specialists.<sup>3</sup> These critiques revolve around four main arguments: the limited motivation of the ruling, the absence of coherence in the reasoning, the excess of radicalism of the CJ and the exclusivist – not to say expansionist – and outdated conception of EU law advocated by the Court.

<sup>3</sup> See, for example, B. ARP, *Slowakische Republik (Slovak Republic) v. Achmea B.V.*, in *American Journal of International Law*, 2018, p. 466 *et seq.*; M. AUDIT, *ECJ, Note on Judgment of the Court (Grand Chamber), March 6th, 2018, Slowakische Republik v. Achmea B.V., Case C-284/16*, in *Revue Trimestrielle de Droit Financier*, 2018, p. 28 *et seq.*; M.R. CALAMITA, *Sulla incompatibilità della "clausola ISDS" degli "intra-EU" BITs con il diritto dell'Unione europea: il caso Achmea*, in *Diritto pubblico comparato ed europeo on line*, 2018, p. 467 *et seq.*, [www.dpceonline.it](http://www.dpceonline.it); J. CAZALA, *L'incompatibilité avec le droit de l'Union européenne du système d'arbitrage investisseur-Etat contenu dans un traité bilatéral d'investissement intra-UE. A propos de l'arrêt Slowakische Republik c. Achmea du 6 mars 2018 (C-284/16)*, in *Revue Trimestrielle de Droit Européen*, 2018, p. 597 *et seq.*; E. CIMIOTTA, *The First Ever Interpretative Preliminary Ruling Concerning the Validity of an International Agreement Between EU Member States: The Achmea Case*, in *European Papers*, 2018, Vol. 1, No 1, p. 337 *et seq.*; A. DELGADO CASTEIRO, *El fin de los TBI intra-UE: una breve reflexión sobre la sentencia Achmea*, in *Aquiescencia*, 8 March 2018, [www.aquiescencia.net](http://www.aquiescencia.net); X. FERNÁNDEZ PONS, *La incompatibilidad con el Derecho de la Unión Europea del arbitraje inversor-Estado previsto en tratados bilaterales de inversión entre Estados miembros. Comentario a la sentencia del TJUE sobre el asunto Achmea, su contexto y sus implicaciones*, in *Revista General de Derecho Europeo*, 2018, p. 1 *et seq.*; L. FUMAGALLI, *Meccanismi ISDS negli intra-EU BITs: la Corte di giustizia pone fine a un lungo dibattito. E ora?*, in *Rivista di Diritto Internazionale*, 2018, p. 896 *et seq.*; E. GAILLARD, *L'affaire Achmea ou les conflits de logique*, in *Revue Critique de Droit International Privé*, 2018, p. 628 *et seq.*; B. HESS, *The Fate of Investment Dispute Resolution after the Achmea Decision of the European Court of Justice*, in *Max Planck Institute Luxembourg for Procedural Research Working Papers Series*, no. 3, 2018, [www.mpi.lu](http://www.mpi.lu); J. HILLEBRAND POHL, *Intra-EU Investment Arbitration after the Achmea Case: Legal Autonomy Bounded by Mutual Trust?*, in *European Constitutional Law Review*, 2018, p. 678 *et seq.*; P. IANNUCELLI, *La Corte di giustizia e l'autonomia del sistema giurisdizionale dell'Unione europea: quousque tandem?*, in *Il Diritto dell'Unione europea*, 2018, p. 281 *et seq.*; I. IRURETAGOiena AGIRREZABALAGA, *Mecanismos de arreglo de diferencias entre inversores y estados (ISDS) y la autonomía del ordenamiento jurídico de la Unión Europea: ¿una ecuación (im)posible?*, in *Revista de Derecho Comunitario Europeo*, 2018, p. 219 *et seq.*; E. LANOTTE, *Arrêt «Achmea»: une décision de principe?*, in *Journal de Droit Européen*, 2018, p. 268 *et seq.*; F. MUNARI, C. CELLERINO, *EU Law is Alive and Healthy: The Achmea Case and a Happy Good-bye to Intra-EU Bilateral Investment Treaties*, in *SIDIBlog*, 17 April 2018, [www.sidiblog.org](http://www.sidiblog.org); Y. NOUVEL, *Note sous CJUE Achmea, 6 mars 2018, C-284/16*, in *Journal du Droit International*, 2018, p. 903 *et seq.*; S. WUSCHKA, *Investment Protection and the EU after Achmea*, in *Zeitschrift für Europarechtliche Studien*, 2018, p. 25 *et seq.*

As regards, first, the brevity of the reasoning, the CJ's ruling is unanimously criticised for being elliptical. This is highly problematic given that the validity of nearly 180 *intra*-EU BITs was at stake. The Court had indeed to decide whether an *ad hoc* arbitral tribunal, such as that referred to in Art. 8 NL-SK BIT, could be regarded as a "court or tribunal of a Member State" within the meaning of Art. 267 TFEU. In his Opinion,<sup>4</sup> the AG had provided many arguments to maintain that such a tribunal was indeed a "court or tribunal" under Art. 267 TFEU. The tribunal meets the conditions required by the CJ's case-law (it is based upon law, is permanent, has compulsory jurisdiction and sufficient guarantees of independence and impartiality). In comparison, the CJ is more than concise. It only stressed that the arbitral tribunal is not part of the judicial system of the Netherlands nor of Slovakia because "it is precisely the exceptional nature of the tribunal's jurisdiction compared with that of the courts of those two Member States that is one of the principal reasons for the existence of Article 8 of the BIT".<sup>5</sup> Needless to say, this (non)argument cannot convince the commentators. In the same vein, whereas the AG, the German Government and the referring German judge had insisted on affirming that Art. 344 TFEU does not apply to disputes between individuals and between individuals and Member States, the CJ accepted, but only implicitly, the applicability of Art. 344 TFEU in the circumstances of the case. Last but not least, the Court remained silent on a very central point: the possibility that the arbitration clause contained in Art. 8 NL-SK BIT would create a discrimination among investors on grounds of their nationality. The German judge had underlined that unlike Dutch and Slovakian investors, those from other Member States are unable to bring proceedings before an arbitral tribunal instead of a domestic court. This represents a considerable disadvantage and may constitute discrimination prohibited by Art. 18 TFEU. Amazingly the Court omitted to answer on this central question.

The lack of coherence is another alleged flaw of the judgment. There is, firstly, a defective logic in the Court's reasoning. The solution given by the CJ is indeed mainly based on the argument that an arbitral tribunal, such as that envisaged by Art. 8 NL-SK BIT, is not entitled to make a reference for a preliminary ruling pursuant to Art. 267 TFEU. Hence the adverse effect on the autonomy of the EU legal order: it cannot be guaranteed that an arbitral award is subject to review by a court of a Member State nor, as a result, that the questions of EU law that the arbitral tribunal may have to address are submitted to the CJ by means of a reference for a preliminary ruling pursuant to Art. 267 TFEU. One can only note the paradox of enouncing this impossibility in a case... which was precisely born from a preliminary reference made by the German judge before the CJ. A number of commentators have stressed another incoherence in the Court's reasoning: while it refers to the specific ("exceptional") nature of investment arbitration tribunals at the beginning of its judgment, this specificity (in particular the

<sup>4</sup> Opinion of AG Wathelet, *Achmea* [GC], cit.

<sup>5</sup> *Ibidem*, para. 45.

rules applied and interpreted by arbitral tribunals) is passed over in silence when the CJ comes to evaluate whether the arbitral tribunal under Art. 8 NL-SK BIT has the possibility of applying and interpreting EU law.

Radicalism, for many international law specialists, is a third shortcoming of the ruling. Indeed, the CJ omitted to consider the possible alternatives to the declaration of invalidity of the arbitration clause at stake. The Court could have distinguished, for instance, between arbitral tribunals resorting to the jurisdiction of third States and those resorting to the jurisdiction of Member States. It also had the opportunity to make the validity of the clause conditional upon the possibility, for a national judge, of reviewing the compatibility of the arbitral award with EU law.<sup>6</sup> Another viable option, for the Court, was to limit the scope of its decision to the (rare) cases in which arbitral tribunals are actually asked to apply or interpret EU legal provisions. However, the CJ preferred to maintain a less nuanced position.

The fourth – and probably more fundamental – critique is related to the so-called exclusivist, expansionist and outdated conception of the autonomy of the EU legal order. Critiques are sharp: the Court is under attack for having forgotten that, under international law, there is no hierarchy between international treaties.<sup>7</sup> The main critiques target the part of the judgment which deals with the applicability of Art. 344 TFEU. The CJ ruled that, pursuant to the NL-SK BIT, the arbitral tribunal is called to rule only on potential infringements of the NL-SK BIT but to this end it must, in accordance with Art. 8, para. 6, NL-SK BIT, take into account the law in force in the concerned Contracting Party and any relevant agreements between the Contracting Parties. Unsurprisingly, the CJ held that EU law must be regarded both as forming part of the law in force in every Member State and as deriving from an international agreement between Member States: “it follows that on that twofold basis the arbitral tribunal referred to in Art. 8 of the BIT may be called on to interpret or indeed to apply EU law, particularly the provisions concerning the fundamental freedoms, including freedom of establishment and free movement of capital”.<sup>8</sup> It is this last sentence that has generated the bulk of criticism. E. Gaillard, with many others, stressed that in most cases arbitral tribunals do not apply nor interpret EU law.<sup>9</sup> Likewise, Mr Wathelet, several Member States and the German referring judge argued that the fact that EU law is part of the law applicable to disputes between investors and States in accordance with Art. 8, para. 6, NL-SK BIT does not mean that those disputes concern the interpretation or the application of the EU

<sup>6</sup> E. GAILLARD, *L'affaire Achmea*, cit., p. 628.

<sup>7</sup> M. AUDIT, *ECJ, Note on Judgment of the Court (Grand Chamber), March 6th, 2018*, cit., p. 26. See also, for an analysis of the judgment as regards the rules of Treaty conflicts, V. BARAUSOVA, *Slovak Republic v. Achmea from a Public International Law Perspective: Is State Consent to Arbitrate Under Intra-EU BITS Still Valid?*, in *European Investment Law and Arbitration Review Online*, 29 November 2018, www.brill.com.

<sup>8</sup> *Achmea* [GC], cit., para. 42.

<sup>9</sup> E. GAILLARD, *L'affaire Achmea*, cit., p. 632.

founding Treaties. And this is so for two main reasons. First, the arbitral tribunal has jurisdiction only to rule on alleged breaches of the NL-SK BIT. Second, the scope of the NL-SK BIT and the legal rules that it introduces, are not the same as those of the TEU and the TFEU.<sup>10</sup> In the same vein, M. Audit insists on the fact that the scope of the NL-SK BIT is wider than that of the EU founding Treaties as it covers State acts or omissions likely to impact a foreign investor and its investment; for him, these rules do not apply in cases where European Treaties are enforced.<sup>11</sup> As a result, the Court is believed to be “expansionist”. Many commentators agree that, apart from State aid law (it could happen, for instance, that a defendant Member State argues that a national State aid had to be modified in application of EU law), the application and interpretation of EU law by an arbitral tribunal such as that provided by the NL-SK BIT is mostly hypothetical. Hence the critique addressed to the Court: a simple eventuality cannot be sufficient to trigger a reaction founded on the logic of exclusivism. Lastly, Y. Nouvel<sup>12</sup> questions what he thinks is the blind and outdated logic of the CJ: isn’t it pure utopia, he asks, to assume that EU law can be insulated from external bodies? In daily life, the EU participates in the activities of international organisations and in the adoption of international agreements. Consequently, it frequently happens that non-EU entities provide their own interpretation of EU law. The attitude of the Court in *Achmea*, according to Nouvel, can best be described as a utopian project of normative autarchy. In sum, from the perspective of both public and private international law, the *Achmea* judgment is flawed and gives evidence of the problematic closure of EU law.

III. It is likewise remarkable that, shortly after the CJ delivered its judgment, nearly all stakeholders – including Member States,<sup>13</sup> EU institutions, arbitral tribunals, international law scholars, EU law scholars – have striven to draw from *Achmea* the fullest and most far-reaching set of consequences in all sorts of fields – whether normative, judicial and even political – perhaps going somehow beyond the purposes of the CJ itself.

First, as regards a normative level, questions have been raised whether the applicability and validity not only of the NL-SK BIT, but also of other *intra*-EU BITs and even *extra*-EU BITs concluded between Member States and third countries, as well as of trade and investment agreements concluded between the EU itself and third-countries (such as the Energy Charter Treaty of 17 December 1994 (ECT) and the Canada-EU Comprehensive Economic and Trade Agreement of 30 October 2016 (CETA)), may be somehow

<sup>10</sup> *Ibidem*, p. 173.

<sup>11</sup> M. AUDIT, *ECJ, Note on Judgment of the Court (Grand Chamber), March 6th, 2018*, cit., p. 32.

<sup>12</sup> Y. NOUVEL, *Note sous CJUE Achmea*, cit., p. 917.

<sup>13</sup> Declaration of the Member State of 15 January 2019 on the legal consequences of the *Achmea* judgment and on investment protection, [www.ec.europa.eu](http://www.ec.europa.eu).

directly affected by *Achmea*, if and to the extent they contain ISDS clauses whose content and effects are similar to those of Art. 8 NL-SK BIT.

Second, the same question has been raised – at a judicial level – with respect to both ongoing and forthcoming proceedings before international and arbitral investment tribunals and to the prospect of domestic judges, whenever called upon to rule on the lawfulness of rulings *medio-tempore* eventually issued by such investment tribunals, refraining from executing or enforcing them or from declaring them void.

Third – at a political level – the necessity has been held, especially by the European Commission, on the one hand of releasing *intra*-EU BITs, *extra*-EU BITs and instruments of trade and investment cooperation between the EU and third-countries from ISDS mechanisms, and, on the other hand, of conceiving institutional and normative novelties, such as, just to name a very well-known example, the proposed establishment of a Multilateral Investment Court (MIC). The purpose of this Court is to have a permanent international body that can settle investment disputes between investors and States. The MIC would replace the current system of ISDS based on *ad hoc* arbitration. According to its proponents, the MIC is meant to enhance predictability and consistency, ensure correctness, eliminate the ethical concerns in the current system and effectively address the problem of excessive costs and duration, by bringing key features of domestic and international courts to investment arbitration. On 13 September 2017, the Commission recommended the opening of the negotiations on the establishment of the MIC<sup>14</sup> and on 20 March 2018 – just two weeks after the *Achmea* judgment was given – the Council adopted the negotiating directives authorizing the Commission to negotiate, on behalf of the EU, an agreement on said project.<sup>15</sup> On the basis of the mandate granted by the Council, the Commission started talks with its partners at the United Nations Commission on International Trade Law (UNCITRAL). The proposed MIC is meant to adjudicate disputes under both future and existing investment treaties and to replace the bilateral investment court systems included in EU trade and investment agreements. While talks are currently ongoing and of course it is still uncertain whether they will lead to the desired reforms, or to any changes at all, so far the EU has made clear that it would favour a permanent international institution with an appeal mechanism; allowed to rule on disputes arising under future and existing investment treaties that States chose to submit to its jurisdiction; composed of full-time, tenured, qualified and independent adjudicators; enabled to conduct proceedings in a transparent manner and to issue decisions expected to be effectively enforced.

As one can easily see, *Achmea* has caused a considerable stir in the EU.

<sup>14</sup> Commission Recommendation for a Council Decision COM(2017) 493 final of 13 September 2017 authorising the opening of negotiations for a Convention establishing a multilateral court for the settlement of investment disputes.

<sup>15</sup> Council Document 12981/17 ADD 1 DCL 1 of 20 March 2018 on negotiating directives for a Convention establishing a multilateral court for the settlement of investment disputes.

IV. Because of all these potential effects on investment law and arbitration, there are good reasons to believe that *Achmea* will remain in law textbooks as a landmark case on the relationship between EU law and international investment law. But there is another possible reading: one that views the judgment as a lecture of EU constitutional law. The center of gravity of the judgment could well be in its first part, in which the CJ restated the crucial importance of the autonomy of the EU legal order and of the principles governing EU legal life (supremacy, mutual trust and sincere cooperation). The Court was also very attentive to the preservation of the “essential characteristics of the EU and its law”, to “the constitutional structure of the EU” and to the “very nature of that law”.<sup>16</sup> Thus *Achmea* seems to be much more than a mere judicial ruling, since it could launch somehow a new stage of the European integration process, inaugurating what perhaps may be called a “constitutional moment”. *Achmea* is not just a judgment on foreign direct investment or on related dispute settlement modalities among two or more Member States. As seen above, it prompted important normative amendments not only within the EU legal context but also in international investment arbitration at large. Likewise, *Achmea* depicts the muscular attitude of the CJ in the international adjudication’s landscape and calls into question the relationship between EU law and international investment law as regards investor-State dispute settlement. This is proved by the strong opposite views maintained by international investment law and EU law specialists about the legitimacy and correctness of the Court’s reasoning and conclusions.

The progression of the Court’s reasoning must be followed to uncover the “constitutional” objective pursued in *Achmea*. The CJ first holds that EU law is “based on the fundamental premise that each Member State shares with all the other Member States, and recognizes that they share with it, a set of common values on which the EU is founded, as stated in Article 2 TEU”.<sup>17</sup> Then the Court deals with the means at its disposal to protect the foundations of the EU legal order: “in order to ensure that the specific characteristics and the autonomy of the EU legal order are preserved, the Treaties have established a judicial system intended to ensure consistency and uniformity in the interpretation of EU law”.<sup>18</sup> To put it differently, the integrity of EU law – and its foundations – are protected by a collective endeavor: altogether, domestic judges and the CJ participate in the full application of EU law and the effective judicial protection of the rights it confers upon individuals. The Court’s focus, at this stage of the reasoning, is on what it names the European “judicial system”. The systemic aspect of the judicial organization is decisive: the CJ describes the European judicial organization as a network of judges, aimed at “setting up a dialogue between one court and another, specifically between the Court of Justice and the courts and tribunals of the Member States”, with the

<sup>16</sup> *Achmea* [GC], cit., para. 33.

<sup>17</sup> *Ibidem*, para. 34.

<sup>18</sup> *Ibidem*, para. 35.

object of “securing uniform interpretation of EU law, thereby serving to ensure its consistency, its full effect and its autonomy”.<sup>19</sup> The objective pursued by the Court in *Achmea* is clearly to insulate the European “judicial system” from disintegrative effects. This is why the CJ is obsessed by the preliminary ruling procedure, as it is best suited to ensure a judicial dialogue that can secure interpretation of EU law consistent with the Member States’ common values.

Under this perspective, *Achmea* may be considered part of a broader judicial development. Its full appraisal suggests indeed that one read it in conjunction with *Associação Sindical dos Juizes Portugueses*<sup>20</sup> and *Minister for Equality for Justice and Equality*.<sup>21</sup> In these cases, which have arisen from the context of the rule of law crisis, the Court puts the emphasis on the independence of domestic judges. Judicial independence is indeed the pre-condition for a European judicial dialogue. *Achmea* may also be related to *Commission v. France*,<sup>22</sup> in which, for the first time, the CJ found that a court against whose decisions there is no judicial remedy should have requested a preliminary ruling pursuant to Art. 267 TFEU in order to avert the risk of an incorrect interpretation of EU law. Since the French *Conseil d’État* failed to make such a reference, although the correct application of EU law in its judgments was not so obvious as to leave no scope for doubt, an infringement of Art. 267 TFEU occurred. *Commission vs France* met with fierce criticism in France but it gives evidence of the Court’s willingness to protect, as much as possible, the judicial dialogue among domestic judges and the Court. This dialogue implies that all courts in the system respect their respective roles. Little by little – and *Achmea* is a crucial step forward – the CJ is designing the main features of what can be termed the “European model of justice”.

This is why the facts and circumstances of the *Achmea* case were so challenging. The Court had to determine to what extent – if at all – Member States could rely on a parallel dispute settlement mechanism without putting at risk the proper functioning of the European judicial system. In particular, the CJ had to deal with two problematic aspects of investment arbitration resulting from the conditions laid down in the NL-SK BIT.

It first raised concerns about the limited capacity of domestic judges to review the compatibility of arbitral awards with provisions of EU law, since the possibility to seek such review was fully dependent on the law of the seat of arbitration. In the *Achmea* case, it was the choice to have the seat in Germany that alone enabled Slovakia to seek judicial review of the arbitral award, by instituting proceedings before a German judge.

<sup>19</sup> *Ibidem*, paras 35 and 37.

<sup>20</sup> Court of Justice, judgment of 27 February 2018, case C-64/16, *Associação Sindical dos Juizes Portugueses* [GC].

<sup>21</sup> Court of Justice, judgment of 4 December 2018, case C-378/17, *Minister for Equality for Justice and Equality* [GC].

<sup>22</sup> Court of Justice, judgment of 4 October 2018, case C-416/17, *Commission v. France*.

But what would have happened if the parties had chosen another Member State, or a third State, as a seat of arbitration?

A second flaw concerned the scope of the judicial review, since it could be exercised only to the extent that German law permitted. Such review was limited to the validity of the arbitration agreement under applicable law in Germany and the consistency with public policy of the recognition or enforcement of the arbitral award. Unsurprisingly the Court found this to be problematic, as it did not correspond to the requirement that an arbitral award is, “in accordance with Article 19 TEU, subject to review by a court of a Member State, ensuring that the questions of EU law which the tribunal may have to address can be submitted to the Court”.<sup>23</sup> The CJ thus requires full capacity of the host State’s domestic judges to review the legality of arbitral awards, at least as regards the application and interpretation of EU law. This high standard of justice was justified by the fact that EU values and citizen’s rights are at stake together with mutual trust: “Article 8 of the BIT is such as to call into question not only the principle of mutual trust between the Member States but also the preservation of the particular nature of the law established by the Treaties, ensured by the preliminary ruling procedure provided for in Article 267 TFEU”.<sup>24</sup>

The BIT provision enabling an investor to bring proceedings before an arbitral tribunal raised another, very serious, difficulty. E. Gaillard<sup>25</sup> rightfully speaks about a “clash of logic” between investment law justice and EU law justice. Under investment law, the objective is to protect investors from what is perceived to be a “biased” justice: national judges are not assumed to be impartial. In order to guarantee a neutral judicial mechanism, arbitration is made fully independent from any national judicial system. This is what the CJ describes as being “precisely the exceptional nature” of the arbitral tribunal’s jurisdiction compared with that of Slovakian and Dutch courts. It is precisely due to this peculiarity that the arbitral tribunal established pursuant to the NL-SK BIT could not be qualified as a “court or tribunal of a Member State” within the meaning of Art. 267 TFEU. Therefore, despite the value of his arguments, the AG Mr Wathelet missed the point. While he strived to convince the Court that the arbitral tribunal was a “tribunal”, he omitted that the essential issue was, instead, to determine whether the arbitral tribunal set up by the NL-SK BIT met the conditions to be qualified as a “national” adjudication. The focus in *Achmea* was not on the judicial but on the national nature of the arbitral tribunal.

The CJ was coherent with its previous case law. In *Ascendi Beiras Litoral*,<sup>26</sup> the Court derived the status of “court or tribunal of a Member State” of the Tribunal Arbitral Tributário from the fact that it was part of the system of judicial resolution of tax dis-

<sup>23</sup> *Achmea* [GC], cit., para. 50.

<sup>24</sup> *Ibidem*, para. 58.

<sup>25</sup> E. GAILLARD, *L’affaire Achmea*, cit., p. 628.

<sup>26</sup> Court of Justice, judgment of 2 June 2014, case C-377/13, *Ascendi Beiras Litoral e Alta, Auto Estradas das Beiras Litoral e Alta*.

putes provided for by the Portuguese Constitution. In *Parfums Christian Dior*,<sup>27</sup> the Court even accepted that a court common to a number of Member States, such as the Benelux Court of Justice, would refer questions for a preliminary ruling pursuant to Art. 267 TFEU in the same way as domestic judges of any one of the concerned Member States. In short, according to the CJ, the capacity to belong to the European judicial system does not depend on a specific structure or institutional setting but on the integration into the national judicial system of at least one Member State.

In sum, *Achmea* is not simply a case about international investment law and EU law. It is about models of justice. Several investment law specialists have read *Achmea* as providing a negative value judgment on arbitration. Their analysis seems to be indirectly supported by the European Commission's 2018 communication on the protection of *intra*-EU investment. It underlines that, unlike the mechanisms envisaged by *intra*-BITs, the EU offers a "complete and exhaustive system" of judicial remedies, which affords full protection of fundamental rights and "is not only aimed at compensating investors after the violation has taken place", but also "at the prevention or resolution of violations of their rights".<sup>28</sup> But the CJ is more nuanced. Its focus is not on the merits or drawbacks of arbitral justice as such. It is on the capacity of arbitral justice mechanisms, as organized by an *intra*-EU BIT, to be adapted to the requirements of EU justice, which is organized as a "system".

Furthermore, the intense defence of the autonomy of the EU legal order in *Achmea* allowed the CJ to support another policy pursued by the Commission, which shortly after the entry into force of the Lisbon Treaty, and the inclusion of direct foreign investments in the common commercial policy under Art. 207 TFEU, urged the Member States to terminate all *intra*-EU BITs still in force, but without any success.<sup>29</sup> The Commission considered *intra*-EU BITs, due to their nature of bilateral differentiated regimes on investments, as an anomaly *vis-à-vis* the uniform integration of markets in Member States, as well as the uniform interpretation and effective application of EU rules on free movement of capitals and on the right of establishment.

In view of all this, *Achmea* cannot be understood in isolation from the context of the rule of law crisis and the disintegrative forces currently threatening the EU. The CJ endeavors to protect the Union and EU law from surreptitious forms of disintegration, coming from direct attacks on justice or from competing models of justice that do not meet the high standards of EU justice, as shaped by the Court itself. Whatever its flaws, *Achmea* is an important case as it provides insights on the kind of justice that is and ought to be promoted in the EU.

<sup>27</sup> Court of Justice, judgment of 4 November 1997, case C-337/95, *Parfums Christian Dior*.

<sup>28</sup> Communication COM(2018) 547 final of 19 July 2018 from the Commission concerning the protection of *intra*-EU Investment.

<sup>29</sup> Commission press release IP/15/5198 of 18 June 2015, europa.eu.

However, in doing this, the risk is that the CJ makes the EU a closed legal system, grounded on the autistic defense of its values, its fundamental freedoms and its mechanisms of judicial protection. The EU could thus be shaped as an overconfident organization, having a growing mistrust of other and different legal regimes of investment protection. Such clinging policy might prove difficult to reconcile with the EU's need for international trade relations, unless and until it proves able to enforce its economic and political power *vis-à-vis* its commercial partners, as today most international trade and investment agreements are far-reaching and provide for ISDS-like mechanisms. Due to *Achmea* and the ensuing complexities of the EU legal system, the EU could run the risk of being perceived as a too demanding partner. It seems that in the much-awaited opinion 1/17 on the compatibility with EU law of the investor-State dispute settlement mechanism provided for by CETA,<sup>30</sup> which unfortunately could not be taken into account by the participants to this Special Section the Court has wisely avoided these pitfalls...

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<sup>30</sup> Court of Justice, opinion 1/17 of 30 April 2019.

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## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta and Juan Santos Vara

# I WOULD RATHER BE A RESPONDENT STATE BEFORE A DOMESTIC COURT IN THE EU THAN BEFORE AN INTERNATIONAL INVESTMENT TRIBUNAL

IVANA DAMJANOVIC\* AND NICOLAS DE SADELEER\*\*

TABLE OF CONTENTS: I. Introduction. – II. Who trumps who? – II.1. Is EU law autonomous? – II.2. EU law and Member States' BITs. – II.3. The peculiar case of the ECT. – III. *Achmea* or how international investment tribunals do not understand EU law. – III.1. Why investment tribunals do not have jurisdiction in all intra-EU disputes? – III.2. The Advocate General's Opinion is not legally binding and preliminary ruling judgment only answers the questions asked. – III.3. Why is commercial arbitration different? – IV. Who fragments what? – IV.1. The peculiar case of the ECT again: fragmentation or integration? – IV.2. Why is intra-EU context different to extra-EU? – V. Why autonomy matters? – V.1. It matters for EU relationship with international courts. – V.2. It matters for EU integration. – V.3. It matters for practical reasons of enforcement. – VI. Conclusion.

ABSTRACT: In its landmark judgment in the case of *Achmea* (judgment of 6 March 2018, case C-284/16 [GC]), the Court of Justice adjudicated that Investor-State Dispute Settlement (ISDS) adversely affects the autonomy of EU law. Accordingly, ISDS clauses in international investment agreements that contravene Arts 267 and 344 TFEU and the principles of mutual trust and sincere cooperation enshrined in Arts. 19, para. 1, and 4, para. 3, TEU are inapplicable under EU law. However, the reasoning of the Court of Justice in *Achmea* did not convince international investment tribunals that they lack jurisdiction in intra-EU investment disputes. This opposition calls for clarification of the different principles underpinning the EU legal order and international investment law. This *Article* presents a debate between these two legal orders, which unfolds around three separate, albeit related issues: the status and applicability of the EU and the Member States' interna-

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tional agreements within the EU legal order; the manner in which the *Achmea* judgment must be interpreted and its application in the international investment law context; and the meaning and relevance of the concept of the autonomy of EU law as the key issue in defining the relationship between EU law and international investment law.

KEYWORDS: autonomy of the EU legal order – international investment law – Arts 267 and 344 TFEU – mutual trust – compatibility of ISDS with EU law – rule of law.

## I. INTRODUCTION

This *Article* is a debate between the EU legal order and international investment law. It is a debate between two legal systems, which share similar foundations but have nonetheless, different objectives and methods of reasoning. These differences have led to mutual tensions, with their full consequences yet to be revealed. In its essence, this debate is a discussion about the validity of the Investor-State Dispute Settlement (ISDS) clauses encapsulated in intra-EU bilateral investment treaties (BITs) and the Energy Charter Treaty (ECT) under EU law. These international investment agreements were concluded between mostly Western EU Member States and the Central and Eastern European States during the 1990s in order to protect Western States' investors in the newly open markets of the former Comecon. At that time they were extra-EU international investment agreements, concluded between EU Member States and third States. From 2004, with the progressive accession of the Central and Eastern European States to the EU, they have become intra-EU BITs. There are still 181 of these agreements in force.<sup>1</sup>

The debate between these two legal orders commenced soon after the main enlargement, around the year 2006, when the European Commission noted "arbitration risks and discriminatory treatment of investors" stemming from intra-EU BITs, whose content has partly been "superseded by Community law upon accession". The Commission thus invited the Member States to review the need for these agreements "in order to avoid legal uncertainties".<sup>2</sup> The debate has intensified since, reaching its climax in March 2018 with the *Achmea* judgment delivered by the Grand Chamber of the CJEU, in which the Court ruled that the ISDS clause in the Netherlands-Slovakia BIT is incompatible with EU law.<sup>3</sup> The consequences of the *Achmea* decision remain controversial and the subject of ever opposing views about its relevance for investment treaty arbitration in the EU.

<sup>1</sup> United Nations Conference on Trade and Development (UNCTAD), *Investment Policy Hub*, investmentpolicyhub.unctad.org. Only two BITs were concluded between "old" Member States: 1961 Germany – Greece BIT and 1980 Germany – Portugal BIT.

<sup>2</sup> Economic and Financial Committee (EFC), 2007 Annual EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments of 23 November 2007, ECFIN/CEFCPE(2007)REP/55240, para. 14.

<sup>3</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Achmea* [GC].

In broader terms, this is a debate about the autonomy of EU legal order and its relationship with international law in general, and investment law in particular. As presented in this *Article*, the debate will oppose two visions on who should have the authority to adjudicate investment disputes between investors from a EU Member State and another EU Member State. The notion of autonomy is the central issue and at the same time the key misunderstanding of this debate. While EU law claims its autonomy, which cannot be adversely affected by international law, international investment law shows little interest in supporting such vision. Indeed, according to investment lawyers, EU law is embedded in a domestic or a regional context. Accordingly, this legal order is, in any case, subordinated to international law.

In more general terms, lawyers have a propensity to claim the autonomy of their legal orders. As autonomy goes hand in hand with national sovereignty, it comes as no surprise that every sovereign State asserts the autonomy of its law. At this stage, however, the EU has no sovereignty. It is neither a federation nor a confederation, let alone an independent State. Yet, it claims the autonomy of its legal order with respect to both the legal order of its 28 Member States and international law, justifying it by the constitutional structure of the EU and the very nature of EU law, which stems from international law. The autonomy has been defined either as “a normative axiom”<sup>4</sup> or as a “central constitutional principle”.<sup>5</sup> Moreover, EU law claims its primacy over domestic laws of its Member States. Such vision however, has not been immediately or unconditionally accepted by legal constituencies of all Member States. Only recently, in Germany and France, the *Bundesverfassungsgericht* (Federal Constitutional Court) and the *Conseil Constitutionnel* respectively, have been referring questions for preliminary rulings to the CJEU.<sup>6</sup> This trend is further exacerbated in dualist legal regimes, shared by several Member States, such as the UK, Italy, and Ireland. More cynical observers would note that this reluctance in accepting the prevalence of EU law over domestic laws of Member States has even resulted in the extreme scenario of Brexit. While most of the Member States have not been that extreme, in reality the authority of EU law over constitutional laws of Member States is tolerated rather than embraced by national constitutional courts.

For pedagogical reasons, this debate espouses a fictional dimension.<sup>7</sup> Two parties argue their case: on the one hand, an imaginary Professor of EU law, Mr Van Gend en Loos, convinced by the soundness of the CJEU case-law regarding the autonomy of the

<sup>4</sup> A. VON BOGDANDY, J. BAST, *Principles of European Constitutional Law*, Oxford: Hart Publishing, 2010, p. 39.

<sup>5</sup> E. PAASIVIRTA, *European Union and Dispute Settlement: Managing Proliferation and Fragmentation*, in M. CREMONA, A. THIES, R.A. WESSEL (eds), *The European Union and International Dispute Settlement*, Oxford: Hart Publishing, 2017, p. 32.

<sup>6</sup> M. BLANQUET, *Le dialogue entre les juges constitutionnels et la Cour de justice: enfin des mots, toujours des maux?*, in B. BERTRAND, F. PICOD, S. ROLAND (dir.), *L'identité du droit de l'Union européenne. Mélanges en l'honneur de Claude Blumann*, Brussels: Bruylant, 2015, p. 288 et seq.

<sup>7</sup> Any resemblance to real characters is unintentional and accidental.

EU legal order; on the other, an investment arbitrator, Ms Icsid, considering that EU law cannot ever trump international investment law. How will this debate proceed? Our protagonists will tackle three issues. Firstly, they will introduce the concept of EU autonomy and, through its lenses, discuss the relationship between EU law and international law. In this respect, the status and applicability of international agreements concluded by the EU and the Member States within the EU legal order is examined (section II). Secondly, the debate will continue by focusing on the *Achmea* judgment, which is at the core of controversy between international investment lawyers and EU lawyers. In this regard, in section III the two protagonists disagree on the effects of the *Achmea* judgment on jurisdictional issues in intra-EU disputes. Their debate then moves towards the interpretation of the *Achmea* judgment by various investment tribunals and its impact on international law, with particular focus on the ECT (section IV). As a third and final issue, the debate returns to the autonomy of the EU legal order, at this point explaining its relevance, by focusing on EU relationship with other international courts; European integration more generally; and the enforcement of intra-EU investment awards in more practical terms (section V). For each issue, Professor Van Gend en Loos will attempt to convince Ms Icsid why she should give up her jurisdiction in intra-EU investment disputes whilst she will, as a matter of course, defend her jurisdiction by questioning the relevance of EU law in investment arbitration. The aim of this fictional debate is not to let one protagonist win over the other, but to identify the bones of contention between their two visions.

## II. WHO TRUMPS WHO?

### II.1. IS EU LAW AUTONOMOUS?

*Ms Icsid*: The relationship between EU law and international investment law is complex and there is room for disagreements, as the debate on this issue has demonstrated so far. However, both the CJEU and investment tribunals agree that EU law is part of international law. For example, the *Electrabel*/tribunal noted that “EU law is international law because it is rooted in international treaties”,<sup>8</sup> and this has been undisputed by all subsequent investment tribunals.<sup>9</sup> Even the post-*Achmea* tribunals, such as the tribunal in *Vattenfall II*, found that EU law, to the extent of the founding Treaties, should not be ex-

<sup>8</sup> ICSID, decision on jurisdiction, applicable law and liability of 30 November 2012, case no. ARB/07/19, *Electrabel S.A. v. Republic of Hungary*, para. 4.120.

<sup>9</sup> See for example, ICSID, decision on jurisdiction of 6 June 2016, case no. ARB/13/30, *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain (RREEF v. Spain)*, para. 73. To this effect, see the comment of the tribunal in ICSID, decision on the *Achmea* issue of 31 August 2018, case no. ARB/12/12, *Vattenfall AB and others v. Federal Republic of Germany (Vattenfall II)*, para. 146.

cluded from “the purview of international law” under Art. 38, para. 1, let. a), of the Statute of the International Court of Justice.<sup>10</sup> In the same manner, the Court of Justice recalls that EU law is “characterised by the fact that it stems from an independent source of law, the Treaties”.<sup>11</sup>

Therefore, if we accept that EU law is part of international law, its Court should not claim that it is an autonomous legal order, which prevails over international law. In effect, the international legal order is a horizontal one. Various international agreements are placed upon equal footing, whereby any conflicts between them must be resolved by the application of general international law treaty conflict rules, which are codified in the Vienna Convention on the Law of Treaties (VCLT). In case of inconsistency between an international investment treaty and EU law, absent the possibility that such inconsistency can be reconciled through interpretation, “unqualified obligation” of any arbitral tribunal constituted under an international investment treaty would be to apply public international law. This applies to all cases, even when it is to the detriment of EU law since “EU law does not and cannot ‘trump’ public international law”.<sup>12</sup> In buttressing the autonomy of the EU legal order, as the CJEU did in *Achmea*, EU law indeed trumps international law.

*Professor Van Gend en Loos*: The claim that EU law trumps international law is nugatory. At the outset, the EU legal system is an “open system”<sup>13</sup> subordinated to international law, be it *jus cogens* or *jus erga omnes* or *jus dispositivum*.<sup>14</sup> Under Art. 3, para. 5, TEU, the EU is to contribute to the strict observance and the development of international law. In accordance with Art. 21, para. 1, TEU, “the Union’s action on the international scene” must be “guided” by “respect for the principles of the United Nations (UN) Charter and international law”. Consequently, when it adopts an act, the EU is bound to observe international law in its entirety, including customary international law, which is binding upon the institutions of the EU.<sup>15</sup>

In addition, any international agreement to which the EU accedes is, by virtue of Art. 216, para. 2, TFEU, binding on the institutions of the EU and its Member States.<sup>16</sup> There-

<sup>10</sup> *Vattenfall II*, cit., paras 145-150.

<sup>11</sup> *Achmea* [GC], cit., para. 33. Regarding the international foundation of the EU legal order, see A. PELLET, *Les fondements juridiques du droit communautaire*, in *Collected Courses of the Academy of European Law*, Leiden: Martinus Nijhoff, 1997, p. 219.

<sup>12</sup> *RREEF v. Spain*, cit., para. 87.

<sup>13</sup> P.J.G. KAPTEYN, P. VERLOREN VAN THEMAAT, *Introduction to the Law of the European Communities*, London: Kluwer Law International, 1998, p. 278.

<sup>14</sup> S. ADAM, S. HAMMAMOUN, E. LANNON, J.V. LOUIS, N. NEUWAHL, E. WHITE, *L’Union européenne comme acteur international*, Brussels: Éditions de l’Université de Bruxelles, 2015, p. 82.

<sup>15</sup> See, to this effect, Court of Justice: judgment of 24 November 1992, case C-286/90, *Poulsen and Diva Navigation*, paras 9 and 10; and judgment of 16 June 1998, case C-162/96, *Racke*, paras 45 and 46.

<sup>16</sup> In accordance with Art. 216, para. 2, TFEU, the treaties concluded have primacy over acts of secondary EU law. See, to that effect: Court of Justice, judgment of 3 June 2008, case C-308/06, *Intertanko and Others*, para. 42 and case-law cited. Moreover, measures emanating from bodies which have been established

fore, when exercising its powers, the EU must observe international law. The CJEU is competent to disapply incompatible provisions of an international agreement concluded by the EU in case of their substantive inconsistency with EU law and international rules which are binding on the EU.<sup>17</sup> Last but not least, the CJEU is under an obligation to “take due account” of the wording and purpose of international law, such as UN Security Council (Security Council) resolutions.<sup>18</sup>

*Mc Icsid*: To my understanding, the EU legal order is only conditionally open towards international law. The CJEU as the supreme guardian of the EU legal order considers EU law as specific international law to which other international law instruments should conform, when necessary to achieve the objectives of the EU founding Treaties. In other words, international law is not deemed to be an autonomous source in the EU legal system. Such approach to international law is always justified by the international character of EU law itself as an autonomous legal order based on the founding Treaties, which cannot be trumped by an international agreement.<sup>19</sup> In that connection, the CJEU has long ago emphasised the contrast between the EU founding Treaties and “ordinary international treaties”.<sup>20</sup> The opinion of AG Poiares Maduro in *Kadi* mirrors that interpretation: “In *Van Gend en Loos*, the CJEU considered that the Treaty had established a ‘new legal order’, beholden to, but distinct from the existing legal order of public international law”.<sup>21</sup> I do not see why the EU founding Treaties would be any different from other international treaties, and how could that be an argument to justify EU law’s prevalence over international law.

*Professor Van Gend en Loos*: One has to differentiate between two issues. On the one hand, as a matter of principle, the EU legal order must be consistent with the general principles of international law.<sup>22</sup> On the other hand, the agreements concluded by the EU have become part of the normative hierarchy of that legal order. In effect, in accordance with the Court’s settled case-law, international agreements concluded by the EU

by an international agreement concluded by the EU and a third State form part of the EU legal order. See Court of Justice: judgment of 20 September 1990, case C-192/89, *Sevinçe*, para. 10; judgment of 16 December 1992, case C-237/91, *Kus*; judgment of 28 February 2008, case C-293/06, *Deutsche Shell*, para. 17.

<sup>17</sup> Court of Justice, judgment of 27 February 2018, case C-266/16, *Western Sahara Campaign UK*, paras 45-48. Taking into account that the territory of Western Sahara does not form part of the territory of Morocco under international law, the CJEU reached the conclusion that the EU-Morocco Agreement was not applicable to the waters adjacent to the territory of Western Sahara. See D. SIMON, *Applicabilité des accords entre l’Union européenne et le Royaume du Maroc ou territoires du Sahara occidental: Acte II*, in *Europe*, 2018, p. 6 *et seq.*

<sup>18</sup> Court of Justice, judgment of 16 November 2011, case C-548/09 P, *Bank Mellî*, para. 106.

<sup>19</sup> Court of Justice, judgment of 3 September 2008, joined cases C-402/05 P and C-415/05 P, *Kadi*, paras 281 and 316; *Achmea* [GC], cit., para. 33.

<sup>20</sup> Court of Justice, judgment of 15 July 1964, case 6/64, *Costa v. ENEL*.

<sup>21</sup> Opinion of AG Poiares Maduro delivered on 16 January 2008, case C-402/05 P, *Kadi*, para. 24.

<sup>22</sup> Arts 3, para. 5 and 21, para. 1, TEU.

pursuant to the provisions of the Treaties constitute, as far as the Union is concerned, acts of the institutions of the EU.<sup>23</sup> Accordingly, one has to understand that the international agreements concluded by the EU pursuant to the provisions of the Treaties are, from the date of their entry into force, an integral part of the EU legal order.<sup>24</sup> It follows that the EU legal order is a monist system.<sup>25</sup>

However, it would be wrong to conclude that, once the EU is bound by an international treaty, the CJEU “must bow to that rule with complete acquiescence and apply it unconditionally”.<sup>26</sup> Although the Court takes great care to respect the obligations that are incumbent on the EU by virtue of international law, it seeks, first and foremost, to preserve the constitutional framework created by the Treaty. In this connection, the integration of international agreement into the EU legal order may be subject to both an *ex-ante* (Art. 218, para. 11, TFEU) and an *ex-post* review (Arts 263 and 267 TFEU). Whenever international agreements are inconsistent with either founding Treaties provisions or general principles of EU law, they are deemed to be invalid.

With respect to the *ex-post* review, the CJEU has jurisdiction, in the context of both an action for annulment (Art. 263 TFEU) and in a request for a preliminary ruling (Art. 267 TFEU), to assess whether an international agreement concluded by the EU is compatible with the founding Treaties and the constitutional principles stemming from them. In so doing, the Court is empowered to nullify the decision of the Council concluding an international agreement whenever such agreement is incompatible with EU law.<sup>27</sup> Therefore, the CJEU does not have the power to declare an international agreement invalid, but can nullify the decision adopted under EU law concluding the agree-

<sup>23</sup> *Racke*, cit., para. 41; and Court of Justice, judgment of 25 February 2010, case C-386/08, *Brita*, para. 39.

<sup>24</sup> Court of Justice, judgment of 30 April 1974, case 181/73, *Haegeman*, para. 5; judgment of 22 November 2017, case C-224/16, *Aebtri*, para. 50; opinion 1/91 of 14 December 1991, para. 37; judgment of 10 January 2006, case C-344/04, *IATA and ELFAA*, para. 36; and judgment of 21 December 2011, case C-366/10, *ATAA*, para. 73.

<sup>25</sup> S. VAN RAEPENBUSH, *Droit institutionnel de l'Union européenne*, Brussels: Larcier, 2011, p. 486; A. POTTEAU, *Les dimensions constitutionnelles de l'autonomie de l'ordre juridique communautaire*, in S. Rodrigues (dir.), *L'Union européenne: Union de droit, Union des droits. Mélanges en l'honneur de Philippe Manin*, Paris: Pédone, 2010, p. 190; A. Rosas, *The European Court of Justice and Public International Law*, in J. WOUTERS, P.A. NOLLKAEPPER, E. DE WET (eds), *The Europeanisation of International Law as Law of the EU*, The Hague: T.M.C. Asser Press, 2008, p. 71. Taking into consideration the process of domestic implementation of international law, Cannizzaro is of the opinion that the EU legal order must be described as “neo-monist”: see E. CANNIZZARO, *The Neo-Monism of the European Legal Order*, in E. CANNIZZARO (ed.), *International Law as Law of the EU*, The Hague: Martinus Nijhoff, 2011, p. 35.

<sup>26</sup> Opinion of AG Poiares Maduro, *Kadi*, cit., para. 24.

<sup>27</sup> The international agreements are concluded under Art. 218, para. 6, TEU by the Council of Ministers.

ment.<sup>28</sup> Of course, the Court's jurisdiction arises only "in the context of the internal and autonomous legal order of the Community".<sup>29</sup>

*Ms Icsid*: Would you not agree that the CJEU goes too far in reviewing the conformity of EU law with international law? The prime example is the *Kadi* case, in which the Court of Justice effectively assessed the validity of UN Security Council measures under EU law. The Court held that "an international agreement cannot affect the allocation of powers fixed by the Treaties or, consequently, the autonomy of the Community legal system",<sup>30</sup> essentially claiming precedence of EU law over the Security Council decisions. Would you not think that the Court is endorsing the tradition of nationalism or "fortress Europe", as some legal scholars noted while casting a critical eye over this judgment?<sup>31</sup>

Furthermore, the CJEU looks at the EU as an almost perfect legal order, in which all EU acts endorse protection of human rights as a condition of their validity, and can be reviewed in "the framework of the complete system of legal remedies established by the Treaty".<sup>32</sup> It seems to me that EU law claims superiority over international law, because it is the rule of law order. At the same time, the CJEU sends an implicit message that international law does not comply with the rule of law, at least not to the same extent. The Court explains this in the following terms: "The Community is based on the rule of law, inasmuch as neither its Member States nor its institutions can avoid review of the conformity of their acts with the basic constitutional charter, the Treaty, which established a complete system of legal remedies and procedures designed to enable the Court of Justice to review the legality of acts of the institutions".<sup>33</sup>

*Professor Van Gend en Loos*: The *Kadi* judgment has to be examined in its specific context. It has to be noted that, at the time when this judgment was delivered, restrictive measures adopted by the Security Council were not subject to any kind of review. These black list measures were fleshed out into the EU legal order, as a matter of efficiency, by a specific EU secondary act – a regulation – which had to be consistent with the general principles of the EU legal order, including fundamental rights.<sup>34</sup> The CJEU

<sup>28</sup> Court of Justice, judgment of 10 March 1998, case C-122/95, *Germany v. Council of the European Union*; judgment of 11 September 2003, case C-211/01, *European Commission v. Council of the European Union*.

<sup>29</sup> *Kadi*, cit., para. 317.

<sup>30</sup> *Ibid.*, para. 282.

<sup>31</sup> See for example, C. TOMUSCHAT, *The Kadi Case: What Relationship Is There Between the Universal Legal Order under the Auspices of the United Nations and the EU Legal Order*, in *Yearbook of European Law*, 2009, p. 654.

<sup>32</sup> *Kadi*, cit., paras 284-285.

<sup>33</sup> *Ibid.*, para. 281.

<sup>34</sup> *Kadi* case concerned the adoption of restrictive measures executing the UN sanctions against the Taliban regime in Afghanistan. The adoption of national measures freezing the assets of the claimants in each Member State would have been ineffective given the free movement of capital within the internal market. Accordingly, the EU adopted a series of measures at the Community level to give effect to Mem-

did not review the lawfulness of the Security Council measures but the lawfulness of an Union act that gives effect to these international law measure. The claimant had a remedy to challenge the EU secondary act while he was deprived of such a remedy under UN law. Hence, would you not agree that EU law offered a better protection to the claimant? That was what the Court had in mind when it asserted that “the Community is based on the rule of law”.

*Ms Icsid*: I would agree that international law, although a rules-based order, in the absence of review mechanisms of measures adopted under these rules, is not perfectly implementing the rule of law. However, it is almost as the EU asserts its specific international law nature, which is with its “complete system of legal remedies and procedures” also a higher rule of law, as an excuse when it wishes to justify its prevalence over international law. In other words, EU law is “better” international law, to say-so. For this reason, it affirms its supremacy whenever international law is unable to achieve the EU law standards, as assessed by the EU itself.

*Professor Van Gen den Loos*: The autonomy of the EU legal order has been buttressed in 2009 by the integration of the Charter of Fundamental Rights of the European Union (EU Charter) into primary law in accordance with Art. 6, para. 1, TEU. This bill of rights clearly brings the EU legal order closer to a constitutional order. What is more, given that the EU acknowledges the protection of human rights as one of its key values, domestic constitutional courts cannot anymore claim that EU law may trump their bill of rights.<sup>35</sup> *Kadi* case was a reaction to the insufficient protection of fundamental rights at the UN level. Today, given that the UN review mechanism has been improved in the wake of this judgment, *Kadi* might have been ruled differently.<sup>36</sup>

*Ms Icsid*: Nevertheless, in light of the *Kadi* judgment, I am still not convinced that the EU legal order is monist. The relationship between EU law and international law is, in practical terms at least, determined by the internal effects of international agreements in the EU legal order. This, arguably, renders EU law dualist.<sup>37</sup> The reception of WTO law into the EU legal order is a case in point. According to settled CJEU case-law, WTO Agreements have direct effect under very narrow conditions. Although the EU and its 28 Member States are parties to the WTO, it is nearly impossible for litigants to challenge

ber States’ UN obligations, including an EU regulation. The claimant whose funds were frozen as a consequence of this action, challenged the EU regulation before the CJEU as the violation of his fundamental rights to property and a fair hearing.

<sup>35</sup> German Federal Constitutional Court, judgment of 29 May 1974, BVerfGE 31, 271, *Solange I - Internationale Handelsgesellschaft von Einfuhr- und Vorratsstelle für Getreide und Futtermittel*.

<sup>36</sup> See J. KOKOTT, C. SOBOTTA, *The Kadi Case – Constitutional Core Values and International Law – Finding the Balance*, in *European Journal of International Law*, 2012, p. 1019 *et seq.*

<sup>37</sup> See F. MARTINES, *Direct Effect of International Agreements of the European Union*, in *European Journal of International Law*, 2014, p. 129.

EU secondary law for breaching WTO law. It is hypocritical to claim that EU law is subordinated to international law and, at the same time, pick and choose when international law prevails over EU secondary law. In filtering the agreements that are deemed to be compatible with the EU legal order, the CJEU constantly sorts wheat from chaff.<sup>38</sup>

*Professor Van Gen den Loos.* One has to bear in mind that the CJEU has been endorsing a rather restrictive interpretation of the primacy of WTO law over EU secondary law for the reasons of reciprocity. In effect, the acknowledgment of direct effect of WTO Agreements' provisions would lead to a disequilibrium:<sup>39</sup> on the one hand, American litigants could invoke directly before the General Court of the EU these international provisions; on the other, European litigants could not invoke the same provisions before US courts.

*Ms Icsid.* Your argument with respect to WTO law indeed makes sense. It would not be politically opportune for the EU or its Member States to do otherwise. In many aspects WTO seems to be a political arrangement rather than a legal one.

However, so far in this discussion you focused on international agreements concluded by the EU. As you explained, the CJEU is empowered to nullify an EU decision concluding an agreement that hampers the general principles of EU law and to disapply incompatible provisions of an international agreement concluded by the EU in the case of their substantive inconsistency with EU law and international rules which are binding on the EU. After all, this is logical and any domestic court would do the same when reviewing the legality of acts made under domestic law. But how can EU law prevail over the agreements concluded between Member States and third non-EU States?

*Professor Van Gend en Loos.* The fact that EU law prevails over the Member States' national laws also implies that EU law prevails over international agreements to which Member States are parties. In effect, such agreements form the integral part of Member States' national legal orders. Therefore, Member States cannot enter into international agreements which would contain commitments for Member States capable of jeopardising the attainment of the objectives of the EU Treaties or affecting the EU rules.<sup>40</sup> In becoming Member States of the EU, they transferred part of their sovereignty to the EU, although they are sometimes still reluctant to accept this.

<sup>38</sup> A. BERRADMDANE, *Le droit international, un ordre juridique propre intégré au système juridique de l'Union*, in B. BERTRAND, F. PICOD, S. ROLAND (dir.), *L'identité du droit de l'Union européenne. Mélanges en l'honneur de Claude Blumann*, Brussels: Bruylant, 2015, p. 288 *et seq.*

<sup>39</sup> Court of Justice, judgment of 23 November 1999, case C-149/96, *Portugal v. Council*, para. 47; General Court, judgment of 20 November 2002, case T-79/01, *Chiquita brands*; Court of Justice, judgment of 1 May 2005, case C-377/02, *Van Parys*.

<sup>40</sup> Court of Justice, judgment of 31 March 1971, case 22/70, *AETR*, paras 17 and 22; opinion 2/91 of 19 March 1993, paras 10-11.

## II.2. EU LAW AND MEMBER STATES' BITs

*Ms Icsid*: In the particular context of the Member States' BITs, these agreements were concluded before the Lisbon Treaty of 2009, that is, before investment was included in the Common Commercial Policy. The EU had no powers with respect to their conclusion. Accordingly, BITs are international agreements concluded between independent States under international law and are thus exclusively governed by international law. The EU did nothing to indicate to the Member States the incompatibility of their intra-EU BITs with the EU obligations. Moreover, the EU encouraged prospective Member States to conclude BITs with the Member States before joining the EU.<sup>41</sup> And the accession to the EU did not imply Member States' duty to withdraw from their BITs.

*Professor Van Gend en Loos*: It is true that the EU encouraged candidate States to conclude BITs with the Member States prior to their accession, with an aim to establish "a favourable climate for private investment, both domestic and foreign".<sup>42</sup> Therefore, it could be said that the EU's aim was primarily focused on enhancing the overall investment climate in these countries, for their own benefit. However, when the Commission realised the incompatibility of intra-EU BITs with the functioning of the internal market,<sup>43</sup> in particular with respect to potential discrimination between investors from different Member States and the exclusive jurisdiction of the CJEU to interpret and apply EU law and State aid rules,<sup>44</sup> it strongly advocated against the maintenance of these treaties.<sup>45</sup> While Member States were fully aware of the Commission's concerns, most

<sup>41</sup> See for example, Art. 64 of the Europe Agreement of 1 February 1993 establishing an association between the European Economic Communities and their Member States, of the one part, and Romania, of the other part.

<sup>42</sup> Art. 85 of the Stabilisation and Association Agreement of 29 October 2001 between the European Communities and their Member States, of the one part, and the Republic of Croatia, of the other part.

<sup>43</sup> See, for example, European Commission observations of 13 October 2011 in Permanent Court of Arbitration (PSA), case no. 2010-17, *European American Investment Bank AG v. Slovakia*.

<sup>44</sup> A notable example is the *Micula* case in which the arbitral tribunal ordered Romania to pay compensation to a Swedish investor, disregarding the Commission's position that such payment would infringe EU State aid rules: see ICSID, award on jurisdiction of 22 October 2012, case no. ARB/05/20, *Micula and Others v. Romania (2012 Micula v. Romania)*. More recently, the issue of State aid has been prominent in a number of Energy Charter Treaty (ECT) cases against Spain, many of which are still pending. In a Decision of 10 November 2017, the Commission emphasised that any compensation to an investor on the basis of the modifications of the Spanish investment incentive scheme would qualify as State aid within the meaning of Art. 107 TFEU, which arbitral tribunals are not authorised to grant. Consequently, any payment of an award in these cases is subject to the standstill obligation: see Commission Decision C(2017) 7384 final of 10 November 2017 on State aid investigation.

<sup>45</sup> Economic and Financial Committee, 2008 Annual EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments of 17 December 2008, 17363/08, paras 16-18; 2009 Annual EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments of 10 December 2009, 17446/09, paras 16-18. Similar concerns have been raised in all subsequent reports of the Economic and Financial Committee up to date.

of them did not share the same views and ignored the European Commission's warnings.<sup>46</sup> In his opinion, AG Wathelet clearly highlighted the split between the Member States along political lines.<sup>47</sup> A number of Member States considered intra-EU BITs compatible with EU law and "in certain circumstances, indispensable to secure legal certainty for intra-EU investors until an alternative mechanism has been found".<sup>48</sup> But it should not be forgotten that the Commission used its legal powers to compel the Member States to terminate their BITs.<sup>49</sup>

*Ms Icsid.* With 181 intra-EU BITs still in force, the impression is that the Commission has not been very successful in using its "legal powers". And while still in force, I do not see how these agreements could be inapplicable under international law.

*Professor Van Gend en Loos.* Primacy of EU law is not only a matter of EU law but more importantly, it is a matter of international law. The drafters of the EU founding Treaties were well aware of the possibility of normative conflicts that could undermine the project of EU integration. For this reason, they introduced a conflict rule in Art. 351 TFEU, which explains why investment tribunals should reach the conclusion that EU law prevails over the BITs. This special conflict rule has been recognised by the international legal community as giving the EC Treaty "absolute precedence" over agreements that Member States have concluded between each other.<sup>50</sup> The provision of Art. 351 TFEU

<sup>46</sup> Some Member States unilaterally denounced their BITs in an earlier stage, notably Ireland and Italy in 2012 and 2013 respectively (however, in all truth Ireland ever concluded only one BIT – with the Czech Republic). Recently, the Czech Republic and Romania have terminated their intra-EU BITs, while Poland and Denmark suggested that they would follow. The Netherlands also announced that it would terminate all its 12 intra-EU BITs: see the Letter of the Dutch Minister for Foreign Trade and Development Cooperation to the Chairperson of the Dutch House of Representatives of 26 April 2018, [res.cloudinary.com](https://res.cloudinary.com).

<sup>47</sup> AG Wathelet in his preliminary observations identified the division of Member States into two groups: (1) those Member States that are countries of origin of investors and which rarely or never appear as respondent States, thus not supporting the argument of incompatibility (Germany, France, the Netherlands, Austria and Finland), and (2) those Member States that regularly appear as respondent States in intra-EU arbitrations, thus supporting the argument of incompatibility (the Czech Republic, Estonia, Greece, Spain, Italy, Cyprus, Latvia, Hungary, Poland, Romania, Slovakia). See opinion of AG Wathelet delivered on 19 September 2017, case C-284/16, *Achmea*, paras 34-38.

<sup>48</sup> Economic and Financial Committee, Annual EFC Report for 2017 to the Commission and the Council on the Movement of Capital and the Freedom of Payments of 29 May 2018, 9411/18, pp. 2, 11-12.

<sup>49</sup> In June 2015, the Commission initiated infringement proceedings against five Member States (Austria, the Netherlands, Romania, Slovakia and Sweden) in accordance with Art. 258 TFEU and launched an administrative dialogue with the other 21 Member States who still had BITs in place (at that stage, all except Ireland and Italy): see European Commission Press Release of 18 June 2015, *Commission asks Member States to terminate their intra-EU bilateral investment treaties*. According to UNCTAD, 19 intra-EU BITs have been terminated because they expired, have been terminated by consent, or have been unilaterally denounced: see UNCTAD, *Investment Policy Hub*, cit.

<sup>50</sup> International Law Commission, *Fragmentation of International Law*. Report of the Study Group of the International Law Commission of 13 April 2006, finalised by Maarti Koskeniemi, A/CN.4/L.682, para. 283.

requires the Member States, whenever their international agreements concluded before their accession to the EU are not compatible with the Treaties, to “take all appropriate steps to eliminate the incompatibilities established”. Moreover, “Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude”.<sup>51</sup> It follows that whenever an agreement concluded by two Member States prior to their accession to the EU, such as the Netherlands – Slovakia BIT, is deemed to be incompatible with EU law, an obligation is placed on these States to remove the incompatibilities. The Member States are obliged not only to remove the pre-existing treaty obligations that clash with their EU obligations but also to eliminate any potential conflicts with future EU secondary law.<sup>52</sup> Such conflict rule perfectly makes sense because it reduces, let alone eliminates the risk of discrepancies within the EU legal order.<sup>53</sup>

*Ms Icsid*: However, Slovakia and the Netherlands did not remove these incompatibilities in their mutual BIT, whose ISDS clause was at the root of the controversy in *Achmea*. By the same token, other Member States made no attempts to renegotiate or modify their BITs prior to *Achmea*. In their respective investment treaties Member States have granted their consent to submit to arbitration *any* claim against them, with no exclusion of intra-EU claims. Therefore, their offer to arbitrate in intra-EU context expressed in these treaties was and still is valid under international law. How could developments in EU law in any way undermine prior consent to arbitration, which the States offered in their intra-EU investment treaties?<sup>54</sup> Moreover, even if the BIT was implicitly and retroactively terminated at the time Slovakia joined the EU in 2004, it would still remain in force for a period of 15 years due to the sunset clause.<sup>55</sup>

*Professor Van Gend en Loos*: As a matter of course, the accession to the EU did not entail an explicit withdrawal from the Netherlands – Slovakia BIT. However, ISDS clauses in this and other intra-EU BITs must be regarded as superseded by subsequent interna-

<sup>51</sup> Art. 351, para. 2, TFEU.

<sup>52</sup> Court of Justice, judgment of 3 March 2009, case C-205/06, *European Commission v. Austria*; judgment of 3 March 2009, case C-249/06, *European Commission v. Sweden*; judgment of 19 November 2009, case C-118/07, *European Commission v. Finland*.

<sup>53</sup> Court of Justice, judgment of 2 August 1993, case C-158/91, *Levy*. This is also clearly expressed in Art. 351, para. 3, TFEU: “In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under the Treaties by each Member State form an integral part of the establishment of the Union and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States”.

<sup>54</sup> To that effect, see ICSID, award of 15 June 2018, case no. ARB/13/31, *Antin Infrastructure Services Luxembourg S.à. r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, para. 224. Although this case involved the ECT, the argument *mutatis mutandi* can be applied to BITs.

<sup>55</sup> Art. 13 of 1991 Netherlands – Slovakia BIT.

tional treaties concluded between the Member States. In the case of Central and Eastern European States, incompatible provisions of intra-EU BITs are firstly superseded by the Treaty on Accession, as from the date of accession of these Member States to the Union (1 May 2004).<sup>56</sup>

Secondly, the Treaty of Lisbon to which all Member States are a party has amended and consolidated the text of the original EU Treaties. In accordance with Art. 30, para. 3, VCLT, when all the parties to the earlier treaty are also parties to the later treaty but the earlier treaty is not terminated or suspended, the earlier treaty applies only to the extent to which its provisions are compatible with the later treaty.

After *Achmea*, the incompatibility between the ISDS clauses in intra-EU BITs and EU law is undisputable from an EU perspective and it should also be, for these reasons, clear from an international law perspective.

*Ms Icsid*. However, it must be noted that Art. 30 VCLT applies to successive treaties relating to the same subject matter. It is open to discussion whether BITs and EU Treaties relate to the same subject matter.<sup>57</sup> Furthermore, how could the *Achmea* judgment, which is clearly placed in a national or regional context, undermine Member States' obligations under the ICSID Convention,<sup>58</sup> which is an instrument of public international law? In your view, is the ICSID Convention also incompatible with EU law? All Member States except Poland are parties to the ICSID Convention. It is undisputed that Member States did not expressly or impliedly terminate their participation in the ICSID Convention when they joined the EU.<sup>59</sup> The *Achmea* judgment cannot be interpreted to support the argument that Member States are no longer bound by the ICSID Convention following their accession to the EU.<sup>60</sup> Consequently, consent to arbitration under Art. 25 of the ICSID Convention is valid and once given, could not be unilaterally or retroactively with-

<sup>56</sup> See the Act of Accession (which is part of the Treaty of Accession) of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, and the Slovak Republic, Arts 2 and 6; the Act of Accession of Bulgaria and Romania, Arts 2 and 6; the Act of Accession of the Republic of Croatia, Arts 2 and 6.

<sup>57</sup> See *Vattenfall II*, cit., para. 212; Arbitral Tribunal of Stockholm Chamber of Commerce (SCC), partial award of 27 March 2007, case no. 088/2004, *Eastern Sugar B.V. v. Czech Republic*, para. 159; Permanent Court of Arbitration, award on jurisdiction, arbitrability and suspension of 26 October 2010, case no. 2008-13, *Achmea B.V. v. The Slovak Republic* (formerly *Eureko B.V. v. Slovak Republic*), para. 258; award on jurisdiction of 22 October 2012, *European American Investment Bank AG v. The Slovak Republic*, para. 184; Arbitral Tribunal of Stockholm Chamber of Commerce, award of 15 February 2018, case no. 2015/063, *Novenergia II - Energy and Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain*, para. 439; opinion of AG Wathelet, *Achmea*, cit., paras 56-57 and paras therein mentioned.

<sup>58</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) of 18 March 1965.

<sup>59</sup> ICSID, award of 9 October 2018, case no. ARB/13/35, *UP (formerly Le Chèque Déjeuner) and C.D. Holding Internationale v. Hungary*, paras 259-260.

<sup>60</sup> *Ibid.*, para. 258.

drawn under Art. 72 of the ICSID Convention.<sup>61</sup> In light of these arguments, I do not see why ICSID tribunals would not have jurisdiction to adjudicate intra-EU disputes.

*Professor Van Gend en Loos*: All protections available to intra-EU investors under BITs are also available under EU law. The fact that the EU Treaties and the CJEU case-law have a wider scope *ratione materiae* than the BITs does not exclude the applicability of Art. 30 VCLT.<sup>62</sup> With respect to the ICSID Convention, one has to note that ICSID is not an autonomous system within international investment law. ICSID establishes procedure (forum and rules) for the settlement of disputes arising out of a particular international investment agreement. An intra-EU BIT could be considered *lex specialis* which supersedes the *lex generalis* enshrined in the ICSID provisions. In any case, without a particular BIT, which prescribes both substantive protections and the mechanism for their implementation through an ISDS clause, there could not be an investment claim and hence, the ICSID Convention could not apply. Additionally, the EU is not a party to the ICSID Convention, which is thus not part of the EU legal order. Therefore, in case of a conflict between EU law and the ICSID Convention, national courts are called on to disapply the latter,<sup>63</sup> in the same manner as they must disapply incompatible provisions of an intra-EU BIT or the ECT. Even if there was a valid offer to arbitrate, such offer is inapplicable in all cases because it is incompatible with EU law. Therefore, *Achmea* sends a clear message to investors and their lawyers that they should not rely any more on ISDS clauses in intra-EU context.

### II.3. THE PECULIAR CASE OF THE ECT<sup>64</sup>

*Ms Icsid*: When you refer to the “intra-EU context”, does this also include the inapplicability of the ISDS clause in intra-EU disputes under the ECT?<sup>65</sup> Based on what you said so far,

<sup>61</sup> *Ibid.*, paras 261-264.

<sup>62</sup> To this effect, see also discussion on the ECT, *infra* under section II.3. For explanation of investment protections under EU law, see Communication COM(2018) 547 final of 19 July 2018 from the Commission to the European Parliament and the Council, *Protection of intra-EU investment*.

<sup>63</sup> See the discussion *infra* under section V.3.

<sup>64</sup> In 1994, both the EU (Decision 98/181/EC, ECSC, Euratom of the Council and Commission of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects) and its Member States concluded the ECT. The ECT has the same status in the EU legal order as a purely EU agreement (exclusive competence) insofar as its provisions fall within the scope of EU competence. In addition, the EU is legally bound by the obligations on fair and equitable treatment and non-expropriation contained in the ECT. Accordingly, the compliance by EU secondary law with the ECT obligations may be subject to review before the EU courts. Needless to say, secondary law must be interpreted in accordance with the EU's obligations stemming from the ECT (Court of Justice, judgment of 10 September 1996, case C-61/94, *European Commission v. Germany*, para. 52). Since the ECT is a mixed agreement, it follows that it is implemented and managed jointly by the EU and the Member States: see opinion of AG Jääskinen delivered on 15 March 2011, case C-264/09, *European Commission v. Slovakia*, para. 60. So far, only one Member State, Italy, has withdrawn from the ECT.

there is a big difference between intra-EU BITs and the ECT. BITs' compatibility with EU law became an issue following the accession of Central and Eastern European countries to the EU. However, the ECT was actually concluded between all EU Member States at that time and thus, effectively was an intra-EU agreement. Additionally, since the EU is a party to the ECT, the ECT also has binding effect on the EU and is a source of EU law. If the Commission now claims that the ECT is inconsistent with EU primary law, why has the EU joined this treaty in the first place? Moreover, why did the Commission play a crucial role in negotiating an agreement incompatible with EU law? As correctly noted by the *Electrabel* tribunal, "as a matter of legal, political and economic history, the European Union was the determining actor in the creation of the ECT".<sup>66</sup> Consequently, "the ECT's genesis generates a presumption that no contradiction exists between the ECT and EU law",<sup>67</sup> as they "share the same broad objective in combating anti-competitive conduct".<sup>68</sup>

*Professor Van Gend en Loos*: The ECT was concluded in 1994 when these issues were not yet controversial. At the time, it was a geopolitically important multilateral treaty, aimed at reducing investment risks for Western European investors in energy-related investment after the fall of communism in then unpredictable markets of Eastern Europe and the former Soviet Union. The EU had 12 Member States whose economic interests were more or less coordinated: on the one hand, they wanted to ensure the expansion to new markets; on the other, it was important to guarantee sustainability of energy use in Europe.<sup>69</sup> There has never been any intention to apply the ECT in disputes opposing EU investors and Member States. In other words, it was never intended that the ECT would be applied as an intra-EU multilateral treaty. The fact that the EU is a party to the ECT does not affect the applicability of the ECT in intra-EU disputes. As already explained, international agreements of the EU are applicable to the extent that they are compatible with EU primary law.

*Ms Icsid*: However, one has to rely on the explicit provisions of the ECT when determining jurisdiction in intra-EU context, instead of reading into the text of the ECT something that is not expressly stated therein. In this regard, Art. 16 ECT clearly states that the contracting parties to the ECT, including the EU, have agreed that, any prior or subsequent treaties that parties enter into with each other, shall not be construed so as to derogate from substantive protections or the right to dispute settlement mechanism of the ECT, where the ECT provision is more favourable to the investor or investment. It seems to me that there is no doubt that the ECT is more favourable to investors than EU law. Therefore, as a con-

<sup>65</sup> According to the Commission, the *Achmea* judgment applies to all intra-EU investment disputes, including those under the ECT: see Communication COM(2018) 547, pp. 3-4.

<sup>66</sup> *Electrabel v. Hungary*, cit., para. 4.131.

<sup>67</sup> *Ibid.*, para. 134.

<sup>68</sup> *Ibid.*, paras 4.137 *et seq.*

<sup>69</sup> European Commission Press Release of 17 December 1994, europa.eu.

flict rule determining the relationship between the ECT and other international treaties, Art. 16 ECT makes clear that in case of a conflict between the ECT and EU law, the ECT should prevail because it is a more favourable agreement for investors in the EU. As such, it poses “an insurmountable obstacle” to the argument that EU law should prevail over the ECT, in particular in cases involving two “old” Member States.<sup>70</sup>

*Professor Van Gend en Loos.* Investment tribunals heavily rely on allegedly “clearer conflict rule” over the EU conflict rule in Art. 351 TFEU,<sup>71</sup> although Art. 16 ECT remains controversial as a conflict rule. Art. 16 should rather be understood as an interpretative rule as it explicitly refers to “construing” rights. Instead, Art. 351 TFEU and Art. 30 VCLT are the relevant conflict rules to be applied in intra-EU disputes under the ECT. The only tribunal which correctly asserted that EU law prevails over the ECT, in view of both EU law and general international law, was the tribunal in *Electrabel*.<sup>72</sup> Although *Electrabel* dispute involved an “old” and a “new” Member State, namely a claim by a Belgian investor against Hungary, whereby the ECT was initially concluded as an extra-EU international treaty, the same conclusion should be reached in cases of disputes between “old” Member States.<sup>73</sup> Precedence of EU primary law over the ECT in such cases is clear in light of a *contrario* interpretation of Art. 351 TFEU and Art. 30, para. 3, VCLT since the ECT has been overridden by all successive treaties between “old” EU Member States concluded after the ECT’s entry into force.<sup>74</sup> Therefore, investment tribunals should apply the ECT in light of EU law.<sup>75</sup> And primary EU law, as explained by the CJEU in the *Achmea* judgment, renders their jurisdiction inapplicable in intra-EU disputes.

<sup>70</sup> *Vattenfall II*, cit., para. 229.

<sup>71</sup> *Ibid.*, para. 227.

<sup>72</sup> The tribunal’s analysis was, however, hypothetical as the tribunal did not find any material inconsistency between EU law and the ECT: *Electrabel v. Hungary*, cit., paras 4.166-4.167. With respect to a potential conflict between EU law and ISDS mechanism, the tribunal reached the conclusion that “nothing in EU law can be interpreted as precluding investor-State arbitration under the ECT and the ICSID Convention” (para. 4.175). With respect to a potential conflict between EU law and substantive protections under the ECT, the tribunal reached the conclusion that the two do not share the same subject-matter but still, however, “share much in common” (paras 4.176-4.177).

<sup>73</sup> See the analysis in *Electrabel v. Hungary*, cit., paras 4.178-4.191. The tribunal thus concluded: “In summary, from whatever perspective the relationship between the ECT and EU law is examined, the tribunal concludes that EU law would prevail over the ECT in case of any material inconsistency”.

<sup>74</sup> Treaty of Amsterdam (1999), Treaty of Nice (2003), Treaty of Lisbon (2009). To this effect, see also the Commission’s submission in *Vattenfall II*, cit., para. 91. In the *Vattenfall II* case, to support the argument of primacy of EU law over the ECT, the Commission has also invoked VCLT Art. 41 (modification of international treaties). According to this argument, by concluding subsequent EU treaties after the ratification of the ECT, Germany and Sweden amended the ECT in order to apply EU law in their mutual relations.

<sup>75</sup> *Electrabel v. Hungary*, cit., para. 4.130.

### III. *ACHMEA* OR HOW INTERNATIONAL INVESTMENT TRIBUNALS DO NOT UNDERSTAND EU LAW

#### III.1. WHY INVESTMENT TRIBUNALS DO NOT HAVE JURISDICTION IN ALL INTRA-EU DISPUTES?

*Ms Icsid*: The argument that the *Achmea* judgment applies to all intra-EU arbitrations, both under intra-EU BITs and the ECT is, however, unsupported in light of the text of this judgment and the questions asked by the referring German court. *Achmea* applies *only* to BITs – that is, bilateral and not multilateral treaties, and *only* to those BITs concluded between the Member States. As we know, the ECT is not a bilateral treaty between the Member States but a multilateral treaty to which the EU is also a party.<sup>76</sup>

Furthermore, *Achmea* relates only to those intra-EU BITs that contain the *same* ISDS clause as the Netherlands – Slovakia BIT that was questioned in *Achmea*. In particular, it is relevant that this ISDS clause explicitly defines “the law in force of the Contracting Party” as the applicable law. In interpreting this ISDS provision, the CJEU drew the conclusion that investment tribunals “*may* be called on to interpret or indeed to apply EU law, particularly the provisions concerning the fundamental freedoms, including freedom of establishment and free movement of capital” – a competence that exclusively belongs to the CJEU.<sup>77</sup> The Court of Justice asserted squarely that only ISDS clause “such as” the one in the Netherlands-Slovakia BIT is incompatible with TFEU Arts 267 and 344, and not all ISDS clauses in all intra-EU BITs.<sup>78</sup> Therefore, the *Achmea* judgment is of limited application.

*Professor Van Gend en Loos*: Such interpretation of *Achmea* is too narrow. You are exclusively focusing on the BIT at issue in the manner of a common law lawyer who is arguing their case by distinguishing it from a precedent that does not suit them. Whether the agreement is bilateral or multilateral, and whether the EU is party to an agreement or not is irrelevant for the case in point. In approaching *Achmea* narrowly, you fail to grapple with the logic of the CJEU and its legal order that the Court is called to defend under the Treaties.

The *Achmea* judgment must be placed in the broader picture of the EU judicial system. This is what the CJEU stressed as its main reason for declaring the ISDS clause at issue incompatible with EU law. The essence of the problem is that investment tribunals do not sit within the EU judicial system<sup>79</sup> while domestic courts form an essential part of that system. The EU judicial system reckons upon the cooperation between the CJEU

<sup>76</sup> ICSID, award of 16 May 2018, case no. ARB/14/1, *Masdar Solar and Wind Cooperatief U.A. v. Kingdom of Spain*, paras 679-680 (emphasis added).

<sup>77</sup> *Achmea* [GC], cit., paras 40-42 (emphasis added).

<sup>78</sup> *Ibid.*, para. 60.

<sup>79</sup> *Ibid.*, para. 45.

and the domestic courts of the 28 Member States. In this system, the domestic courts are called on to apply EU law although they might not quash EU legal acts. They do so in close cooperation with the CJEU through the preliminary ruling procedure. Unlike investment tribunals, domestic courts can refer questions for a preliminary ruling in accordance with Art. 267 TFEU. This is relevant with respect to two aspects.

Firstly, in providing a preliminary ruling mechanism, the Treaty ensures that the CJEU deals with all questions of interpretation and application of EU law. In so doing, the uniformity of EU law is guaranteed.<sup>80</sup> The preliminary ruling procedure in Art. 267 TFEU is the “keystone” of the EU judicial system as it establishes a *dialogue* between the CJEU and the courts and tribunals of the Member States.<sup>81</sup> This dialogue has for its object “securing uniform interpretation of EU law, thereby serving to ensure its consistency, its full effect and its autonomy as well as, ultimately, the particular nature of the law established by the Treaties”.<sup>82</sup> Plainly speaking, every national court in the EU, faced with an EU legal issue, refers relevant questions regarding the interpretation of EU law to the CJEU, thus ensuring the consistent interpretation of EU law by the CJEU. Therefore, the preliminary ruling procedure enhances the dialogue between the CJEU and the national courts with a view to achieving a uniform application of EU law across the EU.<sup>83</sup> Since investment tribunals cannot refer questions of EU law to the CJEU, this may lead to inconsistent interpretation of EU law. As a consequence, the EU legal system enhances uniformity and consistency; on the contrary, international investment law is characterised by its inconsistency. After all, these inconsistencies are one of the reasons for the currently ongoing global ISDS reform.<sup>84</sup>

Secondly, since investment tribunals are situated outside the EU judicial system, their awards cannot be subject to control by domestic courts and the CJEU for their compliance with EU law. In words of the CJEU, their awards cannot be subject to “mechanisms” of the EU judicial system which ensure “the full effectiveness of the rules of the EU”.<sup>85</sup> In accordance with Art. 19, para. 1, TEU, it is for the national court and the CJEU “to ensure the full application of EU law in all Member States”.<sup>86</sup> It is settled case-law that it is “for the national courts and tribunals and for the Court of Justice to ensure the full application of EU law in all Member States and to ensure judicial protection of an

<sup>80</sup> Court of Justice, judgment of 24 November 2011, case C-281/09, *European Commission v. Spain*, para. 42.

<sup>81</sup> *Ibid.*, para. 37.

<sup>82</sup> Court of Justice, opinion 2/13 of 18 December 2014, para. 176.

<sup>83</sup> Court of Justice, judgment of 13 May 1981, case 66/80, *SpA International Chemical Corporation*, para. 11.

<sup>84</sup> United Nations Commission on International Trade Law (UNCITRAL), Note by the Secretariat of 28 August 2018, *Possible reform of investor-State dispute settlement: Consistency and related matters*, UN Doc. A/CN.9/WG.III/WP.150.

<sup>85</sup> *Achmea* [GC], cit., para. 43.

<sup>86</sup> *Ibid.*, para. 36.

individual's rights under that law".<sup>87</sup> In doing so, domestic courts ensure that national law complies with EU law. However, in case of intra-EU investment awards, there is no such mechanism whatsoever. Consequently, awards inconsistent with EU law are valid: this ultimately challenges the EU legal order.

Therefore, ISDS interference with EU law in intra-EU disputes challenges the very foundations of the EU legal order. This is irrespective of whether ISDS mechanism providing for intra-EU disputes is encapsulated in intra-EU BITs, the ECT or the ICSID arbitration, and irrespective of the particular expression or formulation of ISDS mechanism in these instruments.

### III.2. THE ADVOCATE GENERAL'S OPINION IS NOT LEGALLY BINDING AND PRELIMINARY RULING ONLY ANSWERS THE QUESTIONS ASKED

*Ms Icsid*: If that was indeed the case, learned colleague, why the CJEU did not clearly say that its ruling also relates to intra-EU disputes under the ECT? Why the CJEU did not address, depart from, or reject the opinion of AG Wathelet dated 19 September 2017, which emphasised the distinction between intra-EU BITs and the ECT?<sup>88</sup> In particular, if the AG noted that the ECT was concluded "as an ordinary multilateral treaty in which all the Contracting Parties participate on an equal footing", why the CJEU did not correct the AG' reasoning and address the exclusion of ISDS mechanism in intra-EU disputes? Moreover, why the CJEU did not refute the assertion of the AG that "no EU institution and no Member State" sought an opinion from the Court on the compatibility between the ECT and the founding Treaties "because none of them had the slightest suggestion that it might be incompatible"?<sup>89</sup> Instead, in *Achmea* the CJEU is simply silent on the issue of compatibility of intra-EU ISDS under the ECT with EU law. Consequently, several investment tribunals have been recently asserting their jurisdiction in intra-EU disputes relying on the AG opinion.<sup>90</sup>

*Professor Van Gend en Loos*: The CJEU answered only those questions which had been submitted by the domestic court. In *Achmea*, the German *Bundesgerichtshof* (Federal Court of Justice) expressed doubts concerning the compatibility of the Netherlands-Slovakian BIT with Arts 267 and 344 TFEU and with the principle of non-discrimination set forth in Art. 18 TFEU. For these reasons, it asked the CJEU to give a preliminary ruling as regards these questions. It is the task of the CJEU to answer only those questions that the referring domestic court asked, and to the extent that is necessary for the referring court to correctly apply EU law in the main proceedings. In so doing, the CJEU differs from a common law court, which in its judgments not only rules on the legal is-

<sup>87</sup> Court of Justice, opinion 1/09 of 8 March 2011, para. 68; opinion 2/13, cit., para. 175.

<sup>88</sup> Opinion of AG Wathelet, *Achmea*, cit.

<sup>89</sup> *Ibid.*, para. 43.

<sup>90</sup> *Masdar v. Spain*, cit., para. 682; *Vattenfall II*, cit., para. 163.

sue but also provides discussions of doctrine, disquisitions of legal concepts or policy arguments based on considerations outside of legal discourse.<sup>91</sup>

AGs provide independent and impartial opinions concerning the case at issue prior to the Court's deliberations.<sup>92</sup> That said, their opinions are not binding upon the Court. Indeed, dissenting AG's opinions do not call into question the legal validity of the CJEU's judgment. Accordingly, the investment tribunals cannot reckon upon the reasoning of AG Melchior Wathelet.

*Ms Icsid*. However, it is clear that the *Achmea* judgment relies expressly on very particular aspects: 1) the place of arbitration is Frankfurt and therefore, German law applies to the arbitral proceedings; 2) the judicial review falls within the competence of German courts; 3) in the review process, the German Federal Court of Justice submitted a number of preliminary questions to the CJEU.<sup>93</sup> None of these aspects apply in the majority of other intra-EU arbitrations. It is therefore, logical to conclude that in *Achmea* the CJEU merely answered the questions referred by the German *Bundesgerichtshof* regarding the validity of the clause provided for in the Netherlands – Slovakia BIT. Accordingly, it is impossible to generalise anything from that judgment.

*Professor Van Gend en Loos*. This is not at all the case. Of importance is to note that the CJEU judgments interpreting EU law enjoy an authority similar to those of national supreme courts in civil law countries. Accordingly, after receiving the answer from the CJEU to a question concerning the interpretation of EU law which it has submitted to the Court, or where the case-law of the CJEU already provides a clear answer to that question, the domestic court is itself required "to do everything necessary to ensure that that interpretation of EU law is applied".<sup>94</sup> What is more, the national court must set aside the provisions of national law declared to be inconsistent with EU law, without having to request or await its prior removal by the legislature.<sup>95</sup>

It follows that the preliminary ruling of the CJEU in *Achmea* is not only binding on the German court involved in resolving the dispute that gave rise to the preliminary ruling (*inter partes*); the ruling is also binding *erga omnes*, on all other courts of all Member States (*autorité de la chose interprétée*).<sup>96</sup> In other words, preliminary rulings are

<sup>91</sup> For comparative analysis of legal reasoning in judicial opinions in common law and civil law judgments, see M. WELLS, *French and American Judicial Opinions*, in *Yale Journal of International Law*, 1994, p. 101. See also P. BOURDIEU, *The Force of Law: Toward a Sociology of Judicial Field*, in *Hastings Law Journal*, 1987, p. 38. Although the CJEU could not be considered a civil law court, its legal reasoning rather resembles a civil law method.

<sup>92</sup> Art. 19, para. 2, TEU.

<sup>93</sup> *UP (formerly Le Chèque Déjeuner) and C.D Holding Internationale v. Hungary*, cit., para. 254.

<sup>94</sup> Court of Justice, judgment of 5 April 2016, case C-689/13, *Puligienica Facility Esco SpA*.

<sup>95</sup> Court of Justice, judgment of 21 June 2007, case C-231/06 to C-233/06, *Emilienne Jonkman*.

<sup>96</sup> A. TRABUCCHI, *L'effet erga omnes des décisions préjudicielles rendues par la Cour de justice des communautés européennes*, in *Revue trimestrielle des droit de l'homme*, 1974, p. 56 et seq.; S. VAN

binding both on the referring court and on all courts in the EU.<sup>97</sup> It follows that all other courts have to interpret the EU rule in question in accordance with the operative part and the *ratio* of the preliminary ruling.<sup>98</sup> Since in *Achmea* the CJEU found the intra-EU ISDS mechanism inconsistent with EU law, no national court may reach an opposite conclusion. And since the CJEU did not provide any temporal limitation of the effects of its ruling (limitation *ratione temporis*), all EU Member States are bound *ex tunc* by the preliminary ruling in *Achmea*.<sup>99</sup> This is different to a precedent of a common law court, which applies *ex nunc*. Therefore, the provisions under which an investor from one of the Member States may, in the event of a dispute concerning investments in another Member State, bring proceedings against the latter Member State before an arbitral tribunal whose jurisdiction that Member State has undertaken to accept in an investment treaty, have become inapplicable throughout the EU.<sup>100</sup> Accordingly, as the German *Bundesgerichtshof* decided that Slovakia's offer to arbitrate was inapplicable on the ground that it was incompatible with EU law, and thus no effective arbitration agreement could not have been concluded,<sup>101</sup> every other national court, if confronted with an intra-EU investment award, should reach the same conclusion.

### III.3. WHY IS COMMERCIAL ARBITRATION DIFFERENT FROM INVESTMENT ARBITRATION?

*Ms Icsid*: Why the CJEU in *Achmea* made a distinction between investment and commercial arbitration, asserting that the former is incompatible and the latter compatible with EU law? Commercial arbitration tribunals, in the same manner as investment tri-

RAEPENBUSH, *Droit institutionnel de l'Union européenne*, cit., p. 624; F. PICOD (dir.), *Europe Traité*, Vol. 3, Paris: Lexis Nexis, 2016, p. 19. Cf. A. TOTH, *The Authority of Judgments of the European Court of Justice: Binding Force and Legal Effects*, in *Yearbook of European Law*, 1984, p. 1 *et seq.*

<sup>97</sup> To this effect, see *SpA International Chemical Corporation*, cit., paras 12-13 and 15; Court of Justice, judgment of 5 October 2010, case C-173/09, *Elchinov*, para. 29; *Puligienica Facility Esco SpA*, cit., para. 38. Since the CJEU prescribes to civil law tradition, its judgments are assumed to have declaratory effect (they do not create new law but clarify the existing rules) and have binding effect on all relationships governed by the legal instrument since it entered into force: D. CHALMERS, G. DAVIES, G. MONTI, *European Union Law*, Cambridge: Cambridge University Press, 2010, p. 171.

<sup>98</sup> *SpA International Chemical Corporation*, cit., para. 13; Court of Justice, judgment of 22 October 1987, case 314/85, *Foto-Frost*.

<sup>99</sup> Court of Justice: judgment of 27 March 1980, case 61/79, *Amministrazione delle finanze dello Stato v. Denkavit*, para. 16; judgment of 13 January 2004, case C-453/00, *Kühne and Heitz v. Productschap voor Pluimvee en Eieren*, para. 21. See also M. BROBERG, N. FENGER, *Preliminary References to the European Court of Justice*, Oxford: Oxford University Press, 2010, p. 445.

<sup>100</sup> N. DE SADELEER, *The End of the Game: The Autonomy of the EU Legal Order Opposes Arbitral Tribunals Under Bilateral Investment Treaties Concluded Between Two Member States*, in *European Journal of Risk Regulation*, 2018, p. 366.

<sup>101</sup> German Federal Court of Justice, judgment of 31 October 2018, I ZB 2/15, para. 25.

bunals, are not “courts or tribunals of Member States”.<sup>102</sup> Therefore, they also cannot refer questions of EU law for preliminary ruling to the CJEU. In the same manner, commercial arbitration in the EU may lead to awards incompatible with EU law. However, in spite of these risks, the validity of their awards has never been disputed by the CJEU. Moreover, in light of the CJEU’s reasoning in *Achmea*, it seems that the validity of commercial arbitration under EU law has been reinforced.<sup>103</sup>

*Professor Van Gend en Loos*. Although commercial tribunals cannot refer questions for a preliminary ruling, there are two significant differences between commercial and investment arbitration. Firstly, commercial arbitration originates in “the freely expressed wishes of the parties” stated in an arbitration agreement. On the contrary, investment arbitration originates in an international treaty between two Member States, who have removed from their jurisdiction intra-EU disputes although such disputes “may concern the application and interpretation of EU law”.<sup>104</sup> This is in direct contradiction with the Member States’ obligations under EU law, in particular Art. 344 TFEU, by which Member States have undertaken not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for in the Treaty. In other words, under Art. 344 TFEU Member States have undertaken to submit their *inter se* disputes concerning the interpretation and application of EU law *exclusively* to a dispute settlement mechanism within the EU judicial system. As we know by now, it is undisputed that investment tribunals do not form part of the EU judicial system. Therefore, it is now also clear that Art. 344 TFEU applies not only to disputes between Member States *inter se*, as clarified by the Court of Justice in *MOX Plant* case,<sup>105</sup> but also to disputes between private parties and Member States when such disputes concern the interpretation and the application of EU law. This reasoning moves away from what investment tribunals have hitherto been claiming.<sup>106</sup>

Secondly and more importantly, the review of commercial awards regarding their compatibility with EU law is possible in the enforcement stage. Conversely, the review of

<sup>102</sup> Court of Justice, judgment of 23 March 1982, case C-102/81, *Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei Nordstern AG and Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG and Co. KG*, para. 13. See M. BROBERG, N. FENGER, *Preliminary References to the European Court of Justice*, cit., pp. 80-81.

<sup>103</sup> To that effect see *Achmea* [GC], cit., paras 54-55.

<sup>104</sup> *Ibid.*, para. 55.

<sup>105</sup> Court of Justice, judgment of 30 May 2006, case C-459/03, *European Commission v. Ireland*.

<sup>106</sup> See for example, *Achmea B.V. v. The Slovak Republic*, cit., para. 276; UNCITRAL, decision on jurisdiction of 30 April 2010, *Jan Oostergetel and Theodora Laurentius v. The Slovak Republic*, paras 72 and 98; *Eastern Sugar B.V. v. The Czech Republic*, cit., paras 172, 175; *Electrabel v. Hungary*, cit., para. 4.150; Arbitral Tribunal of Stockholm Chamber of Commerce, award of 21 January 2016, case no. V 062/2012, *Charanne and Construction Investments v. Spain*, paras 441-447; ICSID, final award of 4 May 2017, case no. ARB/13/36, *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, para. 204; *Novenergia v. Spain*, cit., para. 441.

investment awards depends on the applicable domestic law and the type of award. It must be noted that such review is fully excluded in the case of ICSID awards. When reviewing commercial awards, national courts can review the validity of arbitration agreements under the applicable law as well as the consistency of the award with public policy.<sup>107</sup> Although such review is limited in its scope, it allows for examination of the compatibility of the commercial award with the fundamental provisions of EU law.<sup>108</sup> In the course of such review, national courts can also refer questions of EU law for a preliminary ruling.<sup>109</sup> Therefore, with respect to commercial arbitration, national courts can review and thus control the compatibility of awards with EU law. Consequently, Member States can ensure the full application of EU law in accordance with their obligation under Art. 19, para. 1, TEU.

*Ms Icsid*: However, there is “no automatic reference to or seizure by the CJEU, as soon as any question of EU law arises before a national court”, which consequently leaves open “the possibility, if not the probability, of divergent interpretations or applications of EU law to similar disputes by courts and tribunals within the European Union”.<sup>110</sup> It also seems to me that the problem with investment arbitration could have been avoided if the CJEU followed AG Wahelet’s opinion in which he concluded that investment tribunals could be considered “courts or tribunals of Member States”.<sup>111</sup> If investment tribunals had an avenue to refer their questions to the CJEU, the review of investment awards for their compatibility with EU law would not have been a problem. In light of the discretion given to the national courts, the mere existence of a possibility of referral given to investment tribunals would have been sufficient to ensure control of the compatibility of their awards with EU law.

*Professor Van Gend en Loos*: In a case brought before a national court, whenever a question of interpretation which is new and of general interest for the uniform application of EU law is raised, or where the existing case-law does not appear to give the necessary guidance to deal with a new legal situation, the domestic courts should refer to the CJEU a question for a preliminary ruling. Although there is a certain degree of discretion given to national courts in deciding when to refer the relevant questions to the CJEU, there are mechanisms in EU law to ensure that national courts comply with pre-

<sup>107</sup> In this regard, domestic legislation is mostly harmonised and allows for a limited review, implementing the grounds for review of arbitral awards prescribed in Art. 5 of the 1958 New York Convention for enforcement of arbitral awards. However, national courts do not interpret these grounds in the same manner, which can lead to differences between jurisdictions.

<sup>108</sup> Court of Justice, judgment of 1 June 1999, case C-126/97, *Eco Swiss China Time Ltd v. Benetton International NV*, paras 35-36.

<sup>109</sup> *Ibid.*, para. 40.

<sup>110</sup> *Electrabel v. Hungary*, cit., para. 4,148.

<sup>111</sup> Opinion of AG Wathelet, *Achmea*, cit., paras 89-131.

liminary ruling requirements. “Where there is no judicial remedy against the decision of a national court”, the domestic court is in principle obliged to make a reference to the CJEU where a question of the interpretation of the Treaty is raised before it.<sup>112</sup> The fact of not referring the questions could give rise to an infringement proceeding in accordance with Art. 258 TFEU<sup>113</sup> and State liability.<sup>114</sup> It must be emphasised that the dialogue between national courts and the CJEU is aimed at building mutual trust and cooperation between the courts in the EU, which would be difficult if the national courts’ authority to make preliminary reference at their own discretion was undermined. Ultimately, such judicial cooperation has been designed to ensure compliance with EU law, which “is of the essence of the rule of law”.<sup>115</sup>

Although the CJEU found that investment tribunals are not courts or tribunals of Member States, they still might have an indirect recourse to the preliminary ruling procedure under Art. 267 TFEU, through the assistance of national courts.<sup>116</sup> However, even with such possibility, I am not convinced that investment tribunals would recognise EU law as a relevant issue in investment arbitration and thus refer questions concerning the interpretation and/or validity of EU law for reference to the CJEU. The practice of arbitral tribunals clearly demonstrates that they had so far little regard for EU law. They have held that there is no EU rule which would prevent Member States from resolving their disputes with investors from other Member States by arbitration.<sup>117</sup> On that basis, no investment tribunal, pre- or post-*Achmea*, has ever upheld the intra-EU jurisdictional objection.<sup>118</sup> Moreover, investment tribunals claimed that there is no EU rule which would prevent arbitral tribunals from applying EU law to intra-EU disputes.<sup>119</sup> Some tribunals went as far as to deny “interpretative monopoly” of the CJEU.<sup>120</sup> It is now clear that such reasoning disregards the autonomy of EU law.

<sup>112</sup> Court of Justice, judgment of 15 March 2017, case C-3/16, *Aquino*, para. 42; judgment of 4 October 2018, case C-416/17, *European Commission v. France*, para. 108.

<sup>113</sup> In *European Commission v. France*, cit., the Court of Justice has recently condemned France for the fact that the French *Conseil d’Etat* did not refer questions for preliminary ruling.

<sup>114</sup> Court of Justice: judgment of 20 September 2003, case C-224/01, *Köbler*; judgment of 13 June 2006, case C-173/03, *Traghetti del Mediterraneo*.

<sup>115</sup> Court of Justice, judgment of 27 February 2018, case C-64/16, *Associação Sindical dos Juizes Portugueses*, para. 36.

<sup>116</sup> To that effect see, *Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei Nordstern AG and Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG and Co. KG*, cit., para. 14.

<sup>117</sup> For example, *Achmea B.V. v. The Slovak Republic*, cit., para. 274.

<sup>118</sup> See the comment of tribunal in *RREEF v. Spain*, cit., para. 89 for pre-*Achmea* awards. For a summary of post-*Achmea* considerations of intra-EU objection, see *Vattenfall II*, cit. (for the ECT context), and *UP v. Hungary*, cit. (for intra-EU BIT context under ICSID).

<sup>119</sup> *Electrabel v. Hungary*, cit., para. 4.147; *Charanne and Construction Investments v. Spain*, cit., paras 438, 443-445; *Eiser v. Spain*, cit., para. 204; *Novenergia v. Spain*, cit., para. 440. For example, tribunal

#### IV. WHO FRAGMENTS WHAT?

*Ms Icsid*. However, arbitral tribunals were also clear that their jurisdiction only concerns breaches of an international investment treaty, whether an intra-EU BIT or the ECT, and not of EU law. Therefore, their role is not to give an “authoritative interpretation of EU law”<sup>121</sup> which would be binding on Member States or the EU, but to interpret an international agreement in question.<sup>122</sup> In this sense, EU law in investment arbitration has been mostly treated as a matter of international law<sup>123</sup> or as a matter of fact.<sup>124</sup> In cases where EU law has been raised as a relevant issue in intra-EU arbitration, arbitral tribunals have generally attempted to interpret the obligations of Member States under the international treaty harmoniously with EU law, in light of the principle of systemic integration in general international law.<sup>125</sup> Investment tribunals have not found any material inconsistency between EU law and international investment law, neither with respect to jurisdictional issues related to ISDS mechanism nor substantive issues related to investment protections guaranteed in investment agreements.<sup>126</sup> It is the EU, firstly the Commission and then the CJEU, that sparked off a debate of unprecedented nature between EU law and investment law, and not *vice versa*.

*Professor Van Gend en Loos*. Given the objectives of EU law as explained so far, the relationship between EU law and investment law should not be understood in terms of conflict. Both regimes share the aim of guaranteeing investment protections, the only difference is in the leeway given to regulatory powers of the State under each regime. In any case, any limitations on economic freedoms within the EU, which might infringe investors’ rights, must be proportionate and justified by reason of public policy.<sup>127</sup> In *Achmea*, the CJEU conclusively resolved the inconsistency between EU law and international investment law with respect to jurisdictional issues. The CJEU did not find necessary to tackle any potential substantive issues and it did not discuss whether ISDS

considered EU law as part of domestic law in ICSID, award of 13 November 2000, case no. ARB/97/17, *Emilio Agustín Maffezini v. The Kingdom of Spain*, para. 69.

<sup>120</sup> *Achmea B.V. v. The Slovak Republic*, cit., para. 282.

<sup>121</sup> *Ibid.*

<sup>122</sup> P. STRIK, *Shaping the Single European Market in the Field of Foreign Direct Investment*, Cambridge: Cambridge University Press, 2014, p. 259.

<sup>123</sup> *Achmea B.V. v. The Slovak Republic*, cit., para. 283; *Electrabel v. Hungary*, cit., para. 4.122.

<sup>124</sup> ICSID, final award of 11 December 2013, case no. ARB/05/20, *Micula and Others v. Romania (2013 Micula v. Romania)*, para. 328.

<sup>125</sup> Art. 31, para. 3, let. c), VCLT. See, for example, *Electrabel v. Hungary*, cit., para. 4.130; *RREEF v. Spain*, cit., para. 76; *2013 Micula v. Romania*, cit., paras 326-327.

<sup>126</sup> *Electrabel v. Hungary*, cit., para. 4.146; *Charanne and Construction Investments v. Spain*, cit., para. 438; *RREEF v. Spain*, cit., para. 79; *Eiser v. Spain*, cit., para. 199; *Novenergia v. Spain*, cit., paras 438-442.

<sup>127</sup> S. DE VRIES, *Tensions Within the Internal Market*, Groningen: Europa Law Publishing, 2006, pp. 49-96.

clause leads to substantive inconsistencies, such as discrimination under Art. 18 TFEU. Furthermore, ISDS outside the intra-EU context has not been questioned by the CJEU.

*Ms Icsid*. However, it cannot be ignored that a number of intra-EU arbitrations do not concern issues of EU law at all but policy areas in which Member States enjoy, if not exclusive competence then a wide discretion in policy making. For example, in *Vattenfall II*, the Swedish energy company Vattenfall challenged under the ECT the German decision to phase out nuclear energy in reaction to the 2011 Fukushima nuclear incident. Germany fully exercised its policy discretion in deciding to close the nuclear plants since nothing in EU law obliged it to do so. And since such decision falls squarely within the domestic powers of Germany, the investor has no guarantees under EU law.

Furthermore, following *Achmea*, international investment tribunals would not have jurisdiction for such intra-EU arbitration although intra-EU jurisdiction has not even been raised in this case prior to the *Achmea* judgment. Therefore, Art. 344 TFEU should be understood to apply only to intra-EU investment disputes which might in their *merits* stage involve a conflict between EU law and international investment law with respect to substantive issues. This could indeed lead to a possibility of an investment tribunal interpreting EU law. However, Art. 344 TFEU should not be applicable to preclude the *jurisdiction* of investment tribunals in *all* intra-EU cases, and in particular not in those cases which do not involve the possibility of divergent interpretation of investors' substantive protections under EU law.<sup>128</sup>

*Professor Van Gend en Loos*. EU law is the relevant law for the interpretation of the international investment agreement involving two EU Member States as a matter of international law. By virtue of Art. 31, para. 3, let. c), VCLT, any investment tribunal would need to apply the *Achmea* judgment as a "relevant rule of international law applicable in the relations between the parties" when interpreting all clauses of an intra-EU BIT, including its ISDS clause. As a matter of fact, determining the jurisdiction of investment tribunals is the first step in any investment arbitration and, naturally, this step precedes the merits stage of the dispute. The tribunal would thus find that EU law applies directly to its jurisdiction in accordance with the BIT at issue, thereby declaring the ISDS clause inapplicable. In the same manner, when interpreting the ISDS clause in Art. 26 ECT in a dispute involving an investor from one Member State against another Member State, the investment tribunal should take into account the *Achmea* judgment and accordingly decline its jurisdiction. *Achmea* applies as a relevant rule of international law to all intra-EU situations, regardless of whether they involve any other substantive issues of EU law relevant for the merits of the claim. In the absence of investment tribunals' jurisdiction, these issues become irrelevant. In all intra-EU investment cases, even those that fall squarely within domestic powers of a Member State, investors' rights are guaranteed under EU law since Member

<sup>128</sup> *Antin v. Spain*, cit., para. 228 (emphasis added).

States' domestic legal orders in all cases must comply with fundamental principles and rights guaranteed in the founding Treaties and the EU Charter.

*Ms Icsid*: Such an approach is jeopardising the consistency of international investment law and contradicts the principle of relative effect of treaties enshrined in Art. 30 VCLT. It is particularly problematic in the multilateral context of the ECT. On the one hand, the ECT ISDS clause should not be applicable in intra-EU disputes. On the other hand, the same clause should continue to apply between third non-EU States and in extra-EU context between EU Member States and third States. If tribunals take *Achmea* as the relevant rule of international law applicable in intra-EU relations for the interpretation of the ECT, and do not apply the same rule in extra-EU relations, this would result in the fragmentation of the ECT.<sup>129</sup> Consequently, we would end up with a dual regime under the same agreement, one favouring respondent States in the intra-EU context, the other favouring investors litigating against host States in the extra-EU and non-EU context. This would indeed undermine the multilateralism to which the EU so much aspires.<sup>130</sup>

*Professor Van Gend en Loos*: It is undisputable that international investment law is one of the most fragmented areas of international law, much worse than environmental law or fundamental rights law, to say the least. The profusion of investment agreements with 2,361 different treaties currently in force, is indeed astonishing.<sup>131</sup> The mere fact that the ECT provides for a specific regime, albeit a multilateral one, compounds the fragmentation of international law. Different *ad hoc* investment tribunals adjudicate investment claims according to the provisions of the specific investment treaty establishing these tribunals, whether a BIT or the ECT. Furthermore, there is no central authority harmonising their jurisprudence. Specific differences between treaties are often used as a justification for departing from earlier practice. Even appreciations of the *Achmea* judgment differ between different tribunals guided by the same procedural rules.<sup>132</sup> On the other hand, and unlike investment law which reckons to a great extent upon a bilateral approach, the EU favours a multilateral approach and a *jus commune* that applies to its 28 Member States. The CJEU is the sole court to rule on all EU legal matters and it is doing its very best to streamline its case-law for the sake of consistency. The case-law on the freedom of establishment is a case in point. All guiding principles have been set-

<sup>129</sup> *Vattenfall II*, cit., para. 158.

<sup>130</sup> In that sense, the principle of autonomy could lead to further fragmentation and a disconnection between EU law and international law, as claimed by C. HILLION, R.A. WESSEL, *The European Union and International Dispute Settlement: Mapping Principles and Conditions*, in M. CREMONA, A. THIES, R.A. WESSEL (eds), *The European Union and International Dispute Settlement*, cit., p. 21.

<sup>131</sup> UNCTAD, *Investment Policy Hub*, cit.

<sup>132</sup> Compare for example, ICSID, award of 25 July 2018, case no. ARB/12/39, *Georg Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia*, paras 75-81; and *Vattenfall II*, cit., para. 46.

tled in the Seventies.<sup>133</sup> Domestic courts feel comfortable in adjudicating disputes in light of the CJEU's settled case-law.

*Ms Icsid*: However, if the EU founding Treaties have created a "municipal legal order of trans-national dimensions",<sup>134</sup> whereby the founding Treaties are its "basic constitutional charter",<sup>135</sup> any Member States' duties under EU law should rather be understood as domestic law obligations, which cannot serve as justification for the Member States' failure to perform an international treaty obligation.<sup>136</sup> After all, *pacta sunt servanda*!<sup>137</sup>

In addition, in the context of the ECT, the EU and its Member States did not include an explicit disconnection clause, which would have ensured that EU law governs relations between Member States *inter se* to the extent that a subject matter is covered by EU law, while the ECT governs the obligations between EU Member States and non-EU ECT parties.<sup>138</sup> Such clause would have ensured that Member States' obligations under the ECT do not hamper the implementation of EU law, while preserving legal certainty towards third parties. As the tribunal in *Eiser* well noted, the "ECT's ordinary meaning" cannot be disregarded "in order to exclude a potentially significant body of claims".<sup>139</sup> After all, "[i]t is a fundamental rule of international law that treaties are to be interpreted in good faith. As a corollary, treaty makers should be understood to carry out their function in good faith, and not to lay traps for the unwary with hidden meanings and sweeping implied exclusions".<sup>140</sup>

#### IV.1. THE PECULIAR CASE OF THE ECT AGAIN: FRAGMENTATION OR INTEGRATION?

*Professor Van Gend en Loos*: In the context of the ECT, the character of the EU as a regional economic integration organisation (REIO) cannot be ignored, including the fact that energy integration in the EU single market has been *work in progress* since the beginning of the ECT, ultimately serving the interests of investors.<sup>141</sup> A disconnection clause can be implied in the text of the ECT in the context of these developments. In particular, an investment by an investor from one EU Member State in the area of an-

<sup>133</sup> C. BARNARD, *The Substantive Law of the EU*, Oxford: Oxford University Press, 2010, p. 295.

<sup>134</sup> See opinion of AG Poiares Maduro, *Kadi*, cit., para. 21.

<sup>135</sup> Court of Justice, judgment of 23 April 1986, case 294/83, *Les Verts*, para. 23.

<sup>136</sup> Art. 27 VCLT.

<sup>137</sup> See the comment of the tribunal in *RREEF v. Spain*, cit., para. 85.

<sup>138</sup> See International Law Commission, *Fragmentation of International Law*, cit., paras 289-294.

<sup>139</sup> *Eiser v. Spain*, cit., para. 186. According to UNCTAD database, of 119 ECT cases, 76 are intra-EU investment disputes: UNCTAD, *Investment Policy Hub*, cit.

<sup>140</sup> *Eiser v. Spain*, cit., para. 186.

<sup>141</sup> While at the time of the conclusion of the ECT the common EU energy market was not yet established, in the meantime, the EU internal energy market has been profoundly transformed, with a number of secondary regulatory measures being adopted: see L. HANCHER, P. LAROUCHE, *The Coming of Age of EU Regulation of Network Industries and Services of General Economic Interest*, in P. CRAIG, G. DE BÚRCA (eds), *The Evolution of EU Law*, Oxford: Oxford University Press, 2011, pp. 752-756.

other EU Member State is made within the “area” of the EU as a REIO, which is the area belonging to the same contracting party even when it involves two different EU Member States.<sup>142</sup> Consequently, the EU’s offer to arbitrate in the Art. 26 ECT is only made to investors from non-EU Member States, thus eliminating the EU Member States’ individual standing as respondents under the ECT.<sup>143</sup> From the very beginning, the EU was clear that the ultimate power to issue rulings on EU law in intra-EU ISDS procedures under the ECT should remain with the CJEU.<sup>144</sup>

*Ms Icsid*: Legal certainty requires that any relevant rule of international law, that is to be taken into account for interpretation, must be clear.<sup>145</sup> If it was intended that the offer to arbitrate in Art. 26 ECT was only made to investors from non-EU Member States, it would have been necessary to include such an arrangement in an explicit language in the ECT.<sup>146</sup> After all, the ECT is “the constitution” of the ECT tribunals and they therefore, must ensure “the full application” of that agreement.<sup>147</sup> Their jurisdiction is derived from the *express* terms of the ECT. Investment tribunals are not institutions of the EU legal order, as the CJEU confirmed in its *Achmea* judgment. Therefore, they are not subject to the requirements of that legal order.<sup>148</sup> The EU has only indicated in its Statement to the ECT Secretariat that the CJEU is “competent to examine” any question relating to the application and interpretation of international agreements concluded by the EU (e.g. the ECT).<sup>149</sup> This does not include the *exclusive* jurisdiction of the CJEU to interpret the ECT.<sup>150</sup>

*Professor Van Gend en Loos*: The ECT, as an international agreement to which the EU is a party, is part of the EU legal order. In this sense, the CJEU has an exclusive competence to interpret the ECT as a matter of EU law, either when examining the compliance of an EU act with EU law or on the basis of a request for a preliminary ruling under Art. 267 TFEU. This was the reason why the consent to the submission of a dispute to international arbi-

<sup>142</sup> In this regard, see the definition of a “Contracting Party” in Art. 1, para. 2, ECT, the definition of a “REIO” in Art. 1, para. 3, ECT, and the definition of “Area” with respect to a REIO in Art. 1, para. 10, ECT.

<sup>143</sup> See *Vattenfall II*, cit., para. 179, citing Commission’s submission to the tribunal. See also Spain’s arguments, for example in *Charanne and Construction Investments v. Spain*, cit., paras 214-219; *Eiser v. Spain*, cit., para. 161 *et seq.*; *Novenergia v. Spain*, cit., para. 404 *et seq.*; *Antin v. Spain*, cit., para. 161 *et seq.*

<sup>144</sup> To this effect, see Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Art. 26(3)(b)(ii) of the ECT, para. 4.

<sup>145</sup> *Vattenfall II*, cit., para. 164.

<sup>146</sup> *Ibid.*, paras 182, 188 and 202; *Eiser v. Spain*, cit., paras 194-195; *Charanne and Construction Investments v. Spain*, cit., para. 430; *Novenergia v. Spain*, cit., para. 453.

<sup>147</sup> *RREEF v. Spain*, cit., paras 74-75.

<sup>148</sup> *Eiser v. Spain*, cit., para. 199.

<sup>149</sup> *Vattenfall II*, cit., para. 190, citing Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Art. 26(3)(b)(ii) of the ECT (1998), para. 4.

<sup>150</sup> *Vattenfall II*, cit., para. 190 (emphasis added).

tration in cases of disputes involving the “application of the forms of action provided by the constituent Treaties of the Communities” was not given unconditionally.<sup>151</sup>

*Ms Icsid*: If it was intended that intra-EU arbitration would not be available to investors, such an intention should have been made explicit through a disconnection clause in the ECT or through the adoption of a supplementary instrument.<sup>152</sup> Moreover, as correctly noted by the *Vattenfall II* tribunal, the *travaux préparatoires* of the ECT reveal that during the negotiation of the ECT, the EU had proposed the insertion of a disconnection clause, which was however ultimately dropped from the draft treaty. In light of that, the tribunal “could only conclude that a disconnection clause was intentionally omitted from the ECT”.<sup>153</sup> The absence of such a clause can indeed indicate that the ECT was *intended* to create obligations between Member States of the EU, including in respect of ISDS,<sup>154</sup> and not *vice versa*. Equally, investment tribunals cannot extrapolate from *Achmea* a new rule of international law, which would render an ISDS clause in the ECT intra-EU relations inapplicable if this is not clearly stated in that judgment.<sup>155</sup> And in any case, as already explained, Art. 16 ECT prohibits the terms of another agreement to be construed as to derogate from the investor’s right to ISDS under the ECT.<sup>156</sup>

In light of all these circumstances, the only way for the EU and its Member States to resolve this uncertainty is to amend the ECT with the effect of excluding arbitration in intra-EU disputes and replacing it by EU law and its dispute settlement.<sup>157</sup> To the best of my knowledge, there have been no such attempts on the EU side so far.

<sup>151</sup> Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Art. 26(3)(b)(ii) of the ECT (1998), para. 5.

<sup>152</sup> *Vattenfall II*, cit., para. 202. For example, potential conflicts between the ECT and the Svalbard Treaty have been explicitly excluded from the operation of Art. 16 ECT: see Final Act of the European Energy Charter Conference, Annex 2.

<sup>153</sup> *Vattenfall II*, cit., para. 206.

<sup>154</sup> *Ibid.*, paras 205-206.

<sup>155</sup> *Ibid.*, paras 164-167.

<sup>156</sup> See discussion *supra*, section II.3.

<sup>157</sup> A disconnection clause would have limited effect if extra-EU ISDS disputes are also not properly addressed: see *RREEF v. Spain*, cit., paras 51-52; A. DELGADO CASTELEIRO, *Disconnecting from the Energy Charter Treaty: Disconnection Clauses and Normative Conflicts Between European Union Law and the Energy Charter*, in A. DIMOPOULOS (ed.), *The EU and Investment Arbitration Under the Energy Charter Treaty*, Cambridge: Cambridge University Press, forthcoming, pp. 18-22. An amendment to the ECT would require the consent of the 3/4 of the Contracting Parties under Art. 42 ECT. As the EU and its Member States constitute only a half of all Contracting Parties, they would need to reach a political agreement with other non-EU Contracting Parties, which might be difficult if the asymmetrical effects of the autonomy of EU law on protection of their investors in issues concerning EU law are also not addressed (see *infra*, section IV.2). A reservation in the context of Art. 46 ECT, which precludes reservations running contrary to the intent of the Contracting Parties to have the ECT unconditionally and integrally applied by all Parties, would also be problematic.

*Professor Van Gend en Loos*. Undoubtedly, in its intra-EU aspect, ISDS provision of the ECT must be brought in line with EU law, excluding intra-EU arbitration. Given that the ECT is part of the EU legal order, it should be brought to conformity with primary law also for the purpose of legal certainty. In the meantime, it is likely that the CJEU will soon have an opportunity to rule on the compatibility of the intra-EU disputes under the ECT with EU law, which should then conclusively resolve the controversy of *Achmea's* applicability in the ECT context.<sup>158</sup> And it is more than likely that such judgment will be in line with the CJEU's reasoning in *Achmea* rendering intra-EU arbitration under the ECT inapplicable. With respect to the future of the ECT, it is likely that *Achmea* does not mark the end of the ECT for the EU and its Member States, despite Italy's withdrawal, but an end of its hybrid intra and extra-EU character and thus a continuation of the EU's new ECT chapter which focuses on a broader global strategy.<sup>159</sup>

#### IV.2. WHY IS INTRA-EU CONTEXT DIFFERENT TO EXTRA-EU?

*Ms Icsid*. The Commission has interpreted *Achmea* as applying to intra-EU context only.<sup>160</sup> However, although *Achmea* concerned an investment treaty concluded between two Member States, the implications of this judgment could reach far beyond internal EU agreements. Many commentators believe that, in light of *Achmea*, the issue of extra-EU BITs remains unclear.<sup>161</sup> Reasoning by analogy, EU law forms part of the Member States' domestic legal order and potential conflicts with EU law cannot be avoided. Given the level of abstraction applied by the CJEU, whereby the Court assessed as a threat to the autonomy of EU law all intra-EU disputes, even when they do not deal with issues of EU law, it is difficult to see how investment arbitration under extra-EU BITs would not give rise to the same abstract concerns regarding the interpretation of EU law. In fact, the ISDS mechanism in BITs concluded between Member States and third countries could also violate Arts 267 and 344 TFEU where the arbitral jurisdiction concerns either the application or the interpretation of EU law. If under an extra-EU BIT or the ECT, an investor from a non-EU State challenges a measure which a Member State adopted to comply with its EU obligations, in such a case the investment tribunal established under that treaty could also interpret EU law, challenging its autonomy. Would the CJEU then also rule that in all such cases the jurisdiction of investment tribunals should be exclud-

<sup>158</sup> Arbitral Tribunal of Stockholm Chamber of Commerce, decision of the Svea Court of Appeals suspending the enforcement of the award until further notice of 16 May 2018, *Novenergia v. Spain*, cit.

<sup>159</sup> See European Parliamentary Research Service, *Energy Charter: A Multilateral Process for Managing Commercial Energy Relations*, July 2017, [www.europarl.europa.eu](http://www.europarl.europa.eu).

<sup>160</sup> Communication COM(2018) 547, pp. 3-4.

<sup>161</sup> See, for example, S. GÁSPÁR-SZILÁGYI, *It Is not Just About Investor-State Arbitration: A Look at Case C-284/16, Achmea BV*, in *European Papers*, 2018, Vol. 3, No 1, [europeanpapers.eu](http://europeanpapers.eu), p. 357 *et seq.*; L. ANKERSMIT, *Achmea: The Beginning of the End for ISDS in and with Europe*, in *Investment Treaty News*, 24 April 2018, [www.iisd.org](http://www.iisd.org).

ed? In particular, what if such a BIT expressly stated that the tribunal should, *inter alia*, decide the case on the basis of domestic law?

*Professor Van Gend en Loos*. Indeed, if one reads *Achmea* broadly, potentially any dispute settlement mechanism outside the EU judicial system might involve the interpretation or application of EU law.<sup>162</sup> However, *Achmea* could be also read as applying only to those cases which not only violate Arts 267 and 344 TFEU but also undermine the principles of mutual trust and sincere cooperation, enshrined in Art. 19, para. 1, and Art. 4, para. 3, TEU respectively. Indeed, these principles could be understood as the core elements of the *Achmea* judgment,<sup>163</sup> which play an important role in the intra-EU context but are not relevant for extra-EU relations.

The principle of mutual trust between Member States mandates that Member States “provide remedies sufficient to ensure effective legal protection in the fields covered by Union law” and by doing so recognise in their domestic legal systems “common values on which the EU is founded, as stated in Art. 2 TEU” and thus ensure that the law of the EU that implements these common values will be respected in their territories.<sup>164</sup> Although this principle plays an important role in the Area of Freedom, Security and Justice, its contribution expands beyond that, to the extent that it has become a structural principle of EU law.<sup>165</sup> In relation to mutual trust, the principle of sincere cooperation requires the Member States to “assist each other” in fulfilling their obligations under EU law in “full mutual respect”. In particular, they are called on to take “any appropriate measures” to ensure the correct implementation of EU law or to refrain from “any measure which could jeopardise the attainment of the Union’s objectives”.<sup>166</sup>

Intra-EU arbitration, which fragments the internal market, must be understood in this context. In other words, it is logical that *inter se* international agreements of EU Member States are subject to the requirements of primacy and effectiveness in the same manner as domestic laws.<sup>167</sup> EU Member States could not be permitted to diverge from internal market rules by an international treaty any more than they could by domestic legislation.

*Ms Icsid*. Indeed, an interpretation of *Achmea* that would render ISDS illegal in all extra-EU BITs could lead to problems in the relations between the Member States and third countries. Member States still have 1138 extra-EU treaties in force.<sup>168</sup> The prohibition of

<sup>162</sup> N. DE SADELEER, *The End of the Game*, cit., p. 367.

<sup>163</sup> See opinion of AG Bot delivered on 29 January 2019, opinion 1/17, paras 105 and 112.

<sup>164</sup> *Achmea* [GC], cit., para. 34.

<sup>165</sup> S. PRECHAL, *Mutual Trust Before the Court of Justice of the European Union*, in *European Papers*, 2017, Vol. 2, No 1, europeanpapers.eu, p. 75 *et seq.*

<sup>166</sup> Art. 4, para. 3, TEU.

<sup>167</sup> E.g. Court of Justice, judgment of 27 September 1988, case C-235/87, *Matteucci*, paras 19-22.

<sup>168</sup> UNCTAD, *Investment Policy Hub*, cit.

ISDS clauses in these extra-EU BITs could compound asymmetry with third countries. In other words, EU investors could be protected in third countries, but third country investors would not receive similar protection in the EU in any case involving an EU measure that is being implemented in national law. By way of illustration, a Belgian investor in China could initiate proceedings against the host State before an ISDS, given that EU law is inapplicable. However, a Chinese investor in Belgium would be unable to avail itself of the same right on the grounds that the tribunal could interpret and apply EU law.<sup>169</sup>

*Professor Van Gend en Loos.* ISDS provision of the ECT as well as similar provisions in extra-EU BITs can remain applicable under Art. 351 TFEU as long as they do not conflict with EU law, with the exclusion of cases which concern EU measures or national measures implementing EU law. An investment tribunal could always argue that ISDS cannot be excluded on the ground that the case does not concern either the application or the interpretation of EU law as the subject-matter has not been harmonised. Considering the sheer breath of EU harmonisation in the energy, transport, industrial, agricultural, trade in goods and in services and financial services sectors, this would be a mere theoretical hypothesis. However, the situation with these external agreements is perhaps less critical as their ability to undermine the principles of mutual trust and sincere cooperation, and thus the autonomy of the EU legal order, is less imminent.

Finally, considering the changes that have been made to Art. 207 TFEU, these extra-EU BITs will eventually disappear as the EU concludes new investment treaties with third countries.<sup>170</sup> Currently, the EU is negotiating investment agreements with India, Indonesia, Japan, Malaysia, Mexico, China and Myanmar. Indeed, once concluded, these bilateral treaties will prevail over the former extra-EU BITs.

## V. WHY AUTONOMY MATTERS?

*Ms Icsid.* Whether we talk about international agreements in general, or investment agreements in particular – bilateral, multilateral, intra-EU, extra-EU, those to which the EU is a party or Member States are parties – we always return to the issue of autonomy of EU law. Autonomy seems to be a *leitmotif* of the EU's relationship with international investment law. But why should autonomy of EU law matter to anyone but the EU itself?

*Professor Van Gend en Loos.* Autonomy matters for several reasons and its importance is not limited exclusively to the EU. Autonomy is important in defining the relationship between EU law and international law. In the context of international investment law, it is not only relevant for the normative relationship between international law and EU

<sup>169</sup> Belgium – China BIT of 6 June 2005. See N. DE SADELEER, *The End of the Game*, cit., p. 368.

<sup>170</sup> Preamble, n. 5, of the Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries.

law but also for defining the relationship between the CJEU and other international courts. Secondly, autonomy matters for the Member States as it ensures the attainment of the Union's objectives, which ultimately serve the interests of Member States and all their subjects. Finally, autonomy of EU law matters for investors too, for practical reasons of enforcement of investment awards.

#### V.1 IT MATTERS FOR EU RELATIONSHIP WITH INTERNATIONAL COURTS

*Ms Icsid*: Potentially any dispute settlement mechanism placed outside the EU judicial system could involve the interpretation or application of EU law. In light of the CJEU's concerns for the autonomy of EU law, as expressed in *Achmea*, could the proposed Investor Court System (ICS) in Comprehensive Economic and Trade Agreement (CETA) and, similarly, a future multilateral investment court, in the same manner as ISDS, be problematic for the autonomy of the EU legal order?

*Professor Van Gend en Loos*: The conclusion of several agreements setting up adjudicating bodies sitting outside the institutional and judicial framework of the EU, with jurisdiction in respect of EU law (e.g. EU patents) raised the issue of preserving the autonomy of the EU legal order and court system. The CJEU's case-law offers guidelines with respect to the compatibility of a new court with EU law. Importantly, the Court has declared that an international agreement may affect its own powers provided that the indispensable conditions for safeguarding the essential character of those powers are satisfied and, consequently, there is no adverse effect on the autonomy of the EU legal order.<sup>171</sup> These agreements were designed, in essence, to resolve disputes on the interpretation or application of the actual provisions of the international agreements concerned.

In accepting the compatibility of external courts with the EU legal order, the CJEU endorses a three-pronged approach. In so doing, the Court strikes a balance between "the international derivation and the specificity of EU law".<sup>172</sup>

Firstly, the external court can interpret and apply exclusively the provisions of the agreement at issue. It follows that the autonomy of the EU would be compromised when the international court which has jurisdiction in relation to the interpretation and application of the agreement, may be called upon to interpret EU law.<sup>173</sup>

Secondly, as a result of the first premise, the external court should not be conferred the competence to interpret authoritatively one way or another EU law. For instance, the autonomy will be affected when the envisioned court is likely to deprive the domes-

<sup>171</sup> Court of Justice: opinion 1/00 of 18 April 2002, *Agreement on the Creation of European Common Aviation Area*, paras 21, 23 and 26; opinion 1/91, cit., para. 30; opinion 2/13, cit., para. 183.

<sup>172</sup> K. LENAERTS, *Droit international et monisme de l'ordre juridique de l'Union*, in *Revue de la Faculté de droit de l'Université de Liège*, 2010, p. 506.

<sup>173</sup> Opinion 1/00, cit., para. 2.

tic courts of the power to request preliminary rulings from the CJEU in the field covered by the agreement.<sup>174</sup>

Thirdly, the agreement cannot affect the jurisdiction of the CJEU to adjudicate disputes between Member States in accordance with Art. 344 TFEU.

In case one of these conditions is not fulfilled, the EU cannot conclude an agreement allowing the EU to be a party to an external court, even though the founding Treaties allow, or even oblige, as in the case of the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), the conclusion of such an agreement.<sup>175</sup> Against this background, the CJEU held that several draft agreements were liable to upset the underlying balance of the EU and undermine the autonomy of EU law.<sup>176</sup> Of course, one could criticize the Court for adopting “an absolute and maximalist vision of the impenetrability of EU and international law”.<sup>177</sup>

However, “[i]t is for the Court to ensure respect for the autonomy of the EU legal order thus created by the Treaties”<sup>178</sup> and the CJEU will ultimately assess the compatibility of the new investment dispute settlement mechanism in light of all these criteria.<sup>179</sup>

## V.2. IT MATTERS FOR EU INTEGRATION

*Ms Icsid*: The CJEU has played a pivotal role in carving out the autonomy of EU. In asserting that EU law is autonomous from international law, the CJEU insulates this legal order from international law. However, all this is causing great difficulties for EU Member States. The EU requires from its Member States to dishonour their international law obligations in order to comply with their EU legal obligations. Needless to say, the *Kadi and Al Barakaat* judgment<sup>180</sup> highlights the extent to which EU law trumps international law. The CJEU’s vision of human rights standards with respect to restrictive measures imposed upon terrorists prevails over the obligations placed on the 28 Member States under UN law. However, there is no customary international law rule that favours EU integration over international law.

*Professor Van Gend en Loos*: That said, I could also claim that other legal orders trump EU law. For instance, Belgium was condemned by the European Court of Human Rights for breaching Art. 3 ECHR on the grounds that asylum seekers were sent back to Greece

<sup>174</sup> *Ibid.*, para. 79; opinion 1/09, cit., para. 77.

<sup>175</sup> Opinion 2/13, cit., para. 182.

<sup>176</sup> *Ibid.*, para. 194.

<sup>177</sup> N. JÄÄSKINEN, A. SIKORA, *The Exclusive Jurisdiction of the Court of Justice of the EU and the Unity of the EU Legal Order*, in M. CREMONA, A. THIES, R.A. WESSEL (eds), *The European Union and International Dispute Settlement*, cit., p. 106.

<sup>178</sup> Opinion 1/00, cit., para. 67.

<sup>179</sup> Opinion of AG Bot, opinion 1/17, cit., paras 115 *et seq.*

<sup>180</sup> In *Kadi*, the CJEU held that that “an international agreement cannot affect the allocation of powers fixed by the Treaties or, consequently, the autonomy of the Community legal system”: *Kadi*, cit., para. 282.

whilst that country did not correctly implement the Dublin II Regulation.<sup>181</sup> In so doing, the European Court of Human Rights indirectly reviewed the legality of an EU act in light of the ECHR.

Undoubtedly, the *sui generis* nature of EU legal order upsets international lawyers, including international investment arbitrators. However, without tools that defend the autonomy of the EU legal order, the EU project would be seriously hampered. The EU in 21<sup>st</sup> century touches upon a wide number of issues of international importance, whereby EU rules overlap with international standards. The main objective of the autonomy of EU law is not to depart from international standards (and indeed in many cases, EU standards are more comprehensive than international ones), but to ensure that these standards do not impede the implementation of EU law and thus ultimately hinder the EU integration. The attainment of the EU objectives requires that the rules of EU law are “fully applicable at the same time and with identical effects over the whole territory of the Community without the Member States being able to place any obstacles in the way”.<sup>182</sup> Intra-EU arbitration could clearly be considered such an obstacle. As clarified by AG Bot, “by means of a bilateral investment agreement, two Member States had agreed to *remove* EU law from the jurisdiction of their own courts, and therefore from the judicial dialogue between those courts and tribunals and the [CJEU], which was capable of having an adverse effect on the *uniformity* and effectiveness of EU law”.<sup>183</sup> Differentiation between the Member States due to international law mechanisms may indeed be a factor in the disintegration of the EU.<sup>184</sup> After all, it’s all about EU integration!

*Ms Icsid*: I still do not see how the achievement of such an abstract goal should in any way matter to foreign investors in the EU. Investors are interested in obtaining full protection of their rights, and not in achieving the political goals of the EU integration.

### V.3. IT MATTERS FOR PRACTICAL REASONS OF ENFORCEMENT

*Professor Van Gend en Loos*: The autonomy of EU law should greatly matter to investors. The consequences could be serious given that the domestic courts in the EU will not be able to enforce the awards. Indeed, in case of a conflict between EU law and the BIT, the ECT or the ICSID Convention, the national courts are called on to disapply the latter. Accordingly, investment tribunals should act responsibly towards investors and decline jurisdiction for intra-EU disputes knowing that their awards cannot be enforced in the EU.

<sup>181</sup> European Court of Human Rights, judgment of 21 January 2011, no. 30696/09, *Nous*.

<sup>182</sup> Court of Justice, judgment of 13 July 1972, case C-48/71, *European Commission v. Italy*, para. 8.

<sup>183</sup> Opinion of AG Bot, opinion 1/17, cit., para. 105 (emphasis added).

<sup>184</sup> B. DE WITTE, *Variable Geometry and Differentiation as Structural Features of the EU Legal Order*, in B. DE WITTE, A. OTT, E. VOS (eds), *Between Flexibility and Disintegration. The Trajectory of Differentiation in EU Law*, Cheltenham: Edward Elgar Publishing, 2017, p. 26.

*Ms Icsid*: Investment tribunals are “mindful of the duty to render an enforceable decision and ultimately an enforceable award” but they are “equally conscious” of their duty to perform their mandate granted under the particular investment agreement.<sup>185</sup> Investment tribunals’ jurisdiction concerns the breaches of that particular treaty and the responsibility of States towards investors under international law. They are “not concerned” with breaches of EU law stemming from Member States’ participation in intra-EU arbitrations.<sup>186</sup> Surely, ICSID awards, which are not subject to domestic judicial review can be enforced, even in the EU.<sup>187</sup> In any case, if not in the EU, all awards can be enforced outside the EU.

*Professor Van Gend en Loos*: All awards can still be challenged in the execution phase, even ICSID awards. While the ICSID Convention indeed states that any award of an ICSID tribunal shall be binding and will not be subject to any domestic remedy, the Convention also provides that the execution of any such award “shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought”.<sup>188</sup> It should not be forgotten that the EU is not a party to the ICSID Convention, although almost all of its Member States are. Therefore, the ICSID Convention is not part of the EU legal order and does not prevail over EU law in domestic legal orders of the Member States. Accordingly, the Member State national court is obliged to refuse the execution of an intra-EU ICSID award, regardless of the Member State’s membership to the ICSID Convention. Such awards could therefore only be enforced in non-EU States, subject to the availability of respondent EU Member State’s assets that could be seized in the third State in which the enforcement has been sought. In addition, payment of compensation in certain cases could also amount to an illegal State aid.<sup>189</sup> Therefore, the autonomy of EU law matters for intra-EU investors more than their investment lawyers wish to admit.

## VI. CONCLUSIONS

*Ms Icsid*: Based on our discussion, we could agree that international investment law and EU law share similar grounds in international law but address the protection of foreign investors “from different perspectives”.<sup>190</sup> The main philosophy of international investment law is unconditionally focused on protection of foreign investors. On the other hand, the highest value of the EU legal order is the integration of its internal market, to which all other goals must conform. With this in view, it therefore does not surprise that

<sup>185</sup> *Vattenfall II*, cit., para. 230.

<sup>186</sup> *Ibid.*, para. 231.

<sup>187</sup> Art. 53 ICSID Convention.

<sup>188</sup> See Art. 54, para. 3, ICSID Convention.

<sup>189</sup> See *supra*, footnote 43.

<sup>190</sup> *Electrabel v. Hungary*, cit., para. 4.177.

the legal reasoning and the methods of interpretation of the CJEU and investment tribunals differ to a significant degree.

The CJEU interprets international law with an aim to ensure “systemic coherence” between primary sources of EU law, which form part of international law, and other sources of international law, in this case international investment agreements. The argument of coherence ultimately serves to achieve stronger integration within the EU.

On the contrary, investment tribunals, while recognising that EU law is international law, have reduced its relevance as international law by refusing to recognise it as a relevant law in the interpretation of investment agreements. Consequently, intra-EU distinction in their view cannot be allowed, as it would lead to the fragmentation, at least in the ECT context.<sup>191</sup>

Ultimately, our discussion reveals the clash between the CJEU’s broader teleological and systemic approach in legal reasoning and arbitral tribunals’ narrower literal and textual focus in the interpretation of investment agreements, which leaves them frozen in time in which they were adopted. It seems to me that this conflict can only be resolved if the EU and its Member States amend the investment agreements to exclude intra-EU arbitration in all cases. Ultimately, this will ensure greater legal certainty for all investors in the EU.

*Professor Van Gend en Loos:* However, the solution to intra-EU *clash* of the EU legal order and international investment law should come soon, or we would at least hope, rather soon. On 15 January 2019, the majority of the Member States adopted a declaration by which they “inform the investor community that no new intra-EU investment arbitration proceeding should be initiated”.<sup>192</sup> While this is a non-legally binding declaration, it does send a political message to investors since States, as parties to intra-EU investment agreements, declare not to be bound by their mutually expressed obligations. Member States also announced that they would terminate their BITs by a plurilateral treaty, or where more expedient, bilaterally, no later than 6 December 2019.<sup>193</sup> Such treaty should also address the issue of the sunset clauses. It can be expected that a solution for the intra-EU application of the ECT will be a more complex task.<sup>194</sup> The fact that some Member States have not signed this declaration politically complicates the matter further.<sup>195</sup> Nev-

<sup>191</sup> *Vattenfall II*, cit., para. 158.

<sup>192</sup> Declaration of the Representatives of the Governments of the Member States of 15 January 2019 on the legal consequences of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union, para. 3.

<sup>193</sup> *Ibid.*, paras 5 and 8.

<sup>194</sup> To that effect, see *ibid.*, para. 9.

<sup>195</sup> Sweden, Luxembourg, Malta, Hungary, Finland and Slovenia have not signed the declaration. While these Member States agree on the issue of intra-EU BITs, they disagree on the issue of the applicability of the *Achmea* judgment to intra-EU arbitration under the ECT. Five Member States issued a separate declaration on 16 January ([www.regeringen.se](http://www.regeringen.se)) expressing the view that it would be “inappropriate”

ertheless, legally speaking, in light of the *Achmea* judgment, all pending intra-EU arbitrations should be terminated, regardless of the international instrument – intra-EU BITs or the ECT – under which a particular claim has been brought. *Achmea* sends a clear message that ISDS clauses in international investment agreements that contravene TFEU Arts 267 and 344 and the principles of mutual trust and sincere cooperation enshrined in TEU Art. 19, para.1, and Art. 4, para. 3, are invalid under EU law.

Given the importance of the autonomy of the EU legal order, there is nothing surprising or political about the *Achmea* judgment. Indeed, *Achmea* follows the line of the Court's reasoning on the autonomy of EU law expressed in the Court's earlier judgments, including the opinion 2/13 in which the CJEU opposed the EU's accession to the ECHR,<sup>196</sup> and opinion 1/09<sup>197</sup> in which the CJEU opposed the creation of a unified patent court in the framework of the European Patent Convention. The Court ultimately underscored that the ISDS mechanism in intra-EU BITs calls into question the principle of mutual trust between Member States and is thus incompatible with the principle of sincere cooperation, which obliges the Member States to ensure full effectiveness of EU law in their respective territories by taking appropriate measures which will ensure fulfilment of their obligations under EU law.<sup>198</sup>

*Achmea* reinforces the importance of the autonomy of EU law as a matter of sovereignty, enshrined in the ability of States to assess the compliance of the awards with public policy. In the EU context, the inability of the CJEU to control the compliance of investment awards with EU law through judicial review undermines the authority of the CJEU and, ultimately, questions the autonomy of EU law.

Finally, *Achmea* confirms the crucial role of the concept of autonomy in defining the relationship between EU law and international law. To quote AG Maduro in *Kadi*: "Relationship between international law and the Community legal order is governed by the Community itself, and international law can permeate that legal order only under the conditions set by the constitutional principles of the Community".<sup>199</sup>

*Ms Icsid*: On the one hand, the EU wishes to eliminate ISDS in intra-EU disputes in order to ensure the attainment of the Union's objectives and protect its legal order. On the other hand, the EU still does not want to completely give up on alternative investment dispute settlement, whether in the form of ISDS in the existing extra-EU BITs or a multilateral investment court in future perspective, as it wishes to afford protection of EU Member States' outward investments in non-EU States. In other words, the EU wants to have its

to make conclusions on the compatibility of EU law with the intra-EU application of the ECT before the CJEU decides on the matter. Hungary issued another declaration ([www.kormany.hu](http://www.kormany.hu)) explicitly excluding the applicability of *Achmea* to the intra-EU ECT disputes.

<sup>196</sup> Opinion 2/13, cit.

<sup>197</sup> Opinion 1/09, cit.

<sup>198</sup> *Achmea* [GC], cit., paras 34, 58.

<sup>199</sup> Opinion of AG Poiares Maduro, *Kadi*, cit., para. 24.

cake and eat it. However, the CJEU's judgment in *Achmea* undoubtedly demonstrates that in the issues of investment, EU's internal legal homogeneity has preceded Member States' political heterogeneity. More broadly, this is clearly a welcome development for a stronger EU's global outreach. However, what is the future for foreign investors in Europe?

*Professor Van Gend en Loos.* One should not be unnecessary dramatic. Investors are afforded substantive protection under both primary and secondary EU law given that the EU legal system provides for a complete system of remedies.<sup>200</sup> Accordingly, they can invoke these provisions before the courts of the host Member State. The domestic court is in principle obliged to make a reference to the CJEU where a question of the interpretation of the Treaty is raised before it.<sup>201</sup> The fact of not referring the questions could give rise to an infringement proceeding in accordance with Art. 258 TFEU<sup>202</sup> and State liability.<sup>203</sup> EU law presumes that all national courts meet the same standards of justice, be it a court in Germany, Ireland, Belgium, Poland or Croatia. The principle of mutual trust implies that there is no second-class justice in the EU and that investors can expect the same level of protection before the courts of any Member State. As a matter of course, this is a topic for another debate.

*Ms Icsid.* To quote greater international law experts than me: "The ICJ, human rights bodies, a trade regime or a regional exception may each be used for good or ignoble purposes and it should be a matter of debate and evidence and not of abstract 'consistency', as to which institutions should be preferred in a particular situation".<sup>204</sup>

Last but not least, consider, much learned Professor, our investor again. S/he finds new opportunities in another Member State. However, without the possibility to bring its claim to an investment tribunal, our investor might not invest. Without that investment, the host State will not be able to obtain revenues from that project. Without these revenues, the development will not take place in the host State. Less developed Member States will continue to struggle to reach the level of development of their more developed counterparts. As a result, it will take much longer to overcome the challenge of a multi-speed Europe. To overcome such challenge, our Member State might look for more willing third State investors, perhaps from China. Additionally, the lack of BIT protection for their intra-EU investments could prompt some investors to consider restruc-

<sup>200</sup> With respect to foreign direct investment, the fundamental freedoms of the internal market that can be directly invoked before national courts are somewhat intertwined. For instance, regarding the dividing line between the freedom of establishment and the free movement of capital, see Court of Justice, judgment of 6 March 2018, joined cases C-52/16 and C-113/16, *Segro*, para. 49.

<sup>201</sup> *Aquino*, cit., para. 42; *European Commission v. France*, cit., para. 108.

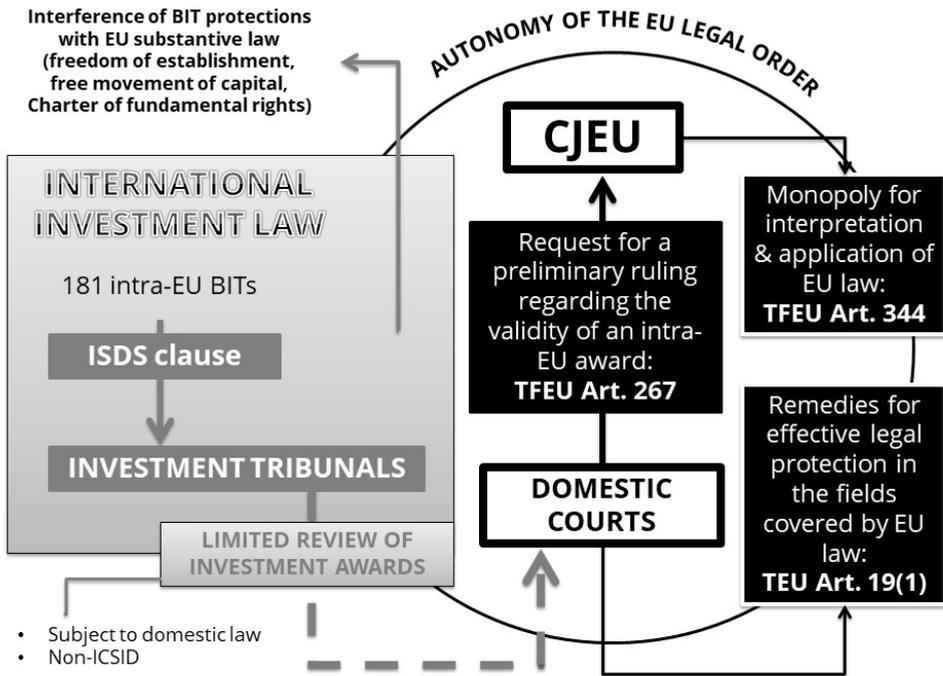
<sup>202</sup> *European Commission v. France*, cit.

<sup>203</sup> *Köbler*, cit.; *Traghetti del Mediterraneo*, cit.

<sup>204</sup> M. KOSKENNIEMI, P. LEINO, *Fragmentation of International Law? Postmodern Anxieties*, in *Leiden Journal of International Law*, 2002, p. 578.

turing their investments through a holding company outside of the EU in order to benefit from extra-EU BIT protections. Imagine what kind of impact could such possible forum shopping have on the legitimacy of investment treaty arbitration, which is at the core of ISDS criticism? Indeed, all this is a topic for another debate.

Nevertheless, having said all that, at any given time, I would rather be an investor claimant before an international investment tribunal than before a domestic court of any of the Member States!



The graph depicts the debate between the two protagonists. It displays the interference of international investment law, and in particular the intra-EU BITs, with the EU legal order. It highlights the difference between the domestic courts called on to provide the remedies for effective legal protection in the fields covered by EU law and the investment tribunals which are precluded from providing such remedies. In brief, the graph explains how and why investment tribunals sit outside the EU legal order.



## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta *and* Juan Santos Vara

## ON *ACHMEA*, THE AUTONOMY OF UNION LAW, MUTUAL TRUST AND WHAT LIES AHEAD

SONSOLES CENTENO HUERTA\* AND NICOLAJ KUPLEWATZKY\*\*

TABLE OF CONTENTS: I. Introduction. – II. Beyond autonomy: mutual trust applies to investment protection and beyond. – III. The application of *Achmea* by investor-State tribunals. – IV. The consequences: how Member States have committed to apply *Achmea*.

ABSTRACT: This *Article* considers the role, application, and implications of the *Achmea* judgment (judgment of 6 March 2018, case C-284/16 [GC]). As such, the Authors first consider the *Leitmotive of Achmea*, that is to say, the principles of autonomy and mutual trust. The latter principle, it is argued, should be given much more attention, particularly in light of its fundamental importance in the overall architecture of the European Union. The *Article* then critically analyses the application of the *Achmea* judgment by intra-EU arbitral tribunals and how these tribunals have distinguished the effects of the judgment for their assessments on jurisdiction. In a concluding section, the Authors finally reflect on the declarations made by Member States on 15 and 16 January 2019 on the implications and interpretation of *Achmea* and the intended effects thereof for pending arbitrations.

KEYWORDS: *Achmea* – bilateral investment treaties – Energy Charter Treaty – autonomy – mutual trust – declaration.

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## I. INTRODUCTION

In its judgment of 6 March 2018 in case C-284/16 *Achmea*, the Court of Justice (the Court) ruled that “Articles 267 and 344 TFEU must be interpreted as precluding a provision in an international agreement concluded between Member States [...] under which an investor from one of those Member States may, in the event of a dispute concerning investments in the other Member State, bring proceedings against the latter Member State before an arbitral tribunal whose jurisdiction that Member State has undertaken to accept”.<sup>1</sup>

Since then, countless articles and commentaries on the implications of the judgment have followed. Often unhelpful and limiting to the alleged need to “protect” intra-EU investment, or the separate system of dispute settlement established pursuant to bilateral<sup>2</sup> and plurilateral<sup>3</sup> treaties, those opinions do not give fair credence to the underlying mantra of the *Achmea* judgment. That is, most importantly, because *Achmea* is a judgment of the European Union legal order. Consequently, this *Article* is written from a EU law perspective. And, from that starting point, *Achmea* should be far from surprising, both to the booming “dispute resolution industry” surrounding intra-EU investors and to EU Member States alike.<sup>4</sup> In doing so, we will first look at the *Leitmotive* behind *Achmea*: the principles of autonomy of Union law and mutual trust. That discussion will then lead us to the application of *Achmea* in publicly-available arbitral awards and how arbitral tribunals have side-stepped the judgment without paying real effort to its implications. Our final section will briefly deal with the legal consequences of the judgment, in light of the declarations of the Member States of 15 January 2019 and 16 January 2019, and end on closing remarks in light of these declarations.<sup>5</sup>

<sup>1</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Achmea* [GC], para. 60.

<sup>2</sup> In 2013, Zachary Douglas estimated there to be approximately 190 intra-EU investment treaties currently in force. See Z. DOUGLAS, *Problem Relating to Intra-EU BITs in the Investment Treaty Cases*, 2013, [www.matrixlaw.co.uk](http://www.matrixlaw.co.uk).

<sup>3</sup> Such as the Energy Charter Treaty (ECT). See Communication COM(2018) 547 final of 19 July 2018 from the Commission on the protection of intra-EU investment, p. 2. Paschalidis has argued that the ECT constitutes a multilateral treaty. See P. PASCHALIDIS, *International Investment Law and EU Law: Are There Systemic Conflicts and Incompatibilities?*, in E. GAILLARD, H. RUIZ-FABRI (eds), *EU Law and International Investment Arbitration*, Huntington: JurisNet LLC, 2018, paras 67 and 87.

<sup>4</sup> In a publication of December 2018, UNCTAD finds that, by 31 July 2018, 83 publicly-known intra-EU investor-State dispute settlement (“ISDS”) proceedings were pending. UNCTAD, IIA Issues Note, *Fact Sheet on Intra-European Union Investor-State Arbitration Cases*, Issue 3 of December 2018, UNCTAD/DIAE/PCB/2018/7, p. 5.

<sup>5</sup> That is, Declaration of the Representatives of the Governments of the Member States of 15 January 2019 on the Legal Consequences of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union, [ec.europa.eu](http://ec.europa.eu) (hereafter Declaration of the 22); Declaration of the Representative of the Government of Hungary of 16 January 2019 on the Legal Consequences of the Court of Justice in *Achmea* and on Investment Protection in the European Union, [www.kormany.hu](http://www.kormany.hu) (hereafter Dec-

## II. BEYOND AUTONOMY: MUTUAL TRUST APPLIES TO INVESTMENT PROTECTION AND BEYOND

As the Court in *Wightman* recalled, the founding Treaties of the Union established a new legal order, whose characteristics have given rise to a structured network of principles, rules and mutually interdependent legal relations binding the EU and its Member States reciprocally as well as binding its Member States to each other.<sup>6</sup> At the heart of that constitutional makeup lies, *inter alia*, the EU's *Kompetenzkatalog*, which stands as witness to the idea that, "by acceding to the EU the Member States limited their freedom of action in international law and renounced the exercise between themselves of rights in international law that conflicted with EU law".<sup>7</sup>

The EU is a subject of,<sup>8</sup> and subject to,<sup>9</sup> public international law. That does not mean, however, that the EU only follows the rules and principles of the public international legal order. The EU Treaties have created a new legal order,<sup>10</sup> subject to its own rules and its own system of enforcement. Under that system, citizens of the Union have rights and obligations independently of their Member States, derive those directly from the Union legal order,<sup>11</sup> and can seek review of any decision or other national measure relating to the application of those rights and obligations to ensure compliance with EU law.<sup>12</sup> That system is composed of the national courts and the Court, the latter of which ensures the uniform interpretation and the validity of EU law throughout the EU.<sup>13</sup> The novelty of the EU is the creation of a different order, whose subjects are not only the Member States but also the citizens, who have rights and obligations independently of their Member State. EU citizenship is, therefore, a fundamental status of the nationals of the Member States that brings with it certain rights and obligations.<sup>14</sup>

That is the premise on which the *Achmea* judgment is founded. That premise does not challenge the traditional public international legal order: within the *sui generis* order established by EU membership, the Member States and their citizens have to solve

laration of Hungary); and Declaration of the Representatives of the Governments of the Member States of 16 January 2019 on the Enforcement of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union: [www.regeringen.se](http://www.regeringen.se) (Declaration of the 5).

<sup>6</sup> Court of Justice, judgment of 10 December 2018, case C-621/18, *Wightman and Others*, paras 44 and 45. See also *Achmea* [GC], cit., para. 33 and the case law cited.

<sup>7</sup> German Federal Court of Justice, judgment of 31 October 2018, case I ZB 2/15, *Achmea* [GC], para. 41.

<sup>8</sup> *Wightman and Others*, cit., para. 45.

<sup>9</sup> Court of Justice, judgment of 27 February 2018, case C-266/16, *Western Sahara Campaign UK* [GC], para. 47.

<sup>10</sup> Court of Justice, judgment of 5 February 1963, case 26/62, *Van Gend en Loos*, p. 12.

<sup>11</sup> *Wightman and Others*, cit., para. 64.

<sup>12</sup> Court of Justice, judgment of 25 July 2018, case C-216/18 PPU, *Minister for Justice and Equality*, paras 49-51.

<sup>13</sup> *Achmea*, cit., para. 33.

<sup>14</sup> *Wightman and Others*, cit., para. 64.

those controversies which are based on EU law within the rules and principles of the common legal system established between them. Nothing else.

The case law referred to in the *Achmea* judgment proves that the impossibility to submit controversies between an EU investor and a Member State to an external dispute settlement mechanism is enshrined at the core of the EU architecture.<sup>15</sup> According to Arts 2 and 19 TEU, “it is for the national courts and tribunals and the Court of Justice to ensure the full application of EU law in all Member States and judicial protection of the rights of individuals under that law”.<sup>16</sup>

*Achmea* recalls once more that – no matter the source or authority on which the controversy in question is based –, within the complete system of Union law, there is no possibility to “externalise” the competence to revise the legality of EU acts to other bodies or institutions outside the Union. That idea finds its origin in the autonomy of Union law and acts “*ad intra*” as well as “*ad extra*”. In other words, any decision of an international organisation or of a treaty-based body has to comply with the EU legal order, if it is sought to be applied within the Union.<sup>17</sup> To that end, all decisions and acts of the Union can be supervised solely within the Union legal order.<sup>18</sup> It follows that Member States cannot decide independently whether certain controversies could be dealt with outside that order.

However, that does not automatically mean that, if the EU is a party to the international agreement establishing the possibility of a separate dispute settlement system, that that option would be compatible with Union law.<sup>19</sup> In fact, the same rationale underlying the judgment in *Achmea* should apply to any investment treaty that would include a dispute settlement clause that could be applied between the Member States.<sup>20</sup> *Achmea* has clearly stated that an EU investor cannot initiate arbitration proceedings against another EU Member State. There is no reason why in the case, for instance, of the Energy Charter Treaty (ECT), that conclusion should be any different. Nor is there anything controversial about that conclusion: in the same way as any sovereign State has to respect its domestic constitutional order when entering into an international agreement, the Member States and the Union themselves have to respect the Union legal order, which includes respect-

<sup>15</sup> Before referring to the specific issue of the nature of arbitral tribunals, the first part of the *Achmea* judgment refers to Opinion 2/13 (Court of Justice, opinion 2/13 of 18 December 2014), and then to the judgment of 27 February 2018, case C-64/16, *Associação Sindical dos Juizes Portugueses* [GC], and to opinion 1/09 of 8 March 2011, and the case law referred therein.

<sup>16</sup> *Minister for Justice and Equality*, cit., para. 50.

<sup>17</sup> Court of Justice, judgment of 3 September 2008, case C-402/05 P, *Kadi and Al Barakaat International Foundation v. Council and Commission* [GC], para. 305.

<sup>18</sup> *Kadi and Al Barakaat International Foundation v. Council and Commission* [GC], cit., para. 326.

<sup>19</sup> *Achmea* [GC], cit., para. 58.

<sup>20</sup> See, in this regard, opinion of Advocate General Bot in opinion 1/17 (opinion of AG Bot delivered on 29 January 2019, paras 122-124 and 134-140) for the conditions under which the Advocate General deems the system of dispute settlement contained in Comprehensive Economic and Trade Agreement between the EU and Canada (also known as “CETA”) compatible with EU law.

ing the principle of autonomy when concluding and applying international agreements. As both the Member States and their citizens are subjects of this legal order, neither of them can renounce that constitutional structure nor decide to submit a controversy to an arbitral tribunal outside the system established in Art. 19 TEU.

But, *Achmea* is about more than autonomy: the second pillar of the Court's reasoning is that of mutual trust. Implied within Art. 2 TEU,<sup>21</sup> and developed within the area of justice and home affairs, the principle of mutual trust goes hand in hand with the principle of sincere cooperation contained in Art. 4, para. 3, TEU and serves to stand as witness that the Union's legal order goes far beyond the traditional understanding of the reciprocal treaty obligations that establish the international law plane. The fact that Member State share with all other Member States, and recognise that they share with them, a set of common values on which the Union is founded implies and justifies the existence of mutual trust.<sup>22</sup> As such, the principle of mutual trust forms part of the exhaustive<sup>23</sup> architecture of the Union and the relations between the Member States as well as between its citizens and the Member States. It is that fundamental part of the architecture of the Union that a resolution system between these parties, outside the system established by the Treaties, unjustifiably<sup>24</sup> calls, or risks calling,<sup>25</sup> into question.<sup>26</sup>

Easily overshadowed by the first pillar, it is that second pillar that, in fact, holds the greatest weight in practice. It is clear that maintaining a single market without internal borders requires that cross-border investors can *rely* on EU law protecting their investments.<sup>27</sup> It is at this point that *Achmea* takes hold. In fact, the principle of mutual trust should not only be considered as a principle confined to, and applied in, the area of justice and home affairs, but it equally should be taken as a fundamental principle of the EU legal order.<sup>28</sup> The *Achmea* case, which concerns an set-aside action of an arbitral award in the field of investment protection, demonstrates the extension of that principle, as the case in itself did not refer to any instrument of judicial cooperation.

Indeed, the judgment clearly pronounces the importance of the principle of mutual trust in a case which does not concern the area of judicial cooperation. The cross-

<sup>21</sup> *Achmea* [GC], cit., para. 58.

<sup>22</sup> *Ibid.*, para. 34. See also opinion 1/17, cit., paras 82 and 107, where AG Bot notes that relations between the EU and third States are not based on mutual trust.

<sup>23</sup> Hence the reference in *Achmea* [GC], cit., para. 36, to opinion 1/09, cit., para. 68; opinion 2/13, cit., para. 175; and *Associação Sindical dos Juizes Portugueses* [GC], cit., para. 33.

<sup>24</sup> See Court of Justice, judgment of 5 April 2016, C-404/15 and C-659/15 PPU, *Aranyosi and Caldaru* [GC], para. 82 ("limitations of the principles of mutual recognition and mutual trust between Member States can be made 'in exceptional circumstances'").

<sup>25</sup> Note the use of the conditional "could" in *Achmea* [GC], cit., para. 56.

<sup>26</sup> *Achmea* [GC], cit., para. 58.

<sup>27</sup> Communication COM(2018) 547 final, cit., p. 17.

<sup>28</sup> Court of Justice, judgment of 16 July 2015, Case C-681/13, *Diageo Brands*, para. 40.

reference of *Achmea* in other judgments reminds also of the fundamental importance of that principle in the architecture of the Union. Take, in this regard, for instance, the recent judgments in relation to the European Arrest Warrant<sup>29</sup> or the revocation of the notification of the United Kingdom (UK) to withdraw from the EU.<sup>30</sup> In *Minister for Justice and Equality* and *RO*, the Court recalled the importance of preserving the system of judicial cooperation and the high level of trust underpinning the area of freedom, security and justice, so that, save in exceptional circumstances, the Member States must consider each other to be complying with EU law and particularly with the fundamental rights recognised thereby.<sup>31</sup> Similarly, in *Wightman*, the Court recalled that despite the UK's notification of its intention to withdraw from the Union, the values on which the Union legal order is established would prevent a Member State to be forced to withdraw from the structured network of principles, rules and mutually interdependent legal relations that establish the Union.<sup>32</sup>

Alongside *Achmea*, these three cases, in fact, share the understanding that the common values established in Art. 2 TEU are the origin of the EU legal order and, by necessity, also the EU enforcement system established to preserve it. *Achmea* and *Minister for Justice and Equality* are two sides of the same coin: *Achmea* indicates the need to retain certain controversies within the EU legal system, as the relations of Member States are ruled by the principle of mutual trust and as that trust could only be ensured within the system established by the Treaties. On the other hand, *Minister for Justice and Equality* recalls the need to preserve the judicial systems of the Member States according to the principle of the rule of law (in particular as regards judicial independence) to ensure the protection provided for in Art. 19 TEU.<sup>33</sup> Any breach of, or any interpretation against, those principles would then violate the constitutional order of the Union. Thus, sharing the values and principles upheld in *Achmea* and *Minister for Justice and Equality* includes, naturally, sharing the trust in other Member States, including the trust in their judicial system. For want of a better comparison, mutual trust must thus be seen as the engine oil in the *sui generis* European machine, reducing the friction and wear of holding together the various obligations and interests of 28 different societies and cleaning the whole apparatus from doubt clogging the system. Some wear and tear will, naturally, remain.<sup>34</sup> But, take away that lubricating force – or start reduc-

<sup>29</sup> *Minister for Justice and Equality*, cit., paras 35 *et seq.* and Court of Justice, judgment of 19 September 2018, Case C-327/18 PPU, *RO*, paras 34 *et seq.*

<sup>30</sup> *Wightman and Others*, cit., para. 45.

<sup>31</sup> *Minister for Justice and Equality*, cit., paras 72 to 75

<sup>32</sup> *Wightman and Others*, cit., paras 45, 61, 62, and 67.

<sup>33</sup> *Minister for Justice and Equality*, cit., para. 53.

<sup>34</sup> See, by analogy, *Aranyosi and Caldaru* [GC], cit., para. 82.

ing it permanently<sup>35</sup> – and the resulting machine will fragment and come to a grinding halt.

And that is the reminder that *Achmea* instills: mutual trust in *inter se* relations between the Member States derives from the trust in the complete and exhaustive system of judicial remedies and fundamental rights protection as a whole. As the European Commission (the “Commission”) recalls in its Communication,

“while international investment law (for example bilateral investment treaties) focuses mainly on compensating investors after the violation has taken place, EU law enables the protection of cross-border investors in the EU through multiple ways and at different levels. Crossborder investors are protected in the EU through a number of mechanisms aiming at the prevention or resolution of violations of their rights committed by the legislator, the administration or the judiciary. The judicial enforcement of rights ensuing from EU law is one of several possible solutions. Where judicial enforcement is considered to be the most appropriate avenue or where other possibilities have been exhausted, an individual can rely on a fully-fledged and complete system of judicial remedies under EU law”.<sup>36</sup>

There is nothing rigid in that approach. The submission of certain controversies to external bodies would damage and undermine the Union order or the existence of mutual trust between the Member States or the autonomy of Union law. That is because, “the very existence of effective judicial review designed to ensure compliance with EU law is of the essence of the rule of law”.<sup>37</sup> But, even more so, the existence of effective judicial review is the essence of the EU. And, within that system, judicial review has to be ensured by the national courts and ultimately by the Court, by way of preliminary reference. Excluding, or even allowing for an “opt out” from the complete system of legal remedies established by the Treaties<sup>38</sup> would undermine that rule of law<sup>39</sup> – that *ordre publique* – framework which is imperative for the Member States and their citizens alike. The reality of the matter is that EU law already protects all forms of cross-border intra-EU investment, throughout the entire life cycle of that investment.<sup>40</sup> That system is, in turn, protected through Art. 19 TEU and Art. 47 of the Charter of Fundamental Rights of the EU.

<sup>35</sup> K. LENAERTS, *La vie Après l’avis: Exploring the Principle of Mutual (yet not Blind) Trust*, in *Common Market Law Review*, 2017, p. 822.

<sup>36</sup> Communication COM(2018) 547 final, cit., p. 17.

<sup>37</sup> *Associação Sindical dos Juizes Portugueses* [GC], cit., para. 36.

<sup>38</sup> Court of Justice, judgment of 28 March 2017, case C-72/15, *Rosneft* [GC], paras 66-67.

<sup>39</sup> *Associação Sindical dos Juizes Portugueses* [GC], cit., para. 36.

<sup>40</sup> Communication COM(2018) 547 final, cit., pp. 3 and 5. At p. 21, the Communication also highlights, along the way, national courts can provide a multitude of remedies, ranging from provisional measures, the obligation to interpret national law in a way that is consistent with EU law, the obligation for judges to set aside of their own motion any act which is in conflict with EU law, the elimination of the consequences of a violation of EU law, or the award of damages for violations of EU law.

And so there is simply no space – or need, for that matter – for a separate avenue providing more substantive rights or protection than that afforded by the Union legal order.

*Achmea* could not have been decided differently: the principles of autonomy and mutual trust prevent Member States from offering – and EU citizens from accepting – a system of dispute resolution outside the Treaties when EU law is both the *means* and the *end* in the life cycle of intra-EU investment.<sup>41</sup>

### III. THE APPLICATION OF *ACHMEA* BY INVESTOR-STATE TRIBUNALS

Even if *Achmea* clearly pronounces the impossibility of EU investors to bring proceedings against a Member State, arbitral tribunals have not followed this line and have attempted to distinguish the judgment and its implications – with disputable logic – from the proceedings put before them. In this section, we will attempt to analyse the reasoning in those publicly-available awards and jurisdictional decisions that distinguished *Achmea* and highlight their shortcomings on the basis of both EU law and international investment law.

No State is under any obligation to give an account of itself to an international tribunal which lacks jurisdiction or whose jurisdiction has not been established.<sup>42</sup> The propriety of arbitral tribunals in investor-State arbitration exercising jurisdiction is, consequently, dependent on the establishment and keeping of proper jurisdiction.<sup>43</sup> It is for that reason, too, that a tribunal must, at any point in time, be satisfied that it has jurisdiction, and must, if necessary, go into that matter *proprio motu*.<sup>44</sup>

This ability, known as *Kompetenz-Kompetenz*, gains in importance where review is sought of a State's continued competence to consent to such arbitration in the first place. And yet, *Kompetenz-Kompetenz* of intra-EU arbitral tribunals remains, as of yet, insufficiently exercised. Of the four publicly-available awards rendered since the judgment in *Achmea* was handed down, not a single arbitral tribunal has declined jurisdiction on the basis that Member States to the EU never had the competence to consent to intra-EU arbitration.<sup>45</sup> And that is despite the (contradictory) fact that there by now exists general

<sup>41</sup> See, by analogy, Court of Justice, judgment of 7 May 2013, case C-617/10, *Åkerberg Fransson* [GC], para. 46.

<sup>42</sup> S. ROSENNE, *An International Law Miscellany*, Alphen aan den Rijn: Kluwer Law International, 1993, p. 149.

<sup>43</sup> See, for an expression of that principle, Art. 41, para. 1, ICSID Convention and Art. 45, para. 1, ICSID Additional Facility Rules, Schedule C ("The Tribunal shall be the judge of its own competence") and Art. 21 UNCITRAL Arbitration Rules ("The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction, including any objections with respect to the existence or validity of the arbitration clause or of the separate arbitration agreement"). See by analogy United Nations Commission on International Trade Law, report no. 40/17 of 7-18 July 2013, para. 150.

<sup>44</sup> International Court of Justice, *Appeal Relating to the Jurisdiction of the ICAO Council* (India v. Pakistan), judgment of 18 August 1972, para. 13.

<sup>45</sup> It might be opportune at this point to highlight that the Commission has sought intervention in all pending intra-EU arbitrations to raise the question of competence and to highlight the effective consequence

agreement among arbitral tribunals established both under BITs and the ECT that EU law forms part of the law to be applied by tribunals established pursuant to a dispute between an investor from one EU Member State and another EU Member State.<sup>46</sup>

Note, in this regard, the recent decision of the arbitral tribunal in *UP and CD Holding v Hungary* (Böckstiegel, Fortier, Bethlehem; BIT, ICSID), which held that “in the present Award, the Tribunal does not consider that a detailed discussion of the substance of *Achmea* is required, because the present case differs in determinative aspects from the case in *Achmea*”.<sup>47</sup> That difference in determinative aspects from the case in *Achmea* was considered to be that the arbitral tribunal in *UP and CD Holding v. Hungary* operated under the ICSID Convention, to which Hungary is a Contracting Party, and the validity of which has not been put into question by the judgment in *Achmea*.<sup>48</sup> That same line of reasoning was also adopted in *Marfin v. Cyprus* (Hanotiau, Edward, Price; BIT, ICSID), which noted that the tribunal’s “jurisdiction derives not only from the Treaty but also from the ICSID Convention [and] its cornerstone principles established in Article 25(1)”.<sup>49</sup>

Under Art. 25, para. 1, ICSID Convention, the jurisdiction of ICSID tribunals extends to “any legal dispute arising directly out of an investment [...] which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally”. This last sentence in particular should be read alongside the Report of the Executive Directors on the Convention note, “[c]onsent of the parties is the cornerstone of the jurisdiction of the centre”.<sup>50</sup> Consent by both the parties to a dispute is thus an indispensable condition for the jurisdiction of ICSID tribunals.

That, however, is not surprising. There exists no self-contained customary international law right to investment arbitration, in the same vein as there exists no self-

of the judgment in *Achmea*. See, in this regard, Commission Decision C(2018) 4303 final of 29 June 2018 on intervention as a non-disputing party in investor-State dispute settlements between an investor from one Member State and another Member State based on BITs concluded between Member States or ECT.

<sup>46</sup> *Ex multis*, ICSID, decision on the *Achmea* Issue of 31 August 2018, case no. ARB/12/12, *Vattenfall v. Germany*, paras 146-148; Permanent Court of Arbitration, final award of 11 October 2017, case no. 2014-03, *JSW Solar and Wirtgen v. Czech Republic*, paras 175-178; ICSID, decision on jurisdiction of 30 November 2012, case no. ARB/07/19, *Electrabel S.A. v. Republic of Hungary*, paras 4.122, 4.189, and 4.195; and ICSID, award of 27 December 2016, case no. ARB/14/3 *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, para. 278. This derives also from Art. 1, para. 3, of the ECT, which indirectly recognizes that acts of EU law, issued by the institutions of the Union, are binding on EU Member States as a matter not only of EU law, but also of the ECT itself.

<sup>47</sup> ICSID, award of 9 October 2018, case no. ARB/13/35, *UP and CD Holdings v. Hungary*, para. 252.

<sup>48</sup> *Ibid.*, paras 253 to 264.

<sup>49</sup> ICSID, award of 26 July 2018, case no. ARB/13/27, *Marfin v. Cyprus*, para. 592.

<sup>50</sup> ICSID Convention, Regulations and Rules, Report of the Executive Directors of the ICSID Convention, ICSID/15/Rev. 1, point 23. On the status of the Report, see B. LEGUME, W. KIRTLEY, *The Status of the Report of the Executive Directors on the ICSID Convention*, in *ICSID Review – Foreign Investment Law Journal*, September 2012, p. 159-171 (concluding that the Report is a non-binding, albeit “reliable” source of interpretation of the ICSID Convention).

contained right to legitimate expectations in public international law.<sup>51</sup> So, the legal act that is the basis for consent to arbitration is always the relevant provision in the investment treaty, that is to say in the BIT or the ECT (or, where the consent is expressed through a contract or national law, the relevant contract or the relevant national law), and not Art. 25 of the ICSID Convention. The ICSID Convention does not create a default rule for consent to arbitration.<sup>52</sup> As such, take away the consent to arbitration by the State concerned (or establish that there never was consent in the first place) and an ICSID tribunal loses jurisdiction (and the ICSID Convention application). Consequently, it is a logical fallacy to reason that if consent to arbitration was withdrawn or never existed, jurisdiction of the tribunal arising from the separate consent to a set of rules governing the practical aspects of the arbitration nonetheless cures that former deficiency and keeps the arbitration alive. The converse, as appears to be suggested, would wreak havoc to the fundamental principle of public international law “that no State can, without its consent, be compelled to submit its disputes [...] either to mediation or to arbitration, or to any other kind of pacific settlement”.<sup>53</sup>

In that context, the argument made by the tribunal in *UP and CD Holding* that Hungary had not shown that EU law, as interpreted in *Achmea*, has the effect that consent has been validly withdrawn retroactively<sup>54</sup> overlooks the fundamental point that consent to arbitration did not have to be withdrawn, because it had never been validly given in the first place. This derives readily from the Court’s reasoning in that intra-EU investment arbitration “could prevent those disputes from being resolved in a manner that ensures the full effectiveness of EU law”,<sup>55</sup> so that Arts 267 and 344 TFEU preclude “a provision in an international agreement concluded between the Member States, such as Article 8 of the BIT, under which an investor from one of those Member States may [...] bring proceedings against the latter Member State before an arbitral tribunal.”<sup>56</sup> The language used could not possibly be any wider. As the German Federal Court of Justice in *Achmea* noted, “[i]f Article 8(2) of the BIT is thus contrary to Articles 267 and 344 TFEU, it cannot apply [...], and no effective arbitration agreement has been concluded between the parties. [...] This meant that the applicant [Slovakia] had made no offer to conclude an arbitration agreement with investors from the Netherlands that the defendant [Achmea] could then accept”.<sup>57</sup> In other words, there was never a valid offer for

<sup>51</sup> See International Court of Justice, *Obligations to Negotiate Access to the Pacific Ocean* (Bolivia v. Chile), judgment of 1 October 2018, para. 162.

<sup>52</sup> See *similarly* ICSID, award of 22 August 2012, case no. ARB/05/1, *Daimler Financial Services AG v. Argentina Republic*, para. 175.

<sup>53</sup> Permanent Court of International Justice, *Status of Eastern Carelia*, advisory opinion of 23 July 1923, p. 27.

<sup>54</sup> *UP and CD Holdings v. Hungary*, cit., para. 264.

<sup>55</sup> *Achmea* [GC], cit., para. 56.

<sup>56</sup> *Ibid.*, para. 60.

<sup>57</sup> German Federal Court of Justice, *Achmea*, cit., paras 25-26.

arbitration pending when the EU investor sought to accept the standing offer for arbitration, thus flouting jurisdiction of any tribunal *ab initio*.

In the same vein, no rights derivative in nature from the BIT or the ECT can, accordingly, be invoked against the Member State concerned. As such, because the request for arbitration in *UP and CD Holding* had been filed after the accession of Hungary to the EU, that is, after 1 May 2004, the BIT had been an agreement between two Member States of the EU and so subject to the limitations of EU law.<sup>58</sup> One could, accordingly, speak of a “reverse Mavrommatis” situation, where jurisdiction for any claims arising out of the BIT or the ECT between an investor from one EU Member State and another EU Member State ceased at the point of accession to, or last confirmation of, the EU Treaties after conclusion of the BIT / accession to the ECT.<sup>59</sup>

The tribunal in *UP and CD Holding v. Hungary* equally reasoned that the applicable BIT provides for a so-called “sunset clause”, according to which protection continues for 20 years after the expiry of the BIT.<sup>60</sup> In relation thereto, it suffices to note that, when applied on an intra-EU basis, any such clause (including that contained in Art. 47(3) of the ECT), would be ineffective for the simple reason that it cannot extend the *ratione temporis* application of a treaty clause which is considered *ultra vires* the Member States’ sovereign competence to act to begin with.<sup>61</sup>

This is also where the tribunals in *Masdar v. Spain* (Beechey, Born, Stern; ECT, ICSID) and *Vattenfall v. Germany* (van den Berg, Brower, Lowe; ECT, ICSID) fall short of reasoning. Both tribunals considered that the judgment in *Achmea* is limited to the BIT between the Netherlands and Slovakia, but does extend to a treaty such as the ECT.<sup>62</sup> Again, that type of reasoning is little persuasive. If the Court had wanted to limit its ruling to bilateral treaties between the Member States, it would have done so, or have used language to that effect. In fact, it did precisely the opposite: the question from the *Bundesgerichtshof* referred to “a provision in a bilateral investment protection agreement”,<sup>63</sup> but the Court formulated its judgment in wider terms, referring to “a provision

<sup>58</sup> See also, to that effect, German Federal Court of Justice, *Achmea*, cit., para. 20.

<sup>59</sup> Permanent Court of International Justice, *Mavrommatis Palestine Concessions* (Greece v. United Kingdom), objection on the jurisdiction of the Court of 30 August 1924, at para. 90 (“in cases of doubt, jurisdiction based on an international agreement embraces all disputes referred to its after its establishment”. See also, for an expression of that principle in the realm of investment arbitration, ICSID, decision on jurisdiction of 29 November 2004, case no. ARB/02/13, *Salini v. Jordan*, paras 176-178.

<sup>60</sup> *Ibid*, para. 265.

<sup>61</sup> Recall German Federal Court of Justice, *Achmea*, cit., para. 41: “by acceding to the EU the Member States limited their freedom of action in international law and renounced the exercise between themselves of rights in international law that conflicted with EU law.” See, by analogy, *Achmea*, cit., para. 33.

<sup>62</sup> ICSID, award of 16 May 2018, case No. ARB/14/1, *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, para. 679; *Vattenfall v. Germany*, cit., paras 139, 208, and 239.

<sup>63</sup> *Achmea* [GC], cit., para. 23.

in an international agreement concluded between Member States".<sup>64</sup> Consequently, *Achmea* speaks not in terms of treaties, but in terms of claims, issues, and parties: Arts 267 and 344 TFEU establish clear boundaries of exclusive jurisdiction for dispute settlement mechanisms between the Member States. It is, in effect, a Europeanisation of the case-law on original jurisdiction of the United States Supreme Court.<sup>65</sup> Alas, the *Masdar v Spain* tribunal concludes otherwise, without further reasoning or taking position on the result that flows from *Achmea*.

In this respect, it is noteworthy, in particular, that the *Masdar v. Spain* tribunal makes no attempt at taking stock of the positions of the EU Member States on intra-EU arbitration. Respondent Member States in intra-EU disputes have consistently argued that the ECT does not apply intra-EU, in particular (in historical order) Hungary, the Czech Republic, Spain, and Italy. Other Member States that used to defend intra-EU arbitration, such as Germany<sup>66</sup> and the Netherlands,<sup>67</sup> have publicly changed their position and stated that they, too, deem *Achmea* relevant under the ECT.

The *Masdar v Spain* tribunal then refers with approval to the opinion of Advocate General Wathelet in *Achmea*.<sup>68</sup> That, again, is not persuasive. It need not be recalled that the Court not once referred to the substance of the Advocate General's conclusions in its judgment. As such, whether or not he deemed a certain interpretation of the law to be correct at the time is not determinative. The fact that the Court explicitly recalled, in the *Achmea* judgment, that it is not bound either by the Advocate General's conclusion or by the reasoning which led to that conclusion should be guidance enough that it was not convinced by the conclusion put forward.<sup>69</sup>

Finally, the tribunal in *Vattenfall v. Germany* refrains from taking itself a view as to whether intra-EU investment arbitration on the basis of Art. 26 ECT is compatible with general principle of Union law of autonomy, Art. 19 TEU, and Arts 267 and 344 TFEU, but merely takes note of the reasoning employed in *Masdar v. Spain*.<sup>70</sup> The former tribunal relies, instead, decisively on Art. 16 ECT, which it considers to be a special conflict rule

<sup>64</sup> *Ibid*, para. 60.

<sup>65</sup> See, for instance, the US Supreme Court, judgment of 14 December 1992, *Mississippi v. Louisiana*, p. 77 (ruling that the US Supreme Court has "original and exclusive jurisdiction of all controversies between two or more States", and that state courts lack subject-matter jurisdiction to resolve those disputes themselves).

<sup>66</sup> Reply by the German government in response to a question posed in the German Parliament, Drucksache 19/2174 of 15 May 2018, dipbt.bundestag.de.

<sup>67</sup> Reply by the Dutch government to a question posed by the lower house of the Dutch Parliament, Raad Algemene Zaken en Raad Buitenlandse Zaken, 21 501-02, no. 1863 of 26 April 2018, www.tweedekamer.nl.

<sup>68</sup> *Masdar v. Spain*, cit., para. 680 *et seq.*

<sup>69</sup> *Achmea* [GC], cit., para. 27.

<sup>70</sup> *Vattenfall v. Germany*, cit., paras 208 and 231.

governing the relationship between the ECT and Union law. Some thoughts on this should be offered.

First, that reasoning overlooks that the effect of the primacy of EU law and its impact on international law applicable between the Member States. As the German Federal Court of Justice (*Bundesgerichtshof*) in its judgment of 11 November 2018 in *Achmea v. Slovak Republic* notes: "In that respect [that is, the limitation of EU Member States' freedom of action in international law,] the primacy of EU law has the consequence that *a provision in an agreement operating between Member States inside the EU cannot apply even as a provision of international law [...]*. Nationals of Member States therefore cannot rely on prior international-law obligations of the Member States that conflict with EU law".<sup>71</sup>

That renunciation between EU Member States of rights in international law, coupled with the implementation into EU law of the ECT<sup>72</sup> has the effect that, while the ECT remains applicable to the Member States by way of their international obligations vis-à-vis other contracting parties to the ECT, it has become inapplicable to EU Member States *inter se* by way of their obligations and limitations to competences under EU law. So, while Art. 16 ECT might be used as a conflict rule between Contracting Parties to the ECT between which EU law does not operate (if indeed that is its object and purpose), it certainly cannot operate between Member States to the Union to the detriment of the primacy of Union law.<sup>73</sup> That, again, loops back the discussion to the issue of consent under international law enunciated above: by limiting their freedom of action in international law through the creation of the Union legal order, the Member States have done away with the power to accept and maintain a conflict rule deriving from the international law plain that could have adverse effects on the autonomy of EU law as it operates between them. As implemented into Union law, Art. 16 ECT consequently has taken on a different ambit as that which it may personify between non-EU Contracting Parties to the ECT. As such, in the context of the internal and autonomous legal order of the Union, which finds application in intra-EU arbitrations, the ambit of Art. 16 ECT is subordinated to the principles of primary EU law, among which stands the principle of primacy. The tribunal in *Vattenfall v. Germany* consequently also erred on this aspect of its analysis.

Opportunity is missed by most people because it is dressed in overalls and looks like work.<sup>74</sup> For the time being, arbitral tribunals have not taken full account of the reali-

<sup>71</sup> German Federal Court of Justice, *Achmea*, cit., para. 41 (emphasis added).

<sup>72</sup> Decision 98/181/EC of the Council and the Commission on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects, p. 1.

<sup>73</sup> See, by analogy, *Kadi and Al Barakat International Foundation v. Council and Commission* [GC], cit., para. 299 *et seq.*

<sup>74</sup> Popularly attributed to Thomas Edison, although with unknown provenance. See G. BRANDRETH (Ed.), *Oxford Dictionary of Humorous Quotations*, Oxford: Oxford University Press, 2013, p. 331.

ty of Union law, despite their clear obligation as creatures of subjects of Union law,<sup>75</sup> and their related mandate to apply that law. They have not only sought to maintain jurisdiction in disputes based on BITs, but also continue to establish jurisdiction on the basis of the ECT (which, as we have noted, by extension of the principles evoked in *Achmea*, is also incompatible with EU law if applied *inter se*). That is a missed opportunity, especially in light of the possibilities for compatible resolution of the jurisdictional hurdle, for instance, via a *juge d'appui*.<sup>76</sup> The only hope then remains that, by way of external or internal influence, the tribunals will start properly applying their *Kompetenz-Kompetenz*, and will start shifting towards an EU law-compatible resolution of the question before them, in line with *Achmea*.

#### IV. THE CONSEQUENCES: HOW MEMBER STATES HAVE COMMITTED TO APPLY *ACHMEA*

Member States are under an obligation to take the necessary measures to comply with judgments of the Court. Even where a judgment is not addressed to all Member States, the doctrine included therein is legally binding across the Union and applicable to any situation materially identical to the one at issue. Alas, in case of *Achmea*, Member States' understanding of the material identity of the situation – despite urging from the Commission – appeared to differ, in particular as concerns the consequences to draw from the judgment vis-à-vis their own *inter se* BITs and the ECT.

The result of this finally crystalized in a declaration signed, on 15 January 2019, by 22 Member States,<sup>77</sup> “On the Legal Consequences of the Judgment of the Court of Jus-

<sup>75</sup> See *Daimler Financial Services AG v. Argentina Republic*. “All international treaties – whether bilateral, plurilateral or multilateral – are essentially expressions of the contracting states’ consent to be bound by particular legal norms. They encapsulate voluntarily accepted restraints upon the universally recognized principle of state sovereignty. Consent is therefore the cornerstone of all international treaty commitments, at least insofar as those commitments exceed the minimum requirements of customary international law.” *Daimler Financial Services AG v. Argentina Republic*, cit., para. 168. Consent is the source of all treaty commitments, irrespective of the type of treaty concerned: *ibid.*, para. 169.

<sup>76</sup> See, on that possibility, Court of Justice, judgment of 23 March 1982, case C-102/81 *Nordsee*, para. 14. See, on this point, for example, also J.C. FERNÁNDEZ ROZAS, *Le rôle des juridictions étatiques devant l'arbitrage commercial international*, in *Collected Courses of the Hague Academy of International Law*, 2001, p. 130. The *juge d'appui* is typically the judge designated for that function by the procedural law of the State where the tribunal has its seat. See C. KESSEDIAN, *L'arbitrage comme mode de règlement des différends est-il remis en cause par le droit européen?*, in C. KESSEDIAN, C. LEBEN (eds), *Le droit européen et l'investissement*, Paris: Panthéon Assas, 2009, p. 120, for references to the relevant specific provisions in British and Danish law. As example, recall International Tribunal for the Law of the Sea, decision of 24 May 2005, *Award in the Arbitration regarding the Iron Rhine (“Ijzeren Rijn”) Railway between the Kingdom of Belgium and the Kingdom of the Netherlands*, para. 103.

<sup>77</sup> That is, Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, the Netherlands, Austria, Poland, Portugal, Romania, Slovenia, and the UK.

tice in *Achmea* and on Investment Protection in the European Union”.<sup>78</sup> Therein, these Member States declare that they deem the judgment in *Achmea* to establish that “all investor-State arbitration clauses contained in bilateral investment treaties concluded between Member States are contrary to Union law and thus inapplicable” and that “[a]n arbitral tribunal established on the basis of investor-State arbitration clauses lacks jurisdiction, due to a lack of a valid offer to arbitrate by the Member State party to the underlying bilateral investment Treaty”.<sup>79</sup> That conclusion would also extend to “sunset or grandfathering clauses”.<sup>80</sup> In relation to the ECT, those Member States further note that any interpretation of the ECT “as also containing an investor-State arbitration clause applicable between the Member States [...] would be incompatible with the Treaties and thus would have to be disapplied”.<sup>81</sup>

While the Declaration of the 22 was meant to be signed by all Member States, six Member States decided to limit themselves to commit only to terminate their intra-EU BITs and either remain silent on the ECT or chose not to take a position thereon. That is, even though the Commission’s view on the implications of *Achmea* for the ECT had been clear already well before the adoption of the Member States’ declarations.<sup>82</sup>

Indeed, a day later, on 16 January 2019, Hungary signed a different declaration, without reference to the effects of *Achmea* on the ECT, as, in its opinion, “the *Achmea* judgment concerns only the intra-EU bilateral investment treaties”.<sup>83</sup> On the very same day, five other Member States<sup>84</sup> signed yet another declaration “On the Enforcement of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union”.<sup>85</sup> Therein, those Member States agree that *Achmea* affects intra-EU BITs and their sunset clauses.<sup>86</sup> Unlike Hungary, however, the *Declaration of the 5* does not take a view on the application of *Achmea* on the ECT, and refers to the set-aside proceeding in the Svea Court of Appeal, case no 4658-18 *Novaenergia II*. They then go on to indicate that “it would be inappropriate, in the absence of a specific judgment on this matter, to express views as regards the compatibility with Union law of the intra EU application of the Energy Charter Treaty.” As such, at the time of writing, just one Member State disagreed on the application of the *Achmea* judgment to the ECT, leaving five Member States silent until the Court has ruled on that issue, too (be that by way of preliminary reference from the Svea Court of Appeal or not).

<sup>78</sup> Declaration of the 22, cit.

<sup>79</sup> *Ibid.*, page 1.

<sup>80</sup> *Ibid.*, page 2.

<sup>81</sup> *Ibid.*

<sup>82</sup> Communication COM(2018) 547 final, cit., p. 3.

<sup>83</sup> Declaration of Hungary, cit.

<sup>84</sup> That is, Finland, Sweden, Malta, Luxembourg, and Slovenia.

<sup>85</sup> Declaration of the 5, cit.

<sup>86</sup> *Ibid.*, pp. 1 and 2.

The above being said, the different declarations agree on a number of common conclusions to be drawn from the judgment in *Achmea*:

- All investor-to-State arbitration clauses contained in BITs concluded between Member States are contrary to EU law and inapplicable;

- Host and home States of intra-EU investors will inform tribunals of pending intra-EU arbitrations of the consequences arising from the preceding point, and will request the courts – including in third countries – which are to decide in proceedings relating to an intra-EU investment arbitration award, to set aside these awards or not to enforce them;

- No new intra-EU investment arbitration proceedings should be initiated under intra-EU BITs;

- By 6 December 2019, Member States will formally terminate all intra-EU BITs by means of a plurilateral treaty or, where that is mutually recognised as more expedient, bilaterally;

- Member States will ensure effective legal protection against State measures that are the object of pending intra-EU arbitration proceedings; and

- Member States, together with the Commission, will discuss without undue delay whether any additional steps are necessary to draw all the consequences from the *Achmea* judgment in relation to the intra-EU application of the ECT.

Far beyond a mere political declaration, these commitments are reciprocal by nature<sup>87</sup> clarify the implications on Member States' international law commitments arising from Union membership, and consequently present a major step towards effective implementation of the judgment in *Achmea*. That is to say that these commitments will have to be taken into account by arbitral tribunals as expressions of the *ex tunc* intention of the Member States (from the point of accession to, or last confirmation of, the EU Treaties), within the meaning of Art. 31, para. 3, let. a), of the Vienna Convention on the Law of Treaties (VCLT), vis-à-vis the particular BIT and/or the ECT.<sup>88</sup>

Basing itself on one of the declarations when deciding the jurisdictional issue laid before it, an arbitral tribunal would thus benefit from the clarification of the Member States that the object and purpose, within the meaning of Art. 31, para. 1, VCLT, of accession to the EU Treaties was to impliedly terminate the relevant BIT (or at least the

<sup>87</sup> See, in this regard, International Court of Justice, judgment of 24 July 1964, *Case Concerning the Barcelona Traction, Light and Power Company, Limited* (Belgium v. Spain), pp. 32-33.

<sup>88</sup> Pursuant to Art. 31, para. 3, let. a), of the VCLT, together with the context shall be taken into account for the interpretation of an international agreement "any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions." It is recalled, in this regard, that all paragraphs of Art. 31 VCLT have equal value: as the International Law Commission's Final Draft on the VCLT notes: "[The] General rule of interpretation' in the singular [...] indicate[s] that the application of the means of interpretation in the article would be a single combined operation. All the various elements [...] would be thrown into the crucible, and their interaction would give the legally relevant interpretation." International Law Commission, Draft Articles on the Law of Treaties with commentaries of 18 July 1966, UN Doc. A/6309/Rev.1, p. 220.

dispute resolution clause thereof) and the *inter se* application of the ECT (or at least Art. 26 thereof).<sup>89</sup> That is, to take account of the intention of Member States as it stood at the point of accession to, or last confirmation of, the EU Treaties. And, since the judgment in *Achmea* is not limited in time but applies *ex tunc*,<sup>90</sup> those statements should be applied to any pending dispute or any award rendered<sup>91</sup> pursuant to a dispute already concluded, with the effect, like in *Achmea*, that the final award is set aside.<sup>92</sup>

That subsequent clarification of the intention of the parties must, then, be read alongside Art. 59 VCLT and the notion of a special “integral”<sup>93</sup> obligation between the Member States that, from the point of accession to, or last confirmation of, the EU Treaties, EU Member States intended to impliedly terminate the dispute resolution clause of the particular BIT and the *inter se* application of Art. 26 ECT between themselves (that is, insofar as it concerns the bundles of obligations arising between the Member States as opposed to the general obligations vis-à-vis other contracting parties to the ECT). The non-limitation in time of the declarations must, furthermore, be seen as an expression of the intention of the Member States as it stood at the point of accession to the Union / last expression of Union membership, given the *ex tunc* effect of *Achmea*.

The above common position – even if in multiple political forms – is a strong response of the Member States. While the legal effects of those declarations are clear, at the time of writing, the practical effects of the various declarations are yet to be assessed. In particular, given the politically-divergent understanding of *Achmea*, it appears likely that the Court will have to take a position specifically on the *inter se* applicability of the ECT. That should, however, not overshadow the fact that, for the time being, EU citizens and the Member States, including their judicial authorities, will have to apply *Achmea* and the principles evoked therein. In a similar fashion, the Commission, as guardian of the Trea-

<sup>89</sup> Even if one were to argue that such a declaration is a mere unilateral interpretative act, it should be recalled that academic writing understands that the legal effects of unilateral declarations may depend on the reactions of the other contracting parties. Furthermore, an interpretative declaration “remains a unilateral act via which its author conveys his understanding of the convention, thereby serving as an indication of the latter’s intention”. See M. BENATAR, *From Probative Value to Authentic Interpretation: The Legal Effects of Interpretative Declarations*, in *Belgian Review of International Law*, 2011, pp. 182 and 183.

<sup>90</sup> See, for instance, Court of Justice, judgment of 19 December 2013, case C-262/12 *Vent De Colère and Others*, para. 39.

<sup>91</sup> Any payment of compensation awarded, either voluntarily or by forced execution would deprive EU law of its full effectiveness. See, to this effect, Court of Justice, judgment of 11 November 2015, Case C-505/14 *Klausner Holz Niedersachsen*, para. 34. See also Court of Justice, judgment of 18 July 2007, Case C-119/05, *Lucchini* [GC], paras 59-63.

<sup>92</sup> German Federal Court of Justice, *Achmea*, cit., operative part.

<sup>93</sup> See International Law Commission, *Fragmentation of International Law: Difficulties Arising from the Diversification and the Expansion of International Law*, Report of the Study Group of the International Law Commission finalized by Martti Koskenniemi of 13 April 2006, UN Doc. A/CN.4/L.682, paras 245 *et seq* (as regards the special “integral” obligation arising from membership to the European Convention on Human Rights).

ties, will have to supervise whether Member States correctly apply the judgment, and – where need be – draw all necessary consequences from non-compliance.

To the Authors, there should be no doubt: the complete and exhaustive system of judicial remedies and fundamental rights protection under the Union legal order leaves no space for an externalized dispute settlement system such as that contained in the relevant BIT or Art. 26 of the ECT. Those dispute settlement systems, as currently applied, do not conform to the values on which the Union legal order is established. Indeed, keeping such *inter se* dispute resolution alive trivialises the guiding principles of the Union and distorts the values and rules that form the “level playing field” that was sought to be created through the establishment of the internal market. As such, the full and correct functioning of the internal market, and ultimately of the EU, is only ensured if those values, rules, and principles are upheld uniformly between Member States and for all citizens (and investors) of all Member States alike. After all, that is the message of *Achmea*.



## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta *and* Juan Santos Vara

## SOME REFLECTIONS ON *ACHMEA*'S BROADER CONSEQUENCES FOR INVESTMENT ARBITRATION

CHRISTINA ECKES\*

TABLE OF CONTENTS: I. Introduction. – II. A delicate good: autonomy of the EU legal order. – III. Consequences for CETA's Investment Court System. – IV. Intra-EU BITS: national courts as the guardian of the Union of law. – V. Autonomy as an obstacle to the Union submitting to the jurisdiction of international courts or tribunals. – VI. The future of international investment protection law after *Achmea*.

ABSTRACT: In the *Achmea* case (judgment of 6 March 2018, case C-284/16), the Court of Justice applied its standing case law on the autonomy of the EU legal order to Investor-state Dispute Resolution (ISDS) and concluded that the ISDS mechanism at hand was contrary to EU law. Irrespective of whether the Court's construction of autonomy is conceptually convincing, the principled elaborations on autonomy in *Achmea*, emphasized the relevance of the preliminary ruling procedure as the institutional backbone of the effectiveness of EU law. This institutional backbone, which allows for a constant dialogue between the Court of Justice and the national judiciary, played an important role in the Courts finding that EU law enjoys direct effect and primacy in *van Gend en Loos* and *Costa v. ENEL*. (respectively, judgment of 5 February 1963, case 26/62 and judgment of 15 July 1964, case 6/64). In the eyes of the Court, it cannot be compromised by offering investors an alternative route of dispute settlement from which no possibility exists to ask preliminary questions. While other aspects of the ruling, that is the Court's considerations on mutual trust, may apply specifically to the type of Intra-EU ISDS mechanisms in *Achmea*, the autonomy reasoning logically also applies to other forms of investment arbitration, such as the Investment Court System (ICS) in the Comprehensive Economic and Trade Agreement between the EU and Canada (CETA) and the envisaged Multilateral Investment Court (MIC). The principled stand on autonomy, as the Court has presented it in a long list of cases, including in *Achmea*, amounts to a considerable, albeit not nec-

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essarily insurmountable obstacle to both Member States and the Union submitting to the jurisdiction of international courts and tribunals.

KEYWORDS: autonomy of EU law – investor-state dispute resolution – mutual trust – *Achmea* – Opinion 1/17 – CETA.

## I. INTRODUCTION

In the case of *Achmea*,<sup>1</sup> the Court of Justice ruled that the Investor-State-Dispute-Settlement (ISDS) mechanism in the bilateral investment treaty between the Netherlands and Slovakia (Netherlands-Slovakia BIT) was *incompatible* with EU law. The case concerned the legality of ISDS in BITs between Member States (intra-EU BITs); yet it also raises considerable doubts about the compatibility with EU law of the Investment Court System (ICS) model introduced in the Comprehensive Economic and Trade Agreement between the EU and Canada (CETA), the Multilateral Investment Court (MIC) that would replace the ICS under CETA at some point and more generally, the future of international investment arbitration, as well as ultimately the Union's ability to submit to the jurisdiction of international courts or tribunals in any substantive field.

*Achmea*, while it has attracted a lot of attention from the investment arbitration community, builds on a long line of case law on the autonomy of the EU legal order and does by no means constitute a surprising turn of any sort. The case confirms that arbitration clauses in intra-EU BITs, at least in their most common form, are incompatible with EU law. Yet it has not entirely ruled out Union submission to the jurisdiction of international courts and tribunals or even Union participation in setting up a MIC. This depends on the precise agreements on how their jurisdiction could be delimited in a way that protects the autonomy of the EU legal order. What *Achmea* has done is that it has put the Court of Justice and AG Bot in a difficult position with regard to pending Opinion 1/17 concerning the compatibility with EU law of the ICS agreed in CETA. AG Bot took the position that *Achmea* "is not prejudicial to the compatibility of the ICS with the requirement of the autonomy of the EU legal order".<sup>2</sup> In conclusion, he advised the Court to find the ICS in CETA in compliance with EU law.<sup>3</sup>

This *Article* discusses in turn the meaning and relevance of the autonomy of the EU legal order as it is constructed in the case law of the Court of Justice (Section II); the conclusions that can be drawn from *Achmea* for the ICS in CETA (Section III); *Achmea's* rationale in the context of intra-EU BITs (Section IV); whether the autonomy of the EU legal

<sup>1</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Achmea* [GC].

<sup>2</sup> Opinion of AG Bot delivered on 29 January 2019, opinion 1/17, para 95 *et seq.* See for his argument section IV below.

<sup>3</sup> *Ibid.*, para. 272.

order is an obstacle for the Union to submit to the decisions of international courts and tribunals (Section V); and finally whether it stands in the way of Union participation in a MIC and what it means for the future of international investment arbitration (Section VI).

## II. A DELICATE GOOD: AUTONOMY OF THE EU LEGAL ORDER

The autonomy of EU law is what makes EU law a legal order.<sup>4</sup> The Court justifies EU law's autonomy "by the essential characteristics of the EU and its law".<sup>5</sup> The autonomy of the EU legal order is constructed in a circular reasoning: the essential characteristics of EU law justify its autonomy and autonomy makes its essential characteristics as a domestic legal order possible. In fact, this reasoning and the consequences flowing from understanding the EU legal order as a domestic legal order lie at the very core of what makes the Union different from international organisations. It is also essentially contested and depends on the support of above all national courts.

EU law depends on its autonomous character (that is, its self-referential nature of not depending on national and international law for its validity and interpretation) for its constitutional character and its ability to ensure the effectiveness of EU law. This formal legal (and absolute) autonomy allows the Court of Justice to uphold the claim that the effects of EU law within the national legal order are a matter of EU law, rather than national law. This in turn ensures the effectiveness of EU law on the ground, which is its most distinctive characteristic. The preliminary ruling procedure (Art. 267 TFEU) is the institutional backbone of this effectiveness and the mechanism that allows in an ongoing dialogue between the Court of Justice and the national judiciary a regular confirmation of the Court's autonomy claim by national courts.<sup>6</sup> The institutionalized interaction is additionally protected by the Member States' obligation not to "submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than" the Court of Justice (Art. 344 TFEU). While this was previously questioned, including by the referring court, in *Achmea* the Court of Justice considered Art. 344 TFEU applicable to disputes between individuals and states, when it concluded that Arts 267 and 344 TFEU must jointly be interpreted to preclude a dispute settlement mechanism as the one in question.<sup>7</sup>

The Court of Justice's position on the autonomy of the EU legal order as expressed in *Achmea* is in line with its settled case law. The Court refers heavily to Opinion 2/13 on

<sup>4</sup> This section draws on: C. ECKES, *EU Powers Under External Pressure - How the EU's External Actions Alter its Internal Structures*, Oxford: Oxford University Press, 2019: see p. 22 *et seq.* for a detailed conceptualization of the autonomy of EU law.

<sup>5</sup> *Achmea* [GC], cit., para. 33.

<sup>6</sup> See C. ECKES, *EU Powers Under External Pressure*, cit., p. 25 *et seq.*

<sup>7</sup> *Achmea* [GC], cit., para. 60. The same position was suggested in the opinion of AG Wathelet delivered on 19 September 2017, case C-284/16, *Achmea*, para. 144.

EU accession to the European Convention on Human Rights in the lengthy preliminary section on autonomy in the *Achmea* case; yet, this is only the most recent culmination of the Court's long line of cases and opinions holding that EU submission to certain international courts or tribunals, while remaining possible as a matter of principle, may threaten the nature and existence of the EU as an autonomous legal order.<sup>8</sup>

More specifically, the Court held in *Achmea* that the protection of the autonomy of the EU legal order requires that no field of EU law be removed from the substantive reach of the preliminary reference procedure. This is fully in line with Opinion 1/09 on the European Patent Court.<sup>9</sup> The *potential effects* of the institutional arrangement of the international court or tribunal must be considered when deciding whether such a removal takes place. In other words, the Court of Justice focused not on the specific arbitration at hand but considered how the international agreement set up arbitration and whether any (hypothetical future) arbitration could have negative effects for the (autonomy of the) EU legal order. The Court held that the EU judicial system would be undermined if disputes could be removed from it by bringing them before arbitral tribunals, which, besides the fact that they are not subject to an exhaustion of domestic remedies rule, do not form part of the EU judicial system and consequently cannot ask the Court of Justice preliminary questions.<sup>10</sup> It should be added that this problem is not easily remedied. The removal of disputes from the ordinary judiciary is the *very purpose* of ISDS mechanisms and the Court's reasoning concerned the removal of *potential questions about EU law* from the preliminary ruling procedure. It was *not limited* to situations in which the arbitral tribunal actually *strictly speaking interprets EU law*. Questions about EU law can also arise from *prima facie* purely national legal issues, because they fall within the widely defined scope of EU law or because they touch upon the Union's interest.<sup>11</sup> The following sections consider what the Court's position on the autonomy of the EU legal order means for the compatibility of different investment arbitration mechanisms. The last section sets out how investment arbitration would have to be construed in order to avoid threatening the EU's autonomy.

### III. CONSEQUENCES FOR CETA'S INVESTMENT COURT SYSTEM

On a *prima-facie*-reading, the ICS in CETA differs on several accounts from the ISDS model in *Achmea*, which is widely used in BITs. First, the ICS model meets higher rule of law

<sup>8</sup> Court of Justice: opinion 2/13 of 18 December 2014; opinion 1/09 of 8 March 2011 (European and Community Patents Court); opinion 1/91 of 14 December 1991. See also explicitly opinion 1/00 of 18 April 2002, para. 12: "the preservation of the autonomy of the Community legal order requires [...] that the essential character of the powers of the Community and its institutions as conceived in the Treaty remain unaltered".

<sup>9</sup> Opinion 1/09, cit.

<sup>10</sup> *Achmea* [GC], cit., paras 50-52.

<sup>11</sup> See for the interpretation of the scope of EU law, see Court of Justice: judgment of 26 February 2013, case C-617/10, *Åkerberg Fransson* [GC], para. 22; judgment of 6 March 2014, case C-206/13, *Siragusa*.

standards. As is well known, the Commission presented its proposal to move to an ICS model replacing existing ISDS mechanisms in all ongoing and future EU investment negotiations in response to critical voices all around and with the intention to address some of the criticism.<sup>12</sup> The criticism levelled at ISDS challenged different aspects all related to its very limited legitimacy, including the lack of judicial independence, predictability and consistency of decisions, as well as transparency. The ICS, it is fair to conclude, addresses (some of) the criticism of the *ad hoc* arbitration of traditional ISDS mechanisms.

CETA was the first FTA to set up an ICS, following a last-minute move by the Commission.<sup>13</sup> The ICS in CETA is composed of a Tribunal of first instance and an Appeal Tribunal, operating with relatively independent arbitrators<sup>14</sup> with high-level legal qualifications comparable to those required for the members of permanent international courts, such as the International Court of Justice and the WTO Appellate Body. The Tribunal<sup>15</sup> has 15 Members; 5 from Canada, 5 from the EU, and 5 from a third country. Members of the tribunal must possess professional qualifications<sup>16</sup> and adhere to an ethics code.<sup>17</sup> The arbitrators are allocated to a case on the basis of drawing from a roster, “ensuring that the composition of the divisions is random and unpredictable, while giving equal opportunity to all Members of the Tribunal to serve”.<sup>18</sup> An Appellate Tribunal reviews the decisions of the Tribunal.<sup>19</sup>

The ISDS mechanism in *Achmea* by contrast was an arbitral tribunal “constituted for each individual case in the following way: each party to the dispute appoints one member of the tribunal and the two members thus appointed shall select a national of a

<sup>12</sup> Commission, Press release of 16 September 2015, *Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations* (hereafter: Commission, ICS Press release), europa.eu. At face value this departs from the Council Directives for the negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America of 17 June 2013, available at data.consilium.europa.eu.

<sup>13</sup> Commission, ICS Press release, cit. The complete text of CETA was published in August 2014. On 29 February 2016, the Commission announced that the EU and Canada had agreed to replace the *ad hoc* ISDS with a permanent institutionalized construction (the ICS).

<sup>14</sup> The Commission used at the hearing for opinion 1/17 of 26 June 2018 the term “hybrid” to characterize the ICS, despite its name, as neither ISDS nor a court system.

<sup>15</sup> Art. 8.27 CETA.

<sup>16</sup> Art. 8.27, para. 4, CETA: “The Members of the Tribunal shall possess the qualifications required in their respective countries for appointment to judicial office, or be jurists of recognised competence. They shall have demonstrated expertise in public international law. It is desirable that they have expertise in particular, in international investment law, in international trade law and the resolution of disputes arising under international investment or international trade agreements”.

<sup>17</sup> Art. 8.30 CETA.

<sup>18</sup> Art. 8.27, para. 7, CETA; see also European Parliament, Policy Department, Directorate-General for External Policies, *In Pursuit of an International Investment Court: Recently Negotiated Chapters in EU Comprehensive Free Trade Agreements in Comparative Perspective*, study by S. HINDELANG and T. HAGEMEYER, Brussels: European Union, 2017.

<sup>19</sup> Art 8.28 CETA.

third State as Chairman of the tribunal".<sup>20</sup> The appointment rules for the tribunal in *Achmea* demonstrate the high level of private autonomy bias in arbitration that is characteristic for the current system.

The ICS moves ISDS on the scale between party-led arbitration and institutionalized judicial bodies towards the latter. It reduces the private autonomy bias, improves the internal coherence of investment law and strengthens the independence of arbitrators. The ICS also aimed to reduce the bias towards investors by limiting the financial incentives to act as an arbitrator, for instance by providing a retainer fee, as well as a random allocation of cases. The general commitment to the ICS model for all future international arbitration mechanisms acknowledges that the private autonomy bias is unjustified. This should be welcomed. Investor-state disputes concern claims by individuals that the public exercise of power is incompatible with the principles and norms by which the public authority has bound itself under the investment treaty. They do not concern disputes between two private parties who are free to attempt to find a pragmatic (rather than necessarily just) outcome for their dispute without involving the state. Additionally, investment awards are ultimately paid by the taxpayer. Yet the ICS does not address other issues that have been criticised with regard to ISDS mechanisms more generally. Crucially, they remain disconnected from any general, i.e. not investment focussed, constitutional system. They do not form part of any system of general rights and principles. They do use the same language or aim to connect to any system that generally establishes the rights of individuals and the limitations on public power, as domestic constitutions do.

In other words, the very purpose of the ISDS mechanism in *Achmea* and of the ICS in CETA is identical: offering an alternative mechanism of dispute settlement that is neither embedded in the national constitutional system nor subject to review by the ordinary judiciary. The ICS in CETA has hence in this particular regard the same effects as the ISDS mechanism in *Achmea*. CETA provides that foreign investors must choose to bring proceedings either before domestic courts or before an ICS tribunal. If they choose the ICS tribunal they are required to discontinue domestic proceedings or refrain from starting them.<sup>21</sup> This is the so-called fork in the road clause, which is a common feature of investment arbitration. It effectively ensures that investment tribunals will be the sole arbitrator.

Not so much the outcome but the Court's reasoning in *Achmea* makes the case also bad news for the ICS. The Court introduced the *Achmea* ruling with eight paragraphs of principled considerations on the *autonomy of the EU legal order* before turning to the central question about the compatibility of the ISDS mechanism with EU law. It found the ISDS in *Achmea* to be in conflict with the *autonomy of the EU legal order* because it

<sup>20</sup> *Achmea* [GC], cit., para. 3.

<sup>21</sup> Art. 8.22, para. 1, let. f) and g), CETA.

*removes disputes from the jurisdiction of the courts of the Member States.*<sup>22</sup> This is not a new criticism. In fact, the Court of Justice had highlighted this point as the decisive feature of the investment chapter in the EUSFTA that requires Member States to endorse the mechanism.<sup>23</sup> In *Achmea*, it added more specifically that the autonomy of the EU legal order can only be preserved by an internal EU judicial system that remains able “to ensure the consistency and uniformity in interpretation of EU law”.<sup>24</sup>

The fundamental nature of the Court’s autonomy concern becomes apparent in its general abstract reasoning. While the AG focused on the specific dispute at hand and on whether this specific award could have had “any impact on questions of EU law”<sup>25</sup> the Court pondered generally whether disputes that an arbitral tribunal under the BIT in question “is called on to resolve are *liable* to relate to the interpretation or application of EU law”.<sup>26</sup> By taking such an abstract approach and considering the *potential* scope of disputes settled by any tribunal rather than the *actual* scope of the specific dispute the Court revealed its deep unwillingness to take any chances that the domestic and autonomous nature of the EU legal order might come under pressure.<sup>27</sup> This indirectly confirms the high relevance of this concern for any and all ISDS mechanisms/the ICS.

The conclusion must be that, despite tangible differences between the ISDS mechanism in *Achmea* and the ICS under CETA, these fundamental concerns of the Court that the removal of disputes from the preliminary ruling procedure as the backbone of the autonomy and effectiveness of EU law seem to apply in the same way to both. This cannot be remedied by clauses declaring that the ICS assesses EU law “as a matter of fact”, aligning the interpretation of EU law by the arbitral tribunal to the “prevailing interpretation” of the Court of Justice and stipulating that “any meaning given to domestic law by the Tribunal shall not be binding upon the courts or the authorities of that Party”.<sup>28</sup> These clauses reduce the likelihood that any tribunal award interferes in a substantive manner with EU law. They do not change the fact that matters within the scope of EU law are decided by judicial bodies that cannot refer preliminary rulings to the Court of Justice. The potential misinterpretation of EU law may also have been a concern of the Court; yet this is not emphasised in the ruling. The Court did not engage with the issue of whether any such (mis-)interpretation by an ISDS tribunal would be binding on the

<sup>22</sup> See *Achmea* [GC], cit., paras 50-52.

<sup>23</sup> Court of Justice, opinion 2/15 of 16 May 2017, para. 292.

<sup>24</sup> *Achmea* [GC], cit., para. 35.

<sup>25</sup> Opinion of AG Wathelet, *Achmea*, cit., paras 177-178.

<sup>26</sup> *Achmea* [GC], cit., para. 39 emphasis added.

<sup>27</sup> See C. ECKES, *EU Powers Under External Pressure*, cit., p. 15 *et seq.*, p. 185 *et seq.* on the plausibility of this concern.

<sup>28</sup> Art. 8.31 CETA; nearly identical for example: Art. 16(2) of the Free Trade Agreement between the EU and the Socialist Republic of Viet Nam, not yet ratified.

EU or whether the binding or non-binding nature of the decisions would make any difference for the threat to the autonomy of the EU legal order.

Opinion 1/17 is pending. The decision of AG Bot was delivered on 29 January 2019.<sup>29</sup> The Court will have to engage precisely with the issue of what about the ICS may or may not threaten the autonomy of the EU legal order and will hence likely shed more light on the issue. The Court's reasoning in a long line of case law, which in *Achmea* it applied specifically to investment arbitration, sets out a long-standing and fundamental concern that it will take into account in Opinion 1/17. Whether the Court sees a possibility to reconcile its autonomy concern with the institutional set up of the ICS in CETA and its potential effects on the EU legal order remains to be seen. Yet it should be concluded that the reasoning in *Achmea* has increased the threshold of necessary judicial justification for finding the ICS in CETA compatible with EU law.

In *Achmea*, the Court ruled on a bilateral investment agreement between two EU Member States. CETA, by contrast, is an FTA between the EU and all 28 Member States as one party and a third country as the other. The involvement of a non-EU actor is another core difference between CETA and the Netherlands-Slovakia BIT in *Achmea*. Moreover, some commentators have interpreted the section in *Achmea*, in which the Court recalls its settled case law that the Union can submit to the decisions of a court created under an international agreement concluded by the EU,<sup>30</sup> as indicating that *Achmea* has nothing to say about international investment treaties concluded by the EU.<sup>31</sup> This reading does neither justice to the formulaic language nor to the reasoning of the Court. In its common use, the often-used phrase "it is true that [...] in principle..."<sup>32</sup> recalls a general principle, followed by an explanation why nonetheless in the case at hand a different conclusion is warranted. The Court's reasoning was based on a rejection that an arbitral tribunal established under an international agreement between two Member States could be considered part of the judicial system of the EU.<sup>33</sup> This reasoning also applies to an arbitral tribunal established in a multilateral agreement involving a third country.

This is not to say that I expect the Court to simply apply the autonomy doctrine as set out in *Achmea* one-on-one to extra-EU constructions that involve non-EU parties. However, if anything, the multilateral nature and the involvement of non-EU parties makes the situation more problematic for the autonomy of the EU legal order. Non-EU actors are not part of the interlocking embrace of European integration.<sup>34</sup> They do not

<sup>29</sup> Opinion of AG Bot, opinion 1/17, cit.

<sup>30</sup> *Achmea* [GC], cit., para. 57.

<sup>31</sup> See J. HILLEBRAND POHL, *Intra-EU Investment Arbitration after the Achmea Case: Legal Autonomy Bounded by Mutual Trust?: ECJ 20 April 2018, Case C-284/16, Slovak Republic v. Achmea*, in *European Constitutional Law Review*, 2018, p. 10.

<sup>32</sup> *Achmea* [GC], cit., para. 57.

<sup>33</sup> *Ibid.*, para. 45.

<sup>34</sup> See C. ECKES, *EU Powers Under External Pressure*, cit., p. 15 *et seq.*, for more details.

share the same interest in the functioning of the European project. They are not subject to the jurisdiction of the Court of Justice. They are not only able but also much more likely to challenge the (international) position and the particularities of the Union.<sup>35</sup> Most importantly, by contrast to courts of the Member States,<sup>36</sup> non-EU actors, including international courts and tribunals, are not bound by the primacy of EU law. A core difference is the relevance of the principle of mutual trust for intra-EU relations. The next section focusses among other things on this point.

#### IV. INTRA-EU BITS: NATIONAL COURTS AS THE GUARDIAN OF THE UNION OF LAW

*Achmea* confirms that, despite the Court's core concern that ISDS mechanisms are liable to remove disputes from the preliminary ruling procedure (and that this may undermine the effectiveness of EU law and the autonomy of the EU legal order), a case may still reach the Court of Justice if an arbitral tribunal is established in a Member State, whose law permits (limited) judicial review and in that context a reference for preliminary ruling.<sup>37</sup> This would in principle be the case for tribunals established under intra-EU BITS and extra-EU BITS. However, this limited review (in the case of German law in *Achmea* limited to reviewing the validity of the arbitration agreement and the consistency with public policy of the enforcement of the arbitral award)<sup>38</sup> does not offer the same guarantee of uniform and effective application of EU law than full judicial review of the claim of the investor in court in the first place. The limited review concerns no longer the substance of the case. In fact, as mentioned above, the removal from ordinary judicial review is the *very purpose* of setting up ISDS mechanisms. If disputes decided upon by the ISDS mechanism/ICS were also subject to full judicial review of the merits by national courts, the setting up an ISDS mechanism/ICS would become futile.

Within the EU, cooperation is built on the *principle of mutual trust*, which in turn is based on the shared commitment to the values in Art. 2 TEU and the enforcement of these values and EU law more generally in the Member States. This enforcement falls

<sup>35</sup> An example of this lower interest and willingness to accommodate the Union's particularities was the reaction of non-EU countries when the EU sought to become an observer in the UNGA in 2010 and other states in the UNGA voted against this: see L. PHILLIPS, *EU Wins New Powers at UN, Transforming Global Body*, in *EU Observer*, 3 May 2011 euobserver.com. Likewise, despite a 2010 Commission announcement that it would explore the possibility of acceding to the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), and the increasing necessity of doing so, it is "practically impossible" that all contracting parties will agree to this. See A REINISCH, *Will the EU's Proposal Concerning an Investment Court System for CETA and TTIP Lead to Enforceable Awards? – The Limits of Modifying the ICSID Convention and the Nature of Investment Arbitration*, in *Journal of International Economic Law*, 2016, p. 769.

<sup>36</sup> *Achmea* [GC], cit., para. 13.

<sup>37</sup> *Ibid.*, para. 53.

<sup>38</sup> *Ibid.*

pursuant to Art. 19 TEU both to national courts and the Court of Justice connected by the preliminary ruling procedure.<sup>39</sup> Hence, removing disputes from the national jurisdiction and from the preliminary ruling procedure also undermines the mechanism that ensures that the Union adheres to the rule of law, which is the basis of principle of mutual trust.

Furthermore, the Court of Justice is clear on its conception of the rule of law within the EU legal order. It identifies a properly functioning and independent national judiciary as the very essence of the rule of law within the Union<sup>40</sup> and a precondition for the principle of mutual trust.<sup>41</sup> The Court further and more specifically expressed that the independence of national courts is “essential to the proper working of the judicial cooperation system embodied by the preliminary ruling mechanism under Art. 267 TFEU” and repeatedly confirmed that the preliminary ruling mechanism “may be activated only by a body responsible for applying EU law which satisfies, *inter alia*, that criterion of independence”.<sup>42</sup> In fact, the Court conclusively held that the ISDS mechanism under the Netherlands-Slovakia BIT “call[ed] into question not only the principle of *mutual trust between the Member States* but also the preservation of *the particular nature of the law established by the Treaties*, ensured by the preliminary ruling procedure provided for in Art. 267 TFEU, and *is not therefore compatible with the principle of sincere cooperation*”.<sup>43</sup>

In other words, the fact that the effective application of EU law in the Member States is threatened by moving disputes to ISDS mechanisms that are not embedded within the national judicial system is liable of undermining mutual trust and threatens the (autonomous) nature of EU law. These two reasons given by the Court should be read as *cumulative* reasons for finding the ISDS mechanism in *Achmea* incompatible with EU law.

*Achmea* clearly confirms the mutual trust reason applies to intra-EU BITs. This is also the reason why the Commission, which has argued all along that intra-EU BITs are incompatible with EU law, has welcomed the Member States’ commitments to terminate all intra-EU BITs following *Achmea*.<sup>44</sup> *Prima facie*, one could think that the mutual trust reason applies *exclusively* to intra-EU BITs<sup>45</sup> and hence neither to the ICS nor to the MIC. The

<sup>39</sup> *Ibid.*, paras 36-37.

<sup>40</sup> Court of Justice, judgment of 27 February 2018, case C-64/16, *Associação Sindical dos Juizes Portugueses* [GC], paras 31-37 and the case-law cited. See also: Court of Justice, judgment of 25 July 2018, case C-216/18 PPU, *LM* [GC], paras 49-54.

<sup>41</sup> This was the central issue in *LM* [GC], cit., and the Court held that “only in exceptional circumstances” based on “a specific and precise assessment of the particular case” the national court may reject execution of a European Arrest Warrant if “there are substantial grounds for believing” that the surrendered person runs a real risk of his fundamental rights to an independent tribunal and a fair trial (para. 73).

<sup>42</sup> *Associação Sindical dos Juizes Portugueses* [GC], cit., para. 43; *LM* [GC], cit., para. 54.

<sup>43</sup> *Achmea* [GC], cit., para. 58.

<sup>44</sup> See the Declaration of the Representatives of the Governments of the Member States of 15 January 2019 on the Legal Consequences of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union (ec.europa.eu); see for the Commission’s reaction: europa.eu.

<sup>45</sup> See opinion of AG Bot, opinion 1/17, cit., para. 82.

consequences for mutual trust among Member States of agreements with non-EU states of either the EU or a Member State are definitely more difficult to establish. Logically, the establishment of an alternative dispute settlement mechanism in the extra-EU context only demonstrates mistrust by the non-EU party towards the judicial system of either the EU or the Member State and not by one Member State towards another. The mistrust of non-EU parties should be irrelevant for the functioning of the EU legal order.

For intra-EU BITs, it could even be argued that in light of the *objective* of alternative dispute settlement mechanisms, that is to offer an alternative judicial route outside and independent from the ordinary courts, the very establishment of such alternative dispute settlement mechanisms demonstrates a level of mistrust. However, this is *not* what the Court of Justice argued. The Court focussed in *Achmea*, including in the discussion of mutual trust, on the *effect* of establishing alternative dispute settlement mechanisms rather than on their *objective*. This is the reason why it is not so easy to limit the mutual trust reason exclusively to intra-EU BITs. Focussing on the effect, the Court discussed that the removal of disputes from the preliminary ruling procedure leads to an incomplete application of EU law as a result of the fact that some disputes within the scope of EU law may end up before arbitral tribunals that do not classify as “court” within the meaning of Art. 267 TFEU and hence cannot refer questions to the Court of Justice. The Court further considered that this undermines the rule of law and by extension the principle of mutual trust within the Union. The concerns of the Court about the effects of incomplete – or incorrect – application of EU law also apply to BITs between a Member State and a non-EU state, as well as international agreements concluded by the EU that set up extra-judicial dispute settlement between private parties and the state, such as the ICS. Disputes are removed from the jurisdictions of the EU and the Member State as a result of the agreement with the third party, including disputes that may raise questions of EU law. Furthermore, the interpretation of EU law by alternative dispute settlement mechanisms involving non-EU parties may, as a matter of principle and depending on the effectiveness of the agreed safeguards, undermine the uniform application of EU law in the same way as interpretations of dispute settlement mechanisms set up in intra-EU agreements.

The second reason concerning the autonomous nature of EU legal order was discussed in detail above. My considerations here are therefore limited to the relationship between autonomy and mutual trust. Mutual trust is part of the autonomy doctrine.<sup>46</sup> It serves the effectiveness of EU law in national courts and administrations, that is on the ground. Yet it is not the only building block at the core of the effectiveness of EU law. The Court’s considerations on the potential negative effects of EU submission to the jurisdiction of international courts and tribunals on the two other building blocks, namely

<sup>46</sup> See K. LENAERTS, *La vie après l’avis: Exploring the Principle of Mutual (Yet Not Blind) Trust*, in *Common Market Law Review*, 2017, p. 806.

the preliminary ruling procedure and the Court's monopoly to offer the correct interpretation of EU law from an EU law perspective, are valid also in the extra-EU context. In *Achmea*, the Court presented its argument as based on two *cumulative* reasons. Without further elaboration by the Court this should be read as that even if the first reason (mutual trust) does not apply the second (autonomy) in principle continues to be an obstacle to the establishment of any ISDS mechanism – in their traditional form, ICS or MIC. Whether the effect of removing disputes from the preliminary ruling procedure as a result of an agreement with a third party is sufficient to undermine mutual trust will be one question in Opinion 1/17. The AG has already answered it in the negative.<sup>47</sup> If the Court agrees with the AG, Opinion 1/17 should address, as a second step, whether interference with the latter two building blocks of the effectiveness of EU law (preliminary ruling procedure and monopoly of the Court of Justice) but not with the former (mutual trust) in the extra-EU context should be judged differently than interference with all three building blocks in the intra-EU context.

Finally, the fact that the Court concluded that ultimately the two cumulative reasons justified finding an infringement of the principle of *sincere cooperation* underlines the fundamental nature of the Court's considerations. Article 4, para. 3, TEU specifically identifies that it is the task of the Member States to give effect to EU law on the ground, including through judicial enforcement.<sup>48</sup> The reference to sincere cooperation is also in line with the Court's general use of sincere cooperation as the origin of, or at least working in support of, other constitutional principles. In its settled case law, the Court has identified a broad range of specific obligations flowing from the principle of sincere cooperation or more fundamentally EU loyalty, in particular for national courts.<sup>49</sup> EU loyalty is the organisational principle in the EU that ensures the *commitment of all parties involved to the overarching cause of making the EU legal order work*.

## V. AUTONOMY AS AN OBSTACLE TO THE UNION SUBMITTING TO THE JURISDICTION OF INTERNATIONAL COURTS OR TRIBUNALS

As explained above, the Court's fundamental concern that international courts or tribunals may threaten the autonomy of the EU legal order is reflected in its settled case law.<sup>50</sup> The Court's strict position limits the Union's capacity to submit to the jurisdiction of international courts or tribunals. The Court's opinion on the Union's accession to the

<sup>47</sup> See opinion of AG Bot, opinion 1/17, cit., para. 82.

<sup>48</sup> Opinion 2/13, cit., para. 173; *Associação Sindical dos Juizes Portugueses* [GC], cit., para. 34.

<sup>49</sup> C. ECKES, *EU Powers Under External Pressure*, cit., p. 45 *et seq.*

<sup>50</sup> See case law cited at note 8 above. See also C. ECKES, *EU Powers Under External Pressure*, cit., p. 185 *et seq.* for a more extensive discussion on which international courts and tribunals constitute a justified threat to the autonomy of the EU legal order.

European Convention on Human Rights is probably the best illustration of this point.<sup>51</sup> On the one hand, the Union is expressly committed to multilateralism and the observance of international law;<sup>52</sup> on the other, the Court's autonomy concerns have proven to stand in the way at least of the Union's accession to the European Convention on Human Rights and to prohibit Member States from concluding intra-EU BITs.<sup>53</sup>

In the present context, we must leave aside the *plausibility* of the Court's autonomy concerns, as any such discussion on their plausibility would require an in-depth consideration of the vulnerability of the EU legal order whose domestic and autonomous nature is essentially contested both by national constitutional courts and by international law.<sup>54</sup> This paper considers the autonomy concerns as they are *presented by the Court*, that is general and fundamental concerns that create an obstacle to Union submission to the jurisdiction of many other forms of international courts and tribunals, including in contexts in which the EU political institutions and the Member States have agreed that the Union should legally submit to their jurisdiction. At least where disputes with *individuals* are concerned, the Court takes (as discussed above) a cautious and perhaps even protectionist approach based on abstract considerations of what the consequences might be.

This does not mean that the Court might not in the individual case attempt to find pragmatic ways to keep the door open to Union participation in international regimes that set up an international court or tribunal, including if they allow private parties to bring complaints. Two reasons speak in favour of finding ways of reconciling the abstract and principled concerns and the political will of submitting the Union to international judicial regimes. First, the Union's role and influence as an international actor would be significantly constrained if the Union were ultimately unable to become a party to any international regime with a court or tribunal. This would also be the case if autonomy only stood in the way of submitting the Union to courts or tribunals that have jurisdiction to rule on disputes between individuals and states. At present, only two international judicial regimes of this form may come to mind, in which the EU is committed to participate: the European Court of Human Rights and ISDS/ICS. However, these forms of international courts and tribunals increase in number and in powers, parallel to the generally increasing role of non-state parties under international law, including natural and legal persons.<sup>55</sup> The creation of the MIC, discussed below, is a case in point.

<sup>51</sup> Opinion 2/13, cit.

<sup>52</sup> Arts 3, para. 5, and 21 TEU. See Commission, Reflection Paper on Harnessing Globalisation, COM(2017) 240, ec.europa.eu.

<sup>53</sup> Opinion 2/13, cit. and *Achmea* [GC], cit., respectively.

<sup>54</sup> See C. Eckes, *EU Powers Under External Pressure*, cit., p. 15 *et seq.*, p. 185 *et seq.*

<sup>55</sup> See: K. PARLETT, *The Individual in the International Legal System: Continuity and Change in the International Legal System*, Cambridge: Cambridge University Press, 2011. While international law remains state-centred, since the post-war period individuals have an increased role in many areas of international law. Parlett concludes that in international claims, while enforcement of individuals' rights remain largely reliant on diplomatic protection, ISDS is *lex specialis* to this general rule (p. 120 *et seq.*). Likewise, individ-

Another example is the Energy Charter Treaty, which involves the EU, its Member States and a range of non-EU states and provides investment protection in the energy sector.<sup>56</sup> The intra-EU application of the Energy Charter Treaty is very similar to intra-EU BITs. The extra-EU application is more similar to ISDS with non-EU states. Furthermore, in light of the growing realization that climate change is the greatest challenge of this century, one could well imagine or at least hope for the political courage to set up an international environmental/sustainability regime that sets up avenues for judicial review, including for cases brought by public interest organisations.

Second, if the Court further developed a doctrine of autonomy of the EU legal order that prevented the political institutions of the Union and the Member States from achieving their express global objectives<sup>57</sup> this would result in a tension between political wish and legal constraints that is even stronger than what we are used to within the European Union. The Union is a construction set up by Member States in order to subject the individual national (day-to-day) politics to the more entrenched legal constraints agreed by the collective. This leads to a particular tension between law and politics,<sup>58</sup> which can be witnessed within the Union. This tension largely flows from the strong role of the CJEU which is established under a regime of international treaties (the European Treaties) and is mandated to apply its own founding principles, including when the Union and Member States take collective decisions under any procedure other than the amendment procedure set out under the European Treaties. AG Bot further developed an extended argument on the issue of reciprocity, which has considerable political weight but seemed rather difficult to relate to the autonomy of the EU legal order in any direct legal way.<sup>59</sup>

When considering the likelihood that the Court might find a pragmatic way of reconciling its fundamental concerns with international political and legal reality, it is worth considering two high profile cases that were decided even more recently than *Achmea*.<sup>60</sup> Neither case concerned ISDS, but both illustrate more broadly the Court's *deference to international law*, as well as *to the political institutions* of both the Union and

uals may now be held criminally responsible under International Law (p. 274 *et seq.*) and Parlett concludes that in international human rights law "in general there has been a steady progression towards individualized claims, particularly in the regional systems" such as the European Court of Human Rights (p. 337 *et seq.*).

<sup>56</sup> Energy Charter Treaty of December 1994, available at [energycharter.org](http://energycharter.org).

<sup>57</sup> See opinion of AG Bot, opinion 1/17, cit., para. 173 *et seq.*, on this matter.

<sup>58</sup> To the extent that the distinction makes sense. Law refers to a solidified and formalized expression of political will (constitutional law; legislation) or a judicial decision (case law) of the past, adopted pursuant to specific procedural rules and expressing a particular normative claim. Law adopted in the past has a framing and constraining force on present politics, including law-making.

<sup>59</sup> Opinion of AG Bot, opinion 1/17, cit., para. 72 *et seq.*; in para. 85 the AG simply purports the link between reciprocity and autonomy. Reciprocity has extensively been criticized for being an openly political consideration in the context of the Court's case law on the absence of direct effect of WTO law.

<sup>60</sup> Court of Justice: judgment of 20 November 2018, joined cases C-626/15 and C-659/16, *Commission v. Council (Antarctica)*[GC]; judgment of 10 December 2018, case C-621/18, *Wightman*.

the Member States. This deference may appear at first sight only tenuously related to the issue of whether the autonomy of the EU legal order, as it is construed by the Court of Justice, stands in the way of full participation of the Union in the creation of international courts and tribunals. Yet the Court's willingness to defer to international law and to the political will of the EU institutions and the Member States is crucial to finding pragmatic ways of allowing Union participation in international judicial regimes while protecting the absolute legal autonomy as it is construed by the Court of Justice.

The first case, *Antarctica*, concerned two actions for annulment brought by the Commission against Council decisions approving the submission, on behalf of the Union *and its Member States*, of several documents to an international body.<sup>61</sup> The point of contention (as is the case in a growing body of post-Lisbon litigation) was *not the substantive position* but the question of *on behalf of whom* the paper and the positions at issue could be submitted: the Union alone or the Union together with its Member States.

The Court dismissed the Commission's challenges and held that permitting the Union "to have recourse [...] to the power which it has to act *without the participation of its Member States in an area of shared competence, when, unlike it, some of them have the status of [...] consultative parties, might well [...] undermine the responsibilities and rights of those consultative parties*".<sup>62</sup> In other words, the Court emphasized the powers of Member States under the international regime, which were comparatively stronger than those of the Union. In addition, the Court pointed out that the Union had "acknowledge[d] the special obligations and responsibilities of the [...] [Member States as] consultative parties" when it joined the regime.<sup>63</sup> The Court further expressed deference to the Council as the political institution by pointing out that there was still "the possibility of the required majority being obtained within the Council for the European Union to exercise that external competence alone".<sup>64</sup> This appears to imply that the Council could have decided either way, submitting the documents alone or together with the Member States and that the Court would not have interfered by imposing legal limits based on internal competence considerations irrespective of which choice the Council had made.

The Court's argument in *Antarctica* seems two-pronged. First, the Union should involve the Member States because they are the more powerful actors under the international regime in question. This is supported by effectiveness considerations and entails a certain deference to international law. Second, the Union should respect that it had acknowledged these powers of the Member States under international law and the Council could have decided differently, that is submitting the documents only on behalf of the Union. This reflects a level of deference to the decisions of the Union's political institutions.

<sup>61</sup> Commission for the Conservation of Antarctic Marine Living Resources.

<sup>62</sup> *Commission v. Council* [GC], cit., para. 133.

<sup>63</sup> *Ibid.*, para. 131

<sup>64</sup> *Ibid.*, para. 126 with references to Court of Justice: judgment of 21 June 2017, case C-600/14, *Germany v. Council* [GC], para. 68, and opinion 2/15, cit., para. 244.

The weight that the Court attached to a Union commitment under international law and arguably also to the constraints of international law imposed on the Union as an international actor (not being able to be a consultative party by contrast to the Member States) must be read in conjunction with the earlier mentioned, often-repeated, and at times strongly-defended<sup>65</sup> dimension of the autonomy doctrine that entails that “an international agreement cannot affect the allocation of powers fixed by the Treaties”.<sup>66</sup> *Antarctica* seems to allow or even require<sup>67</sup> the submission of documents on behalf of the Union and its Member States, not because of the internal division of competences but because of powers that the Member States hold under international law.<sup>68</sup> The ruling should be read as the Court not only accepting the Council’s decision to submit the documents together with the Member States because this was legally possible within the framework of the European Treaties, but concluding that a joint submission was necessary in the specific situation. In other words, while generally within the category of shared competences, the Council could choose to act alone. The specific situation under the international regime in question warranted participation of the Member States. In any event, this should not be read to indicate that the Court would accept a decision of the Council to take joint action if the internal competence division did not allow for it, that is in the area of exclusive competences. Conceptually, it should be added that the *Antarctica* case concerned the political autonomy of the Union to take a specific position under an international legal regime (hereby submitting specific positions and documents). This political autonomy of the Union is – as any autonomy – relative. The legal conceptual autonomy of the EU legal order, depending on the monopoly of jurisdiction of the CJEU and the primacy of EU law, is construed by the Court to be absolute.

In the second case concerning the UK’s ability to unilaterally revoke the declaration of the intention to withdraw from the Union under Art. 50 TEU,<sup>69</sup> the Court reconfirmed its deference to international law and demonstrated this time its deference to the sovereignty of the Member States. The Court first recalled that Member States have “limited their sovereign rights”<sup>70</sup> by joining the Union but then concluded that the submission of the intention to withdraw under Art. 50, para. 1; TEU “depend[ed] solely on [...] sovereign choice” of the withdrawing state.<sup>71</sup> The Court then went on for eight further paragraphs emphasizing the “sovereign nature” of that choice.<sup>72</sup> The Court of Justice

<sup>65</sup> Opinion 2/13, cit., para. 201.

<sup>66</sup> *Achmea* [GC], cit., para. 32.

<sup>67</sup> In *Commission v. Council* [GC], cit., para. 133, the CJEU indicated that permitting the Union to make a different choice might undermine the responsibilities and rights of the Member States.

<sup>68</sup> See also: C. ECKES, *Antarctica: Has the Court of Justice got cold feet?*, 3 December 2018, european-lawblog.eu.

<sup>69</sup> *Wightman*, cit.

<sup>70</sup> *Ibid.*, para. 44.

<sup>71</sup> *Ibid.*, para. 50.

<sup>72</sup> *Ibid.*, paras 51-58.

further referred to the Vienna Convention on the Law of Treaties (general public international law) to find support for its reasoning.<sup>73</sup>

Neither of the two cases stands in direct connection to international investment arbitration and one swallow does not make a summer. Yet if one reads these cases as a sign that the Court takes a (more) cautious position on international law constraints on the Union and *vis-à-vis* the political will of the Member States, as well as the EU institutions, they might allow us to speculate whether the Court might try to find a pragmatic way of approaching Opinion 1/17. Pragmatism, including in order to ensure continuous support from national courts and Member States, is over the years one of the strong points of the Court. Its level of deference towards international law seems indeed at times be influenced by such pragmatic considerations.<sup>74</sup> One option would be to indicate how an international judicial regime could meet the high threshold of offering enough safeguard mechanisms to protect the absolute autonomy of EU law. In that sense, Opinion 2/13 was very principled and did not seem to offer a lot of room for a way forward.

## VI. THE FUTURE OF INTERNATIONAL INVESTMENT PROTECTION LAW AFTER *ACHMEA*

*Achmea* has certainly disconcerted the international investment arbitration crowd. More so than the Court's earlier rulings on the autonomy of the EU legal order and the Union's ability to commit to international dispute settlement mechanisms. I would say that their concern is justified. The referring court emphasized the relevance because of the "numerous bilateral investment treaties still in force between Member States which contain similar arbitration clauses"<sup>75</sup> and which the Member States are now committed to terminate.<sup>76</sup> I have argued above why the relevance of *Achmea* goes beyond the intra-EU BITs.

At the same time, the Council adopted the negotiation directives authorizing the Commission to negotiate a convention establishing a multilateral court for the settlement of investment disputes on 1 March 2018.<sup>77</sup> That is five days before the *Achmea* ruling. *Achmea* was even interpreted as an attempt to give the ICS a leg up.<sup>78</sup> My reading is much more cautious. I would say that any plan to establish a MIC must take account of the Court of Justice's autonomy concerns, expressed in its settled case and

<sup>73</sup> *Ibid.*, para. 70.

<sup>74</sup> Compare the Court of Justice's approach to international law in *Commission v. Council* [GC], cit., and Court of Justice, judgment of 21 December 2016, case C-104/16 P, *Council v. Front Polisario* [GC].

<sup>75</sup> *Achmea* [GC], cit., para. 14.

<sup>76</sup> Declaration of the Representatives of the Governments of the Member States, cit.

<sup>77</sup> Council, Negotiating directives of 1 March 2018 for a Convention establishing a multilateral court for the settlement of investment disputes, data.consilium.europa.eu.

<sup>78</sup> C. BROWER, J. AHMAD, *From the Two-Headed Nightingale to the Fifteen-Headed Hydra: The Many Follies of the Proposed International Investment Court*, in *Fordham International Law Journal*, 2018, p. 791 *et seq.*

specifically applied to ISDS in *Achmea*. And, it is not readily understandable what the realistic legal options are.

What could be pragmatic ways of reconciling Union submission to international judicial regimes with the Court's autonomy concern? What safeguard clauses in the international agreement could ensure that the autonomy of the EU legal order remains protected in the context of all disputes and all circumstances that may arise under that agreement? First, in light of the Court's case law on the independence of the national judiciary, it is unlikely that the Court would accept any form of reference mechanism modeled on the preliminary ruling procedure that would allow ISDS tribunals to refer questions to the Court of Justice. For the arbitral tribunal in *Achmea* it explicitly rejected this possibility,<sup>79</sup> which was sketched by the AG.<sup>80</sup> CETA does not provide for a mechanism for prior involvement either. An example of such a mechanism that springs to mind is the EU-Ukraine Association Agreement, which contains arbitration provisions for any disputes arising under the agreement.<sup>81</sup> It also contains a strict carve-out clause for all "question of interpretation of a provision of EU law", which are referred to the Court of Justice and whose interpretation is then binding on the tribunal.<sup>82</sup> However, this concerns arbitration between the contracting parties rather than individuals.<sup>83</sup> For ISDS tribunals dealing with disputes brought by individuals, this option is in my view excluded as long as the international court or tribunal is not embedded within the national judiciary which is the precise purpose of ISDS. Furthermore and even more importantly, such a prior involvement mechanism would put into question the objective of investment arbitration, which is to guarantee a separate dispute resolution mechanism disconnected from the domestic judiciary.

Second, the suggestion has been made to sidestep *Achmea* by making interpretations of EU law in the context of investment arbitration non-binding.<sup>84</sup> *Achmea* did not give a clear answer to the question whether EU legal autonomy could be adversely affected by interpretations of investment tribunals that are not binding as a matter of EU law.<sup>85</sup> However, as was discussed above, the non-binding nature would alleviate the impact of substantive positions of the international court or tribunal within the EU legal order. It does not address the core concern of the Court that removing disputes from the preliminary ruling procedure altogether undermines the autonomy of the EU legal order.

<sup>79</sup> *Achmea* [GC], cit., para. 46.

<sup>80</sup> Opinion of AG Wathelet, *Achmea*, cit., para. 85.

<sup>81</sup> Chapter 14 of the EU-Ukraine Association Agreement, available at [trade.ec.europa.eu](http://trade.ec.europa.eu).

<sup>82</sup> Art. 322, para. 2, of the EU-Ukraine Association Agreement.

<sup>83</sup> In fact, Art. 321, para. 2, of the EU-Ukraine Association Agreement establishes expressly: "Any ruling of the arbitration panel shall be binding on the Parties and shall *not create any rights or obligations for natural or legal persons*" (emphasis added).

<sup>84</sup> J. LEE, *The Empire Strikes Back: Case Note on The CJEU Decision in Slovak Republic c. ACHMEA BV*, in *Contemporary Asia Arbitration Journal*, 2018, p. 150.

<sup>85</sup> J. HILLEBRAND POHL, *Intra-EU Investment Arbitration after the Achmea Case*, cit.

Third, CETA has made an attempt to ensure that the arbitration tribunal does not rule on the allocation of responsibility between the EU and its Member States.<sup>86</sup> The procedure allows the Union to determine the correct respondent and should be read in combination with an internal EU regulation managing the financial responsibility.<sup>87</sup> Such a construction could reasonably effectively avoid indirect pronouncement of international courts and tribunals on issues of competence within the EU legal order, which was certainly a core concern of the Court of Justice in the context of the EU's accession to the European Convention on Human Rights.

Fourth, the most far-reaching option would be to commit the international court and tribunal in question to respect the primacy of EU law. One central issue that distinguishes national judiciaries from arbitral tribunals of any sort and more generally EU actors from non-EU actors is their *commitment to the primacy of EU law*, which is the formal basis of the Court of Justice's ability to ensure the uniformity and autonomy of EU law. EU actors are committed to give EU law primacy both over national and international law of any formal status. Without the possibility of referring preliminary question, the international court or tribunal would however be left to its own devices to determine whether EU law is relevant to the dispute before it and how EU law should be interpreted. Enforcement of the primacy of EU law (if the court or tribunal disregards it) would depend on the scope and intensity of the usually very limited review by ordinary courts, discussed above. Reviewing whether any particular award is contrary to EU law would entail engaging with the substance of the case. This would stand in tension for example with the ICSID Convention, providing that awards should be treated as "final judgment of a court".<sup>88</sup> Furthermore and importantly, all these tentative considerations leave aside that non-EU parties are unlikely to accept references to the Court of Justice, let alone an extension of the primacy of EU law over the international regime.

By way of conclusion, *Achmea* is highly relevant not only for intra-EU BITs but also for the ICS and the future of ISDS. It demonstrates the fundamental nature of the Court of Justice's autonomy concern in the context of investment arbitration. At the same time, *Achmea* does not exclude that, in Opinion 1/17, the Court will take a pragmatic approach to the legality of the ICS/MIC plans and allow the realization of the political will in favour of international investment arbitration. It would be interesting to read the legal reasoning that could reconcile the ICS/MIC plans with the autonomy of the EU legal order.

<sup>86</sup> Art. 8.21 CETA.

<sup>87</sup> Regulation 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party.

<sup>88</sup> Arts 54 and 55 of the ICSID Convention.





## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta *and* Juan Santos Vara

## *ACHMEA*: CONSEQUENCES ON APPLICABLE LAW AND ISDS CLAUSES IN EXTRA-EU BITs AND FUTURE EU TRADE AND INVESTMENT AGREEMENTS

QUENTIN DECLÈVE\*

TABLE OF CONTENTS: I. Introduction: the *Achmea* judgment. – II. The European Commission's assessment and the EU Member States' position. – III. Potential consequences for existing BITs, CETA and future trade and investment agreements. – III.1. Various forms of applicable law clauses. – III.2. Extra-EU BITs which are silent on the applicable law in investment disputes, and Extra-EU BITs whose applicable law clause contains a reference to the domestic law of the host State. – III.3. Extra-EU BITs whose applicable law clause provides for the application and interpretation of international law. – III.4. Extra-EU BITs whose applicable law clause provides for the sole application and interpretation of the provisions contained in the BIT. – IV. Conclusion.

ABSTRACT: In its judgment in *Achmea* (judgment of 6 March 2018, case C-284/16 [GC]), the Court of Justice ruled that an investor-State arbitration clause in a bilateral investment treaty concluded between two EU Member States was contrary to the principle of the autonomy of the EU legal order. In this *Article*, I suggest that the *Achmea* judgment could have implications for the validity, not only of ISDS clauses in intra-EU BITs, but also of ISDS and applicable law clauses in BITs and other agreements concluded by the EU (or its Member States) with third States.

KEYWORDS: intra-EU arbitration – investment law – investor-State dispute settlement – autonomy of EU law – extra-EU BIT – CETA.

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## I. INTRODUCTION: THE *ACHMEA* JUDGMENT

In its judgment of 6 March 2018 in *Achmea*,<sup>1</sup> the Court of Justice ruled that an investor-State arbitration clause in a bilateral investment treaty (BIT) concluded between two EU Member States (intra-EU BIT, in the case at hand between the Netherlands and Czechoslovakia) violated EU law and was contrary to the principle of the autonomy of the EU legal order.

This judgment marked a strong victory for the European Commission which had long claimed that such intra-EU BITs were incompatible with the EU legal order.<sup>2</sup>

In that case, Achmea, a Dutch insurance company which had established a subsidiary in Slovakia in order to market private sickness insurance products, had initiated investor-State arbitral dispute settlement (ISDS) proceedings against Slovakia following the adoption of new regulations governing the insurance sector. The proceedings were initiated on the basis of a 1991 BIT between the former Czechoslovakia and the Netherlands (the Czechoslovakia-Netherlands BIT).

In 2012, the arbitral tribunal ruled in favour of Achmea and ordered Slovakia to pay Achmea damages of approximately 22 millions of euro.

Subsequently, Slovakia sought the annulment of that award before the German courts (the place of arbitration was Germany) on the grounds that the arbitration clause in the Czechoslovakia-Netherlands BIT was contrary to:

- Art. 344 TFEU which prohibits EU Member States from submitting a dispute concerning the interpretation or application of EU law to any method of settlement other than those for which the EU Treaties provide;
- Art. 267 TFEU which provides for a preliminary ruling mechanism that ensures that only the CJEU gives a final legally binding interpretation of EU law;
- Art. 18 TFEU which prohibits discrimination on grounds of nationality.

The German court decided to stay the proceedings and referred these questions to the CJEU for a preliminary ruling.

On 6 March 2018, the Court of Justice ruled that Arts 267 and 344 TFEU preclude an arbitral clause such as that found in the Czechoslovakia-Netherlands BIT. It therefore was not necessary to examine whether such a clause might also be discriminatory because investors of other Member States were precluded from having recourse to arbitration against Slovakia.

<sup>1</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Achmea*.

<sup>2</sup> See European Commission Press Release of 15 June 2015, *Commission asks Member States to terminate their intra-EU bilateral investment treaties*, in which the Commission announced that it had initiated infringement proceedings against five Member States requesting them to terminate their intra-EU BITs. The European Commission also requested the authorization to participate in intra-EU investor-State arbitration proceedings as *amicus curia* in (at least) eleven cases in order to persuade the tribunals to decline their jurisdiction, F. DIAS SIMÕES, *A Guardian and a Friend? The European Commission's Participation in Investment Arbitration*, in *Michigan State International Law Review*, 2017, p. 257 *et seq.*

The Court considered Arts 267 and 344 TFEU together. Its starting point was that, as the CJEU had previously explained in Opinion 2/13 on the accession of the EU to the European Convention on Human Rights,<sup>3</sup> those provisions help to preserve the principle of the autonomy of the EU legal order.<sup>4</sup> Based on that premise, the CJEU then applied a three-step analysis in order to establish whether an arbitral clause such as the one found in the Czechoslovakia-Netherlands BIT undermined that autonomy: 1) whether arbitral tribunals established pursuant to the Czechoslovakia-Netherlands BIT needed to apply and interpret EU law; 2) whether arbitral tribunals established pursuant to the Czechoslovakia-Netherlands BIT could request a preliminary ruling from the CJEU and 3) whether judicial review of awards rendered pursuant to the Czechoslovakia-Netherlands BIT guaranteed the autonomy of the EU legal order?

For the purpose of this *Article*, I will only focus on the first question (*i.e.* whether arbitral tribunals established pursuant to the Czechoslovakia-Netherlands BIT need to apply and interpret EU law), given that the answer to that question might have strong implication for the validity of ISDS and applicable law clauses in BITs and other agreements concluded by the EU (or its Member States) with third States.

In answering this question, the CJEU focused on the provision in the Czechoslovakia-Netherlands BIT (*i.e.* Art. 8, para. 6) laying down the law to be applied by an arbitral tribunal in resolving an investor-State dispute.

The CJEU noted that the applicable law included the domestic law of the Member State concerned and other relevant agreements between the parties to the treaty.<sup>5</sup> It followed that EU law (in particular, the fundamental freedoms), which forms part of the national laws of Member States, may be part of the applicable law. As a result, the CJEU found that an arbitral tribunal established pursuant to the Czechoslovakia-Netherlands BIT might need to interpret and apply EU law.<sup>6</sup> Since such application and interpretation would be made by an arbitral tribunal (*i.e.* a body which does not form part of the EU judicial system), the CJEU found that such application and interpretation could potentially affect the autonomy of the EU legal order.

In light of this finding, it was therefore necessary for the CJEU to turn to the second step of the analysis and to analyse whether, irrespective of this interpretation or application of EU law by an arbitral tribunal, the autonomy of the EU legal order could still be safeguarded by means of preliminary references made by such arbitral tribunal to the CJEU as well as by judicial review of the arbitral award handed down by this tribunal.

Ultimately, the CJEU found that 1) arbitral tribunals established pursuant to intra-EU BITs were not allowed to refer preliminary questions to the CJEU<sup>7</sup> and 2) that invest-

<sup>3</sup> Court of Justice, opinion 2/13 of 18 December 2014.

<sup>4</sup> *Achmea*, cit., para. 32 *et seq.*

<sup>5</sup> *Ibid.*, para. 40.

<sup>6</sup> *Ibid.*, para. 42.

<sup>7</sup> *Ibid.*, para. 49.

ment arbitration tribunals were not subject to sufficient judicial review in a manner that ensures the full effectiveness of EU law.<sup>8</sup>

The CJEU therefore concluded that Arts 267 and 344 TFEU preclude Member States from concluding agreements that include a provision on arbitration such as Art. 8 of the Czechoslovakia-Netherlands BIT.

## II. THE EUROPEAN COMMISSION'S ASSESSMENT AND THE EU MEMBER STATES' POSITION

Shortly after the CJEU delivered its judgment in *Achmea*, the European Commission published a communication on the protection of intra-EU investments in which it summarized its views on the *Achmea* judgment.<sup>9</sup>

According to the Commission, that judgment

“implies that all investor-State arbitration clauses in intra-EU BITS are inapplicable and that any arbitration tribunal established on the basis of such clauses lacks jurisdiction due to the absence of a valid arbitration agreement. As a consequence, national courts are under the obligation to annul any arbitral award rendered on that basis and to refuse to enforce it. Member States that are parties to pending cases, in whatever capacity, must also draw all necessary consequences from the *Achmea* judgment. Moreover, pursuant to the principle of legal certainty, they are bound to formally terminate their intra-EU BITS”.

In the *Q&A*<sup>10</sup> that accompanied the Communication, the European Commission also emphasised that the *Achmea* judgment does not have consequences for agreements with third States. According to the Commission, *Achmea* “only concerns intra-EU disputes” and “different legal considerations apply to external EU investment policies”.

On 15 January 2019, the EU Member States declared their commitment to terminate all BITs between themselves.<sup>11</sup>

<sup>8</sup> *Ibid.*, para. 56.

<sup>9</sup> Communication COM(2018) 547 final of 19 July 2018 from the Commission on the protection of intra-EU investment.

<sup>10</sup> European Commission Fact Sheet of 19 July 2018, *Commission provides guidance on protection of cross-border EU investments – Questions and Answers*, europa.eu.

<sup>11</sup> Declaration of the representatives of the governments of the Member States of 15 January 2019 on the legal consequences of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union, 15 January 2019, ec.europa.eu. That declaration also extended the findings of *Achmea* to arbitration proceedings arising out of the 1994 Energy Charter Treaty. It was signed by 22 EU Member States with the exception of Luxembourg, Malta, Finland, Hungary, Slovenia and Sweden. On 16 January 2019, Luxembourg, Malta, Finland, Slovenia and Sweden on the one hand, and Hungary, on the other hand, signed respectively two other declarations emphasizing that, according to them, the judgment of the CJEU in *Achmea* was silent on the issue of the validity of arbitration proceedings arising out of the Energy Charter Treaty.

### III. POTENTIAL CONSEQUENCES FOR EXISTING BITs, CETA AND FUTURE TRADE AND INVESTMENT AGREEMENTS

In light of the CJEU's findings in the first question, I suggest in this *Article* that – contrary to the position expressed by the European Commission in its communication of 19 July 2018 – the *Achmea* judgment could have implications for the validity of ISDS clauses BITs and other agreements concluded by the European Union (or its Member States) with third States (extra-EU BITs), such as the EU-Canada Comprehensive Economic and Trade Agreement (CETA).<sup>12</sup>

The starting point of my analysis is the fact that the CJEU's assessment of the choice of law clause in Art. 8, para. 6, of the Czechoslovakia-Netherlands BIT was central to the Court's findings. That clause defined the law to be applied, in resolving disputes between a contracting party and an investor, by arbitral tribunals established pursuant to that BIT. The applicable law included "the law in force of the Contracting Party concerned" and "other relevant agreements between the Contracting Parties". Taking into account that EU law is part of the law in force in every Member State and derives from an international agreement between the Member States, the CJEU concluded that an arbitral tribunal established pursuant to the Czechoslovakia-Netherlands BIT might potentially<sup>13</sup> apply and interpret EU law. Given that such interpretation and application of EU law by arbitrators affected the autonomy of the EU legal order, the CJEU concluded that the arbitration clause contained in the Czechoslovakia-Netherlands BIT was contrary to EU law. The CJEU also made clear that other international agreements concluded by the EU, and thus including other extra-EU BITs, must also respect the autonomy of the EU legal order.<sup>14</sup>

With this in mind, I argue that, depending on the applicable law clause contained in a particular BIT, the *Achmea* judgment could have implications for extra-EU BITs and international agreements concluded by the European Union.

<sup>12</sup> See also, M. GATTI, *Opinion 1/17 in Light of Achmea: Chronicle of an Opinion Foretold?*, in *European Papers*, 2019, Vol. 4, No 1, forthcoming, [www.europeanpapers.eu](http://www.europeanpapers.eu).

<sup>13</sup> It is important to note that, although an investor may rely on a BIT of which the applicable law clause provides for the application and interpretation of the host State's law, that does not necessarily imply that EU law will be applied and interpreted by the arbitral tribunal having jurisdiction to hear that dispute. Indeed, the national measure at stake in that dispute could be a purely domestic law which does not, whatsoever, emanate from neither EU's primary (*i.e.* EU Treaties) nor EU secondary law (*i.e.* EU Regulations or EU Directives). For example many investment arbitration cases initiated against Spain resulted in the removal of purely domestic measures (such as feed-in tariffs) adopted in favored of the solar industry.

<sup>14</sup> *Achmea*, *cit.*, para. 57. This was also confirmed by AG Bot in his Opinion on whether the investment court system (ICS) in CETA is compatible with EU law (see Opinion of AG Bot delivered on 29 January 2019, opinion 1/17). AG Bot also emphasized that, unlike what was the case for the intra-EU agreement at issue in *Achmea*, international agreements with non-Member States such as CETA are not based on mutual trust between the parties. Instead, they are based on reciprocity between the European Union and a third State (*ibid.*, paras 72-85, 107-109).

### III.1. VARIOUS FORMS OF APPLICABLE LAW CLAUSES

Applicable law clauses in BITs can take many different forms.<sup>15</sup> Some BITs do not contain any rules on the applicable law,<sup>16</sup> other BITs contain clauses that refer exclusively to the principles of international law. Certain BITs merely refer to international law including the substantive rules of the BIT itself.<sup>17</sup> Finally, there are BITs that contain applicable law clauses that combine the host state law and international law.<sup>18</sup> Finally, a BIT might provide for the application of the BIT only.<sup>19</sup>

In the light of those elements, BITs can be classified into three broad categories: 1) BITs which are silent on the law applicable in investment disputes, and BITs whose applicable law clause contains a reference to the domestic law of the host State (which for EU Member States, includes also EU law) (section III.2); 2) BITs whose applicable law clause provides for the sole application and interpretation of international law (section III.3); and 3) BITs whose applicable law clause provides for the sole application and interpretation of the provisions contained in the BIT (section III.4).

### III.2. EXTRA-EU BITS WHICH ARE SILENT ON THE APPLICABLE LAW IN INVESTMENT DISPUTES, AND EXTRA-EU BITS WHOSE APPLICABLE LAW CLAUSE CONTAINS A REFERENCE TO THE DOMESTIC LAW OF THE HOST STATE

Following *Achmea*, it is clear that intra-EU BITs whose applicable law clause contains a reference to the domestic law of the host State are contrary to the autonomy of the EU legal order. Likewise, the *Achmea* reasoning likely applies also to extra-EU BITs which contain a similar applicable law clause, since investor-State disputes under those extra-EU BITs are also likely to trigger questions relating to the application and interpretation of EU law.<sup>20</sup>

In the same vein, the reasoning of the CJEU in *Achmea* can be extended to extra-EU BITs which are silent on the issue of the applicable law. Indeed, when a BIT is silent on

<sup>15</sup> R. DOLZER, C. SCHREUER, *Principles of International Investment Law*, Oxford: Oxford University Press, 2012, p. 288 *et seq.*

<sup>16</sup> As explained by Yas Banifatemi, BITs that do not contain rules on applicable law are by no means exceptions. Y. BANIFATEMI, *The Law Applicable in Investment Treaty Arbitration*, in K. YANNAKA-SMALL (ed.), *Arbitration Under International Investment Agreements: A Guide to the Key Issues*, Oxford: Oxford University Press, 2010, p. 200.

<sup>17</sup> E.g. Art. 26, para. 4, of the Energy Charter Treaty which provides that arbitral tribunals in investor-State disputes under that Treaty shall decide the issues in dispute in accordance with the Energy Charter Treaty itself and applicable rules and principles of international law.

<sup>18</sup> E.g. Art. 10, para. 5, of the 1992 Spain-Argentina BIT.

<sup>19</sup> E.g. ICSID, award of 27 June 1990, case no. ARB/87/3, *AAPL v. Sri Lanka*, in which the tribunal found that, although the BIT at stake (i.e. the 1980 UK-Sri Lanka BIT) did not provide for an applicable law clause, by arguing their case on the basis of that BIT, the parties had expressed their choice of the BIT as applicable law (see: R. DOLZER, C. SCHREUER, *Principles of International Investment Law*, cit., p. 291).

<sup>20</sup> As discussed before, the CJEU in *Achmea* found that the autonomy of the EU legal order could be undermined by the mere potential application of EU law by an arbitral tribunal.

the issue of the applicable law, the application of the residual rules provided for in the arbitration rules chosen by the parties to the dispute will resolve the matter. Typically, the parties will opt for the arbitration rules of the ICSID Convention or of the United Nations Commission on International Trade Law (UNCITRAL).

According to Art. 42, para. 1, of the ICSID Convention, “[t]he Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable”. Art. 35 of the 2010 UNCITRAL Arbitration Rules provides that “[t]he arbitral tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law which it determines to be appropriate”.

Consequently, an arbitral tribunal established pursuant to one of those types of BIT might apply and interpret the domestic law of the host State (including EU law since EU law is part of the Member States’ domestic law). That would be contrary to the autonomy of the EU legal order. Therefore, in light of *Achmea*, extra-EU BITs that are silent on the issue of the applicable law could indeed be contrary to EU law.

### III.3. EXTRA-EU BITS WHOSE APPLICABLE LAW CLAUSE PROVIDES FOR THE APPLICATION AND INTERPRETATION OF INTERNATIONAL LAW

A separate question concerns the validity of ISDS provisions in extra-EU BITs whose applicable law clause provides for the application and interpretation of the principles of international law.<sup>21</sup>

In theory, EU law is international law.<sup>22</sup> Therefore extra-EU BITs containing applicable law clauses which allow for the application of international law are susceptible to be contrary to the autonomy of the EU legal order.

However, EU law enjoys a *sui generis* nature which “combines features both of an international organization and of a [S]tate”.<sup>23</sup> Conceptually it could therefore be argued

<sup>21</sup> E.g. Art. 26 of the Energy Charter Treaty or Art. 9 of the 1991 France-Hungary BIT.

<sup>22</sup> In *Van Gend en Loos* (judgment of 5 February 1963, case C-26/62), the CJEU found that the EU constituted “a new legal order of international law” (p. 12). In *Achmea*, cit., para. 41, the CJEU found that “EU law must be regarded both as forming part of the law in force in every Member State and as deriving from an international agreement between the Member States”. In *Vattenfall v. Germany* (ICSID, award of 31 August 2018, case no. ARB/12/12, paras 148-155), the arbitral tribunal constituted of Albert-Jan Van Den Berg (President), Charles N. Brower and Vaughan Lowe found that “EU law, to the extent of the TEU and the TFEU, including their interpretation by the ECJ, constitutes a part of international law”. However, the tribunal did not “consider it necessary or appropriate to determine whether other aspects of EU law that are not rooted in the EU Treaties also constitute international law”. Despite EU law being found to be part of international law, the tribunal refused to take account of EU law for the purposes of interpretation of Art. 26 of the Energy Charter Treaty.

that EU law does not form part of the “traditional” notion of international law. Under this theory, extra-EU BITs whose applicable law clause provides for the application and interpretation of international law would exclude the possibility of applying and interpreting EU law or the host State’s domestic law and thus the autonomy of the EU legal order would remain unaffected.

#### III.4. EXTRA-EU BITS WHOSE APPLICABLE LAW CLAUSE PROVIDES FOR THE SOLE APPLICATION AND INTERPRETATION OF THE PROVISIONS CONTAINED IN THE BIT

If an applicable law clause contained in an Extra-EU BIT solely provides for the application of the substantive provisions contained in the BIT itself, the findings of the CJUE in *Achmea* might also not be applicable to such BITs.<sup>24</sup> Indeed, such an applicable law clause excludes the possibility of applying and interpreting EU law or the host State’s domestic law.

One might however argue that an EU measure (or its national implementation by a Member State) may still be, by itself, the cause of violations of international obligations. Therefore, when analyzing the validity and the effects of such a measure, a tribunal may still be called upon to examine the content of (and sometimes interpret) EU law if such law constitutes a breach of the host State’s obligations under the BIT. In such a case, the tribunal would necessarily examine the exact meaning and consequences of that law, and such examination would infringe the principle of autonomy of EU law.

However, such a position disregards the fact that international courts and tribunals with jurisdiction to consider whether a State has complied with its international treaty obligations, and which therefore might be called upon to scrutinise national law, typically consider the meaning of national law to be a question of fact which is therefore not subject to interpretation.<sup>25</sup> Art. 8.31 of CETA has expressly clarified that:

<sup>23</sup> K. ZIEGLER, *The Relationship Between EU Law and International Law*, in D. PATTERSON, A. SODERSTON (eds), *A Companion to EU and International Law*, Oxford: Wiley-Blackwell, 2016, p. 2.

<sup>24</sup> Opinion of AG Bot, opinion 1/17, cit., para. 110.

<sup>25</sup> In Permanent Court of International Justice, judgment of 25 May 1925, *Certain German Interests in Polish Upper Silesia* (Germany v. Poland), the Court found that “[f]rom the standpoint of International Law and of the Court which is its organ, municipal laws are merely facts which express the will and constitute the activities of States, in the same manner as do legal decisions or administrative measures. The Court is certainly not called upon to interpret the Polish law as such; but there is nothing to prevent the Court’s giving judgment on the question whether or not, in applying that law, Poland is acting in conformity with its obligations towards Germany under the Geneva Convention”. In addition, the WTO panels and Appellate Body, have routinely repeated that municipal law is an issue of fact. See, WTO AB, panel report of 19 December 1997, no. WT/DS152/R, in *India v. United States – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, para. 66 and WTO, panel report of 28 February 2000, case no. ds152, *European Communities v. United States, US – Section 301*, para. 7.18. The statement by the United States at the meeting of the WTO Dispute Settlement Body held in Geneva on the 27 August 2018, available at [geneva.usmission.gov](http://geneva.usmission.gov), gives additional examples of cases in which the WTO panels have repeated this proposition (p. 16 *et seq.*).

"1. When rendering its decision, the Tribunal established under this Section shall apply this Agreement as interpreted in accordance with the Vienna Convention on the Law of Treaties, and other rules and principles of international law applicable between the Parties.

2. The Tribunal shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of this Agreement, under the domestic law of a Party. For greater certainty, in determining the consistency of a measure with this Agreement, the Tribunal may consider, as appropriate, the domestic law of a Party as a matter of fact. In doing so, the Tribunal shall follow the prevailing interpretation given to the domestic law by the courts or authorities of that Party and any meaning given to domestic law by the Tribunal shall not be binding upon the courts or the authorities of that Party".

Nevertheless, that principle according to which national law should be considered as facts before international courts and tribunal is "debatable".<sup>26</sup> According to Sharif Bhuiyan, it is "problematic in that it fails to take account that rules of national law do not lose their normative quality in relation to the rights, obligations and transactions that they seek to regulate, simply because their content or meaning is determined as a factual matter and on the basis of evidence".<sup>27</sup> For instance, in the *Serbian Loans cases*, the Permanent Court of International Justice recognized that it had "to decide as to the meaning and scope of a municipal law".<sup>28</sup> Likewise, in *Brazilian Loans*, that same court sought the possibility to make a just appreciation of the interpretation of national law by domestic courts and ruled that in case of divergent interpretation, it will "select the interpretation which it considers most in conformity with the law".<sup>29</sup> According to Sharif Bhuiyan, "this task of selecting the most appropriate interpretation from amongst the diverging interpretations by domestic courts cannot be performed without interpreting, to a certain degree, the relevant national law".<sup>30</sup>

Whether this express reference in Art. 8.31 of CETA to the obligation for the tribunal to consider municipal law as a matter of fact is sufficient to safeguard the autonomy of the EU legal order awaits a response from the CJEU.<sup>31</sup> The CJEU will certainly address this question in its upcoming Opinion on the compatibility with the EU Treaties, including fundamental rights, of the chapter on investor-State dispute settlement (chapter 8)

<sup>26</sup> C. W. JENKS, *Prospects of International Adjudication*, 1964 quoted in J. CRAWFORD, *Brownlie's Principles of Public International Law*, Oxford: Oxford University Press, 2012, p. 52.

<sup>27</sup> S. BHUIYAN, *National Law in WTO Law*, cit., p. 42.

<sup>28</sup> Permanent Court of International Justice, judgment of 12 July 1929, *Payment of Various Serbian Loans Issued in France* (France v. Kingdom of the Serbs, Croats and Slovenes).

<sup>29</sup> Permanent Court of International Justice, judgment of 12 July 1929, *Payment in Gold of Brazilian Federal Loans Contracted in France* (France v. Brazil).

<sup>30</sup> S. BHUIYAN, *National Law in WTO Law*, cit., p. 215, footnote 29.

<sup>31</sup> In his Opinion, AG Bot found that the fact that Art. 8.31 of CETA provides that EU law and the law of the Member States (which includes EU law) will be considered as a question of fact was one of the key features to find that the ICS in CETA complied with EU law (Opinion of AG Bot, opinion 1/17, cit., paras 110, 129, 130 and 156).

in CETA. This answer will hopefully provide clarity on the manner in which applicable law clauses should be drafted in future trade and investment agreements (such as a future UK-EU post-Brexit partnership).

#### IV. CONCLUSION

In this *Article*, I have argued that the *Achmea* judgment could have implications for the validity, not only of ISDS clauses in intra-EU BITs, but also of ISDS clauses in BITs and other agreements concluded by the EU (or its Member States) with third States.

I have also highlighted that, in negotiating future trade and investment agreements with third States, negotiators will need to apply particular care to the wording of the clause on the applicable law.

Furthermore, the question of whether investor-State arbitration clauses in investment agreements with third States (and possibly trade agreements) may be saved due to the fact that domestic law (and thus EU law) is a question of fact awaits a response from the CJEU in Opinion 1/17.



## ARTICLES

### SPECIAL SECTION – THE *ACHMEA* CASE

### BETWEEN INTERNATIONAL LAW AND EUROPEAN UNION LAW

*edited by* Ségolène Barbou des Places, Emanuele Cimiotta *and* Juan Santos Vara

## OPINION 1/17 IN LIGHT OF *ACHMEA*: CHRONICLE OF AN OPINION FORETOLD?

MAURO GATTI\*

TABLE OF CONTENTS: I. Introduction. – II. *Achmea's* relevance as a precedent for Opinion 1/17. – III. Application of the *Achmea* test to the CETA tribunal. – IV. Conclusion: an Opinion foretold?

ABSTRACT: The *Achmea* judgment of the Court of Justice (judgment of 6 March 2018, case C-284/16 [GC]) indicates that two Member States cannot set up an investor-to-state dispute settlement mechanism via a bilateral investment agreement *inter se*. Does this imply that the Union cannot set up an international investment tribunal through an agreement with a third State? The Court will rule on this issue in Opinion 1/17, dealing with the compatibility between the Canada-EU Comprehensive Economic and Trade Agreement (CETA) and EU Treaties. The present *Article* suggests that the Court drafted *Achmea* having Opinion procedure 1/17 in mind. However, the *Achmea* judgment is ambiguous: the Court implicitly distinguished *Achmea* from CETA but elaborated a test potentially applicable to all investment tribunals, including the CETA Tribunal, which is at issue in Opinion procedure 1/17. Should the Court apply the *Achmea* test in Opinion 1/17, the fate of the CETA Tribunal might be all but sealed.

KEYWORDS: investment – ISDS – CETA – Investment Court System – autonomy – mutual trust.

### I. INTRODUCTION

In the *Achmea* judgment,<sup>1</sup> the Court of Justice ruled that the principle of autonomy of EU law prevents two Member States – Slovakia and the Netherlands – from setting up an investor-to-State dispute settlement (ISDS) mechanism via a bilateral investment

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<sup>1</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Achmea* [GC].

agreement (BIT) *inter se*.<sup>2</sup> *Achmea* has crucial constitutional relevance: not only does it have a dramatic impact on arbitration within the EU, but might prevent the Union from concluding investment agreements with third countries.

The Court of Justice will soon rule on the later issue: in Opinion procedure 1/17,<sup>3</sup> the Court is requested to decide on the compatibility between EU Treaties and the Canada-EU Comprehensive Economic and Trade Agreement (CETA), which includes an investor-to-public authorities dispute settlement mechanism (the Investment Court System, ICS).<sup>4</sup> Although the case is pending, several commentators suggested that its outcome is predetermined by *Achmea*: the same reasons that motivate the incompatibility between intra-EU arbitration and EU principles in *Achmea* might imply the inconsistency between CETA and EU Treaties.<sup>5</sup> Other authors, however, read *Achmea* in a different manner: the findings of this judgment are allegedly circumscribed to intra-EU investment agreements and are motivated solely by the specific characteristics of intra-EU arbitration.<sup>6</sup>

Should *Achmea* be interpreted as an indication that the Investor Court System included in CETA is not compatible with the EU legal order? The present *Article* answers this question, to provide insight into the Court's understanding of the principle of autonomy and its potentially strategic use of precedents. It is argued that the Court anticipated, to a certain extent, the result of Opinion 1/17, although its position is ambiguous.

The investigation begins by suggesting that, at first sight, *Achmea* does not seem to be intended as a precedent for Opinion 1/17; nonetheless, a closer investigation points in the opposite direction (section II). It is then submitted that, if the Court applied in Opinion 1/17 the same test it used in *Achmea*, it would probably conclude that the CETA tribunal is not compatible with EU law (III). The conclusion explores the consequences of *Achmea* from the perspective of Opinion 1/17 and provides explanations for the apparently contradictory views expressed by the Court (IV).

<sup>2</sup> Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, 29 April 1991, 2242 UNTS 205, p. 82.

<sup>3</sup> Court of Justice, request for an opinion submitted by Belgium on 13 October 2017, opinion procedure 1/17.

<sup>4</sup> Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part, signed on 30 October 2016.

<sup>5</sup> *Inter alia*, C. ECKES, *Don't Lead with Your Chin! If Member States Continue with the Ratification of CETA, They Violate European Union Law*, in *European Law Blog*, 13 March 2018, [www.europeanlawblog.eu](http://www.europeanlawblog.eu); S. GÁSPÁR-SZILÁGYI, *It Is Not Just About Investor-State Arbitration: A Look at Case C-284/16, Achmea BV*, in *European Papers*, Vol. 3, 2018, No. 1, [www.europeanpapers.eu](http://www.europeanpapers.eu), p. 357 *et seq.*, p. 370.

<sup>6</sup> *Inter alia*, L. PANTALEO, *The Participation of the EU in International Dispute Settlement: Lessons from EU Investment Agreements*, Berlin, Heidelberg: Springer, 2018, p. 62; P. IANNUCELLI, *La Corte di giustizia e l'autonomia del sistema giurisdizionale dell'Unione europea: quousque tandem?*, in *Il diritto dell'Unione europea*, 2018, p. 300-303; J.H. POHL, *Intra-EU Investment Arbitration after the Achmea Case: Legal Autonomy Bounded by Mutual Trust?*, in *European Constitutional Law Review*, 2018; A. DIMOPOULOS, *Achmea: The principle of Autonomy and Its Implications for Intra and Extra-EU BITs*, in *EJIL:Talk!*, 27 March 2018, [www.ejiltalk.org](http://www.ejiltalk.org).

## II. *ACHMEA'S* RELEVANCE AS A PRECEDENT FOR OPINION 1/17

In *Achmea*, the Court of Justice answered the preliminary question of the German Federal Court of Justice by conducting a three-pronged test. To be compatible with EU law, a tribunal should have at least one of three characteristics: it should not interpret EU law, it should belong to the judicial system of the Member States, or its awards should be reviewable by the Member States' courts.<sup>7</sup> As the arbitral tribunal set up by the Czechoslovakia-Netherlands BIT has none of these characteristics, it has adverse effects on the autonomy of EU law. If applied in Opinion 1/17, this test might possibly lead the Court to rule that the CETA Tribunal is incompatible with EU law, as shown in the next section. Before discussing the application of the *Achmea* test to the CETA Tribunal, at any rate, one should preliminarily wonder whether the *Achmea* test should be applied to the CETA tribunal in the first place.

The Court ostensibly applied the *Achmea* test to "an arbitral tribunal such as that referred to in Art. 8 of the [Czechoslovakia-Netherlands] BIT",<sup>8</sup> i.e. an arbitral tribunal set up by two Member States (hereinafter, "intra-EU tribunal"). Does this *caveat* limit the relevance of *Achmea* as a precedent?

The *Achmea* test seems to be relevant only for a specific class of international tribunals, i.e. those that decide disputes affecting the rights of individuals. *Achmea* is concerned with the removal of disputes from the jurisdiction of the courts of the Member States and, consequently, with the functioning of Art. 267 TFEU and the uniformity of EU law, as shown in the next section.<sup>9</sup> Therefore, *Achmea* does not seem to be directly relevant in respect of tribunals that decide disputes between international subjects, such as the Dispute Settlement Body of the World Trade Organization.<sup>10</sup> *Achmea* consequently does not have the consequence of rendering the EU incapable of setting up international tribunals *in toto*:<sup>11</sup> obstacles would exist only in respect of bodies deciding disputes affecting individuals – mostly, investment tribunals.

<sup>7</sup> *Achmea* [GC], cit., paras 39-56.

<sup>8</sup> *Ibid.*, para. 43; see also, to that effect, paras 39, 49 and 50.

<sup>9</sup> *Ibid.*, para. 36; cf. Court of Justice, Opinion 1/09 of 8 March 2011, para. 79. See also Court of Justice, Opinion 2/15 of 16 May 2017, para. 292.

<sup>10</sup> On the alleged inconsistency between *Achmea* and the Court of Justice's case-law on WTO dispute settlement, see B. ARP, *Comment to Achmea*, in *American Journal of International Law*, 2018, p. 466 *et seq.*, p. 471; A. DIMOPOULOS, *Achmea: The principle of Autonomy and Its Implications for Intra and Extra-EU BITs*, cit.

<sup>11</sup> According to G. KÜBEK, during the hearing of Opinion procedure 1/17, "several Member States, the Council and the Commission urged the Court to consider the need to cultivate the development and strengthening of a rule-based international order, especially in current times. The autonomy of the EU legal order principle should not be interpreted so narrowly as to prevent the EU from remaining in or adhering to any international dispute resolution mechanisms", see G. KÜBEK, *CETA's Investment Court System and the Autonomy of EU Law: Insights from the Hearing in Opinion 1/17*, in *Verfassungsblog*, 4 July 2018, www.verfassungsblog.de.

The CETA Tribunal certainly decides disputes affecting the rights of individuals, but it would be set up by an agreement concluded by the Union and a third State, not via an agreement between Member States. Would the *Achmea* test apply to such an “extra-EU” Tribunal, or does it apply only to intra-EU tribunals, such as that at issue in *Achmea*?

The introductory remarks and the final considerations of *Achmea* seem to suggest, at least at first sight, that the test is applicable only to intra-EU situations. The Court focuses its introductory remarks (paras 31-38) on the principle of mutual trust, a principle that is applicable to the relations between the Member States and that is not applicable to the relations with third States. The Court argues that primacy and direct effect of EU law have given rise to principles, rules and mutually interdependent legal relations “binding [the] Member States to each other”.<sup>12</sup> These States are linked by “common values” that justify “mutual trust”,<sup>13</sup> they “ensure in their respective territories the application of and respect for EU law”,<sup>14</sup> including fundamental rights, and they must consider each other to be complying with EU law.<sup>15</sup> It is “in that context” that national courts and the Court of Justice must ensure the full application of EU law in all Member States, notably by using the procedure of Art. 267 TFEU, to ensure the consistency, the full effect, and the “autonomy” of EU law.<sup>16</sup>

While the Court’s introductory considerations do not permit *per se* to answer the preliminary question, it is “in the light of those considerations” that the Court then formulates the *Achmea* test.<sup>17</sup> It might, therefore, be surmised, at least in principle, that the Court’s reference to mutual trust at the beginning of its considerations might be indicative of its intention to narrow down the implications of *Achmea* and prevent it from functioning as a precedent for Opinion 1/17.<sup>18</sup>

The coda of the judgment (paras 57-59) distinguishes the legal background of *Achmea* from that of Opinion 1/17 in a more explicit manner. Once having performed the *Achmea* test on the Slovakia-Netherlands arbitral tribunal, the Court recalls that the EU can in principle conclude an agreement establishing a tribunal responsible for the interpretation of its provisions and whose decisions are binding on EU institutions, including the Court of Justice.<sup>19</sup> However, such a rule does not apply to the Czechoslovakia-Netherlands BIT, which was concluded “not by the EU but by Member States”.<sup>20</sup> The BIT, therefore, calls into question “mutual trust” among the Member States, the preservation of the “particular nature of the law established by the Treaties”, as well as the principle of sincere coopera-

<sup>12</sup> *Achmea* [GC], cit., para. 33; see Court of Justice, opinion 2/13 of 18 December 2014, para. 167.

<sup>13</sup> *Achmea* [GC], cit., para. 34.

<sup>14</sup> *Ibid.*

<sup>15</sup> *Ibid.*; See also opinion 2/13, cit., para. 191.

<sup>16</sup> *Achmea* [GC], cit., paras 36-37.

<sup>17</sup> *Ibid.*, paras 38.

<sup>18</sup> See J.H. POHL, *Intra-EU Investment Arbitration after the Achmea Case*, cit.

<sup>19</sup> Provided, of course, that the autonomy of EU law is respected, see *Achmea* [GC], cit., para. 57.

<sup>20</sup> *Ibid.*, para. 58.

tion.<sup>21</sup> It is significant that the Court mentions the principle of mutual trust again, at the end of the judgment, after having raised it in its introductory remarks. And it is even more striking that the Court expressly stresses the difference between the legal regimes applicable to the Czechoslovakia-Netherlands BIT, on the one hand, and to the agreements concluded by the EU (such as CETA), on the other hand.

The relevance of the judgment's coda is reinforced by its apparently superfluous character. The Court *de facto* reaches the conclusion of *Achmea* in para. 56, directly after the performance of its three-pronged test. Here the Court notes that the contested BIT, because of its characteristics, could prevent disputes from being resolved in a manner that ensures the full effectiveness of EU law. This consideration could have permitted the Court to answer the preliminary request: an agreement between the Member States that reduces the effectiveness of EU law is inevitably incompatible with it. Nonetheless, the Court introduced three further paragraphs – the coda – whose sole function seems to consist in distinguishing *Achmea* from Opinion 1/17. It might perhaps be argued that the unnecessary recalling of EU's ability to submit itself to an international court at the end of a judgment concerning an international agreement concluded by the Member States can be seen as “expressive of the Court's willingness to narrow down the implications of its ruling”.<sup>22</sup>

However, that is not necessarily the case. While the introduction and conclusion of *Achmea* seem to distinguish this case from Opinion 1/17, the principles interpreted in the judgment may be relevant for Opinion 1/17 too. The principle of autonomy is indeed applicable to both intra- and extra-EU tribunals. In *Achmea*, the Court links autonomy to mutual trust among the Member States, but we know from the case-law that autonomy does not apply solely in the context of intra-EU relations, but also to the agreements between the Union and third States.<sup>23</sup> In other words, the principle of EU law autonomy is not “delimited by the principle of mutual trust” among the Member States.<sup>24</sup>

The Court seems indeed to imply that *Achmea* may have consequences beyond purely intra-EU situations. The referring tribunal had asked whether the Czechoslovakia-Netherlands BIT violated Art. 344 TFEU, a provision introducing obligations for the Member States.<sup>25</sup> Nonetheless, the Court held that the BIT has an adverse effect “on the autonomy of EU law”<sup>26</sup> at large, a principle that is expressed “in particular” in Art. 344

<sup>21</sup> *Ibid.*

<sup>22</sup> L. PANTALEO, *The Participation of the EU in International Dispute Settlement*, cit., p. 62.

<sup>23</sup> See e.g. Court of Justice: opinion 1/91 of 14 December 1991, paras 30-46; opinion 1/92 of 10 April 1992, paras 18-35; opinion 1/00 of 18 April 2012, paras 11-46.

<sup>24</sup> See *a contrario* J.H. POHL, *Intra-EU Investment Arbitration after the Achmea Case*, cit., p. 15. See also pp. 22-23.

<sup>25</sup> Art. 344 TFEU: “Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein” (italics by the author). See *Achmea*, paras 14-17.

<sup>26</sup> *Achmea* [GC], cit., para. 59.

TFEU,<sup>27</sup> but that also applies to the Union as such. The interpretation of EU autonomy provided by the Court in *Achmea*, therefore, appears applicable *mutatis mutandis* in the context of Opinion 1/17, too.

Moreover, and most importantly, the test developed by the Court in *Achmea* does not refer to any intra-EU element and is consequently *prima facie* applicable to extra-EU tribunals too, as shown in the next section. The Court could have answered the preliminary question by using principles relevant only within the EU, such as non-discrimination or mutual trust. Such arguments were in fact raised before the national judge and the Court of Justice.<sup>28</sup> For instance, the Court could have ruled that intra-EU investment agreements are incompatible with EU law because they are premised on the lack of confidence in the judiciary system of the state of destination of the investment, which is *de facto* bypassed via arbitral tribunals. By contrast, a similar argument could not be made in the context of CETA, as there is no “mutual trust” between the EU and Canada, at least not under EU law.

Had the Court utilised a test based on mutual trust to solve *Achmea*, this judgment would not have raised significant expectations with respect to Opinion 1/17. On the contrary, the Court’s choice to employ standards potentially applicable to extra-EU tribunals may suggest that the *Achmea* test might be employed again in Opinion 1/17.

If so, would the CETA Tribunal pass the *Achmea* test?

### III. APPLICATION OF THE *ACHMEA* TEST TO THE CETA TRIBUNAL

The central part of the *Achmea* judgment (paras 39-56) contains a test that, as noted above, has three elements. A tribunal (deciding disputes affecting the rights of individuals) that lacks all three elements is incompatible with the principle of autonomy of EU law. It is worth stressing that these three elements are alternative, not cumulative: if a tribunal has at least one of those elements, it is apparently compatible with EU law.

This section presents the test and applies it to the Slovakia-Netherlands tribunal and the CETA Tribunal. For ease of exposition, the three elements of the test are not discussed in the same order in which they are found in *Achmea*.

According to the *Achmea* test, a tribunal should, in the first place, be “situated within the judicial system of the EU”, meaning that it may be regarded as a “court or tribunal of a Member State within the meaning of Art. 267 TFEU”.<sup>29</sup> Only a “court or tribunal” would be capable of making preliminary references to the Court of Justice under Art. 267 TFEU, which may ensure the full effectiveness of the rules of the EU.<sup>30</sup> In *Ascendi*

<sup>27</sup> *Ibid.*, para. 32.

<sup>28</sup> *Ibid.*, para. 14; opinion of AG Wathelet delivered on 19 September 2017, case C-284/16, *Achmea*, paras 256 and 268.

<sup>29</sup> *Achmea* [GC], cit., para. 43.

<sup>30</sup> *Ibid.*, para. 43.

*Beiras*, the Court held that an arbitral tribunal could be considered as a court or tribunal under Art. 267 TFEU, *inter alia*, because it was created by a national law.<sup>31</sup> Differently, the arbitral tribunal in *Achmea* "is not part of the judicial system of the Netherlands or Slovakia", because of the "exceptional nature" of its jurisdiction compared with that of national courts.<sup>32</sup> The distinction would seem to lie in the source of the tribunal's authority: an international agreement rather than national law. Similar considerations might apply *a fortiori* to extra-EU tribunals. If a tribunal constituted by an agreement between two Member States is not part of the EU judicial system, a tribunal constituted via an agreement between the EU, the Member States and a *third state* (e.g. CETA) may hardly be part of that system.<sup>33</sup>

The second condition of the *Achmea* test applies specifically to those bodies that are not part of the EU judicial system. To be compatible with EU law, they should adopt awards "subject to review by a court of a Member State", which may then issue a preliminary request to the Court of Justice.<sup>34</sup> According to the Court, the standard of review ensured in the case of the Czechoslovakia-Netherlands BIT is insufficient. This agreement requires the arbitral tribunal to apply the United Nations Commission On International Trade Law (UNCITRAL) arbitration rules, which grant the tribunal the possibility to choose its seat and, consequently, the law applicable to the procedure governing judicial review of the validity of the award.<sup>35</sup> The arbitral tribunal in *Achmea* chose to sit in Frankfurt, which made German law applicable to the procedure governing judicial review. German law provides only for limited review, concerning, in particular, the validity of the arbitration agreement and the consistency with public policy. In light of the case-law of the Court of Justice, such a limited review might be compatible with EU law, as long as it concerns commercial arbitration.<sup>36</sup> However, the Court held in *Achmea* that "arbitration proceedings such as those referred to in Art. 8 of the BIT are different from commercial arbitration proceedings", because they derive, not from the freely expressed wishes of the parties, but from a treaty by which the Member States "agree to remove from the jurisdiction of their own courts" disputes which may concern the application or interpretation of EU

<sup>31</sup> *Rectius*, a decree having the force of a law, see Court of Justice, judgment of 12 June 2014, case C-377/13, *Ascendi Beiras*, paras 29 and 34; see also *Achmea* [GC], cit., para. 44; see also P. IANNUCELLI, *La Corte di giustizia e l'autonomia del sistema giurisdizionale dell'Unione europea*, cit., p. 294.

<sup>32</sup> *Achmea* [GC], cit., para. 45.

<sup>33</sup> In *Achmea* the Court discusses the possibility that the arbitral tribunal might be a "court common to a number of Member States", see *Achmea* [GC], cit., paras 47-49. Since the Court reaches a negative conclusion in *Achmea*, it can be assumed that the CETA Tribunal cannot be considered as a court common to the Member States, especially because it includes a non-EU state as a party.

<sup>34</sup> *Achmea* [GC], cit., para. 50.

<sup>35</sup> Art. 8, para. 5, of the Czechoslovakia-Netherlands BIT, cit.; *Achmea* [GC], cit., para. 51.

<sup>36</sup> See Court of Justice, judgment of 26 October 2006, C-168/05, *Mostaza Claro*, paras 34 to 39; see also *Achmea* [GC], cit., para. 54.

law.<sup>37</sup> Again, it would seem that the problem lies with the source of the tribunal's authority: being constituted via an international agreement, an international arbitral tribunal does not benefit from the lax standard of review that is granted in the case of arbitration set up via a contract.<sup>38</sup> Being CETA an international agreement, as much as the Czechoslovakia-Netherlands BIT, one may argue that the standard for judicial review of the awards of the CETA Tribunal should be as high as that applicable to the BIT. Considering that CETA allows the parties to identify the arbiters' seat,<sup>39</sup> and consequently the law applicable to the review of awards, there is the possibility that those awards might not be subject to sufficient review by a court of a Member State.<sup>40</sup>

The third – and most crucial – condition is that the arbitral tribunal should not resolve disputes “liable to relate to the interpretation or application of EU law”.<sup>41</sup> The Czechoslovakia-Netherlands BIT expressly affirms that the arbitral tribunal decides on the basis of the law, taking into account, *inter alia*, the laws of the contracting party and international agreements between them.<sup>42</sup> As EU law is both a law of the parties and the product of agreements with them, the arbitral tribunal could inevitably be called to interpret it.<sup>43</sup>

What about the CETA Tribunal? The negotiators of this agreement sought to avoid conflicts with the Court of Justice, by stressing in Art. 8.31, para. 2, CETA that the Tribunal cannot “determine the legality of a measure under domestic law” and that its appreciation of domestic law “shall not be binding upon the courts” of the parties. Therefore, the awards of the Tribunal do not formally have the effect of “binding” the Union to a particular interpretation of EU rules - something that the Court had found problematic in its earlier case-law.<sup>44</sup>

However, in *Achmea* the Court seems to have raised the bar: the question is not whether the tribunal can adopt interpretations of EU law “binding” on Union institutions, but whether the disputes before the tribunal are liable to relate to the “interpretation” of EU law. The mere fact that a tribunal decides a dispute affecting individuals by interpreting EU law may trigger an interference with the autonomy of EU law,<sup>45</sup> possibly

<sup>37</sup> *Achmea* [GC], cit., para. 55.

<sup>38</sup> See also J.H. POHL, *Intra-EU Investment Arbitration after the Achmea Case*, cit., p. 21.

<sup>39</sup> See e.g. Art. 8.23, para. 2, let. c), allowing the submission of claims under UNCITRAL rules; cf. Art. 18 of the UNCITRAL Arbitration rules.

<sup>40</sup> In addition, one may note that CETA allows investors to submit claims under ICSID rules, which do not allow for a review of the award, see CETA, Art. 8.23, para. 2, let. a) and b), as well as Art. 53, para. 1, of the ICSID Convention.

<sup>41</sup> *Achmea* [GC], cit., para. 39.

<sup>42</sup> Art. 8, para. 6, of the Czechoslovakia-Netherlands BIT, cit.

<sup>43</sup> *Achmea* [GC], cit., paras 40-42.

<sup>44</sup> Cf. opinion 1/00, cit., para. 13; opinion 2/13, cit., para. 184. See further A. DIMOPOULOS, *Achmea: The principle of Autonomy and Its Implications for Intra and Extra-EU BITs*, cit.

<sup>45</sup> P. IANNUCELLI, *La Corte di giustizia e l'autonomia del sistema giurisdizionale dell'Unione europea*, cit., p. 291.

because such an interpretation might generate a “factual pressure” on the conduct of the Member States and, hence, on the Court and its interpretative monopoly.<sup>46</sup>

It is not necessary that the tribunal actually interprets EU law (something that the *Achmea* tribunal was not doing): the “abstract possibility”<sup>47</sup> for the tribunal to interpret EU law is sufficient to render the Czechoslovakia-Netherlands agreement incompatible with EU law. Such an attention for purely potential situations is not surprising, considering that in Opinion 2/13 the Court had found that the “very existence of [...] a possibility” of conflicts between the European Convention of Human Rights and EU primary law triggered a violation of autonomy.<sup>48</sup>

Therefore, from the perspective of Opinion 1/17, the relevant question is not “may the CETA Tribunal bind the EU to an interpretation of EU law”, but rather “may the CETA Tribunal interpret EU law”? At first sight, this would not seem to be the case. According to Art. 8.31, para. 2, CETA, in determining the consistency of a measure with CETA, the Tribunal may consider the domestic law of the disputing Party only “as a matter of fact”. This seems understandable because, as a matter of principle, an international body should consider domestic law as a matter of fact.<sup>49</sup> Nonetheless, one cannot exclude that the CETA Tribunal may interpret EU law when it adjudicates potential violations of CETA. Art. 8.31, para. 2, CETA implicitly acknowledges this possibility, by admitting that the Tribunal may give a “meaning” to domestic law – albeit one nonbinding for domestic courts. Furthermore, Art. 8.28, para. 2, admits that the CETA appellate Tribunal may reverse a Tribunal’s award based on, *inter alia*, “manifest errors in the appreciation of the facts, including the appreciation of relevant domestic law”.<sup>50</sup> If there can be two “appreciations” of domestic law, one might assume that such law is not a fact, but can be “appreciated”, viz. interpreted, in different manners.<sup>51</sup>

CETA negotiators presumably anticipated this issue, since they agreed, in Art. 8.31, that the Tribunal is not free in the appreciation of domestic law but must follow the “prevailing interpretation” given to the domestic law by the “courts or authorities” of the

<sup>46</sup> S. HINDELANG, *Repellent Forces: The CJEU and Investor-State Dispute Settlement*, in *Archiv des Völkerrechts*, 2015, p. 68 *et seq.*, pp. 74-76; see also H. LENK, *An Investment Court System for the New Generation of EU Trade and Investment Agreements: A Discussion of the Free Trade Agreement with Vietnam and the Comprehensive Economic and Trade Agreement with Canada*, in *European Papers*, Vol. 1, 2016, No. 2, [www.europeanpapers.eu](http://www.europeanpapers.eu), p. 665 *et seq.*

<sup>47</sup> S. WUSCHKA, *Investment Protection and the EU after Achmea*, in *Zeitschrift für Europarechtliche Studien*, 2018, p. 25 *et seq.*, p. 38.

<sup>48</sup> See e.g. opinion 2/13, cit., para. 208; see also para. 109. See further P. EECKHOUT, *Opinion 2/13 on EU Accession to the ECHR and Judicial Dialogue: Autonomy or Autarky?*, in *Fordham International Law Journal*, 2015, p. 955 *et seq.*, particularly pp. 966-967, and 974-979.

<sup>49</sup> See Permanent Court of International Justice, *Case Concerning Certain German Interests in Polish Upper Silesia (Germany v. Poland)*, judgment of 25 May 1926, p. 19.

<sup>50</sup> Art. 8.28, para. 2, CETA.

<sup>51</sup> See H. LENK, *An Investment Court System for the New Generation of EU Trade and Investment Agreements*, cit., p. 674.

parties. It is remarkable that the negotiators tried to bind the CETA Tribunal to the domestic practice of the parties, as this is generally not the case.<sup>52</sup> Nonetheless, the CETA tribunal might have a certain latitude in the identification of what constitutes a “prevailing interpretation” of EU law: is it only the interpretation of the Court of Justice, or does it include the decisions of the EU General Court or those of national courts? Should the CETA Tribunal take into account the practice of non-judicial “authorities” at the EU or national level – such as the European Commission or national governments – as Art. 8.31 CETA seems to suggest? It cannot be excluded that the CETA Tribunal might select the “prevailing interpretation” of EU law that it prefers. By choosing an interpretation of EU law, it would *de facto* interpret it.

A “prevailing interpretation” of EU law might not even exist, as investors can bring claims against recently enacted laws, which have never been interpreted by domestic “courts or authorities”. For instance, in 2011 Philip Morris sued Australia before its plain tobacco packaging law was even adopted.<sup>53</sup> Similarly, if the Union introduced restrictive tobacco packaging rules, a Canadian tobacco company might sue the European Union before the CETA Tribunal. The CETA Tribunal would then have to give a “meaning” to the EU measure providing for the packaging rules before the Court of Justice has the chance to do so. Therefore, there is at least the abstract possibility that the CETA Tribunal might provide its own interpretation of EU law.<sup>54</sup>

The CETA Tribunal thus seems to lack all the elements contained in the *Achmea* test: *i*) it is not “situated within the judicial system of the EU”, *ii*) its awards may not be subject to sufficient “review by a court of a Member State”, and *iii*) it might resolve disputes “liable to relate to the interpretation or application of EU law”.

#### IV. CONCLUSION: AN OPINION FORETOLD?

It would seem that the Court drafted *Achmea* with Opinion 1/17 in mind, but its message appears contradictory. On the one hand, the Court obliquely indicates that the findings of *Achmea* are not relevant for Opinion 1/17. On the other hand, *Achmea* introduces a test applicable to both intra- and extra-EU tribunals, including the one at issue in Opinion procedure 1/17.

The ambiguities of *Achmea* raise four questions. In the first place, does *Achmea* imply that all international dispute settlement mechanisms are inevitably incompatible

<sup>52</sup> Cf. e.g. ICSID, award of 1 November 1999, case no. ARB (AF)/97/12, *Azinian and Others v. Mexico*, para. 86.

<sup>53</sup> See Notice of Arbitration, Australia-Hong Kong Agreement for the Promotion and Protection of Investments, 21 November 2011, [www.italaw.com](http://www.italaw.com).

<sup>54</sup> See P. IANNUCELLI, *La Corte di giustizia e l'autonomia del sistema giurisdizionale dell'Unione europea*, cit., p. 303; see also N. DE SADELEER, *Tribunaux d'investissement sur la sellette : CJUE, gde ch., 6 mars 2018, Achmea, aff. C-284/16*, in *Revue des affaires européennes*, 2018, p. 117 *et seq.*, p. 125.

with EU law? It does not. As noted in section II, the *Achmea* test is potentially applicable only to tribunals deciding disputes affecting individuals' rights, such as those at issue in *Achmea* and Opinion 1/17. It is not applicable to organs deciding disputes between international subjects, such as the WTO Dispute Settlement Body.

Should the Court apply the *Achmea* test in Opinion 1/17? Arguably, yes. The Court might possibly hold in Opinion 1/17 that the *Achmea* test cannot apply to extra-EU tribunals, as it was conceived for intra-EU tribunals. However, it is difficult to imagine why the *Achmea* test, which never refers to the intra-EU characterisation of the case, should not apply in Opinion 1/17. It has been argued that a teleological interpretation of the Treaties might lead the Court to be lenient with CETA: the impossibility to include investor-to-state mechanisms in international agreements would allegedly constitute an obstacle for the EU's external policy.<sup>55</sup> However, one should take all EU external objectives into account.<sup>56</sup> Investor protection mechanisms might arguably lead to "regulatory chill", as public authorities might refrain from measures taken in the public interest because of the possibility of investment arbitration.<sup>57</sup> Investment tribunal may indeed hold public authorities liable for measures that are the result of choices of economic or social policy,<sup>58</sup> something that is normally excluded by domestic courts, precisely to avoid a regulatory chill.<sup>59</sup> Although CETA mentions the "right to regulate" of the parties,<sup>60</sup> it does not seem to dramatically reduce the scope of manoeuvre of its Tribunal and, hence, the risk of regulatory chill.<sup>61</sup> It cannot be excluded that CETA might *de facto* prevent the Union to foster objec-

<sup>55</sup> See *ibid.*, S. WUSCHKA, *Investment Protection and the EU after Achmea*, cit., p. 45.

<sup>56</sup> See Arts 3, para. 5, and 21 TEU, as well as Arts 205 and 207, para. 1, TFEU.

<sup>57</sup> See e.g. K. TIENHAARA, *Regulatory Chill and the Threat of Arbitration: A View from Political Science*, in C. BROWN and K. MILES (eds), *Evolution in International Treaty Law and Arbitration*, New York: Cambridge University Press, 2011, p. 606 *et seq.*; R. LENCUCHA, R. LABONTE, J. DROPE, *Tobacco Plain Packaging: Too Hot for Regulatory Chill*, in *The Lancet*, 2015, p. 1723 *et seq.*; K. PELC, *What Explains the Low Success Rate of Investor-State Disputes?*, in *International Organization*, 2017, p. 559 *et seq.*

<sup>58</sup> See e.g. ICSID, award of 23 May 2003, case no. ARB (AF)/00/2, *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, para. 154.

<sup>59</sup> See for instance Court of Justice: judgment of 9 September 2008, joined cases C-120/06 P and C-121/06 P, *FIAMM*, paras 171-172; judgment of 13 June 1972, joined cases 9/71 and 11/71, *Compagnie d'approvisionnement, de transport et de crédit and Grands Moulins de Paris*, para. 13; judgment of 25 May 1978, joined cases 83/76, 94/76, 4/77, 15/77 and 40/77, *Bayerische HNL Vermehrungsbetriebe and Others*, para. 5. See also L. JOHNSON, O. VOLKOV, *Investor-State Contracts, Host-State 'Commitments' and the Myth of Stability in International Law*, in *American Review of International Arbitration*, 2013, p. 361 *et seq.*

<sup>60</sup> Art. 8.9 CETA. See also C. TITI, *Le «droit de réglementer» et les nouveaux accords de l'Union européenne sur l'investissement*, in *Journal du droit international*, 2015, p. 39 *et seq.*; D. NYER, *The Investment Chapter of the EU-Canada Comprehensive Economic and Trade Agreement*, in *Journal of International Arbitration*, 2015, p. 697 *et seq.*, p. 700-703; F. HOFFMEISTER, G. ALEXANDRU, *A First Glimpse of Light on the Emerging Invisible EU Model BIT*, in *The Journal of World Investment and Trade*, 2014, p. 379 *et seq.*, pp. 394-395.

<sup>61</sup> See e.g. N. PIGEON, *La mise en œuvre de la compétence de l'Union européenne en matière d'investissements internationaux*, PhD Thesis, University Paris I, 2018, pp. 535-545; M. PAPARINSKIS, *Inter-*

tives such as improving the quality of the environment or the sustainable management of natural resources.<sup>62</sup> A teleological interpretation of the Treaties might thus suggest that the Court should not be particularly lenient with the CETA Tribunal.

If one assumes that the *Achmea* test should apply to the CETA Tribunal, a third question comes to the fore: would the CETA Tribunal fail the *Achmea* test? Probably, yes. The negotiators sought to render CETA more palatable to the Court of Justice, by restraining its ability to interpret domestic law,<sup>63</sup> by enhancing its transparency, and by characterising it as a permanent tribunal.<sup>64</sup> These elements might perhaps convince the Court to apply the *Achmea* test loosely in Opinion 1/17, based on the assumption that the CETA Tribunal will exercise restraint. However, such a scenario does not appear very likely. Investment tribunals are not known for their predictability and restraint<sup>65</sup> and the Court of Justice is generally wary of any potential interference with the autonomy of EU law.<sup>66</sup> In Opinion 2/13, in particular, it was very rigorous with a court that protects the human rights of individuals.<sup>67</sup> One may expect it to be equally rigorous with a tribunal that protects the economic interests of investors.

Nonetheless, it is impossible to predict how the Court will rule in Opinion 1/17 because the indications of *Achmea* are contradictory. Such contradictions lead to a fourth question: why did the Court distinguish *Achmea* from Opinion 1/17 in the introduction and conclusion of the judgment, but solved the case through a test potentially applicable to CETA? One can only formulate hypotheses in this respect. The apparent contradictions in *Achmea* may be the product of dissension within the Court or might have been an attempt at preserving some room of manoeuvre for the solution of future cases. Alternatively, the contradictions might be the accidental consequence of a practical

*national Investment Law and the European Union: A Reply to Catharine Titi*, in *European Journal of International Law*, 2015, p. 663 *et seq.*, p. 669.

<sup>62</sup> Art. 21, para. 2, let. f), TEU.

<sup>63</sup> In addition, CETA contains rules for determining the respondent party which are arguably aimed at preventing the Tribunal from passing judgment on issues of EU law, see C. CONTARTESE, L. PANTALEO, *Division of Competences, EU Autonomy and the Determination of the Respondent Party: Proceduralisation as a Possible Way-Out?*, in E. NEFRAMI, M. GATTI (eds), *Constitutional Issues of EU External Relations Law*, Baden-Baden: Nomos, 2018, p. 409 *et seq.*, pp. 436-438.

<sup>64</sup> H. LENK, *An Investment Court System for the New Generation of EU Trade and Investment Agreements*, cit.

<sup>65</sup> See e.g. UNCTAD, *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II*, United Nations, 2012, pp. 11 and 91; S. HINDELANG, *Study on Investor-State Dispute Settlement (ISDS) and Alternatives to Dispute Resolution in International Investment Law*, in European Parliament Directorate-General for External Policies, *Investor-State Dispute Settlement Provisions in the EU's International Investment Agreements*, www.europarl.europa.eu, 2014, p. 39 *et seq.*, pp. 73-75.

<sup>66</sup> See e.g. B. DE WITTE, *A Selfish Court?: The Court of Justice and the Design of International Dispute Settlement beyond the European Union*, in M. CREMONA, A. THIES (eds), *The European Court of Justice and External Relations Law: Constitutional Challenges*, Oxford: Hart, 2014, p. 33 *et seq.*

<sup>67</sup> See opinion 2/13, cit., particularly paras 109 and 208.

choice. The Court could use the principle of mutual trust to solve *Achmea*, thus distinguishing it from Opinion 1/17. However, the Court might have chosen not to emphasise mutual trust because this principle is problematic, given the authoritarian tendencies of some Member States, which do not exactly elicit “trust”.

Another scenario is possible: the Court might have formulated *Achmea* strategically, to set a precedent that legitimises Opinion 1/17 *ex ante*. The composition of the Court might be remarkable: while Opinion 1/09, Opinion 2/13, and Opinion 1/17 were assigned to the plenary, *Achmea* was decided by a Grand Chamber.<sup>68</sup> A majority of the Grand Chamber, which might be a minority in the plenary, may have intended to trail-blaze the path for Opinion 1/17. To throw critics off, the Court might have deliberately inserted contradictory elements in *Achmea*, thereby preventing one from concluding with certainty that Opinion 1/17 has indeed been foretold.

<sup>68</sup> See further B. ARP, *Comment to Achmea*, cit., p. 469.





## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

#### INTRODUCTION

This *Special Section* investigates, from a multidisciplinary perspective, foundations, tools and implications of regulatory competition in the EU legal order. The term *regulatory competition* refers to a process enabling economic actors to select and deselect the law regulating their formation or activity, putting jurisdictions in competition with one another for the attraction of scarce resources. Some of the *Articles* of the *Special Section* will use a slightly different terminology – speaking about policy competition or jurisdictional competition – to refer, however, to situations that still fall within the scope of application of the above-mentioned definition.

Earlier theoretical models posited that, under conditions of perfect competition, the creation of a market for the rules, whereby laws are made to match the preferences of economic actors, contributes to maximising allocative efficiency. This vision proved to be over-optimistic, failing to take into due consideration the negative spill-over effects that regulatory competition could have in many fields, such as labour law, tax and environmental law, by inducing a *race to the bottom*. Indeed, one of the ways in which States can succeed in the race to attract the much-needed resources is by lowering regulatory standards. This notwithstanding, the promotion of regulatory competition has been eagerly retained as one of the main objectives of the neoliberal agenda. According to it, putting law-makers and regulators in competition with one another is a way to undermine *excessive* regulation, freeing up more space for market forces.

With regard to the EU, regulatory competition has been often regarded as an inevitable consequence of its multi-tiered structure. The *Special Section* challenges this view, holding that regulatory competition is not just an accident, but, as duly emphasised by Menéndez in the opening *Article*, a process that was not “brought about by the decentralised force of private actors, but designed by political fiat”. To put it differently, promoting or curbing regulatory competition are political choices made to pursue specific policy objectives.

Moving from this premise, the first part of the *Special Section* offers an in-depth examination of the complex relationship between the European integration process and

regulatory competition, exploring its historical and conceptual foundations, as well as critically engaging with its implications on the EU constitutional architecture.

The *Article* by Menéndez provides a cross-temporal analysis of the rise (and partial fall) of regulatory competition as a tool to advance market integration in the EU. According to Menéndez, a key moment in this evolution was the push toward the completion of the internal market, which occurred in the second half of the '70s. In that context, the promotion of regulatory competition contributed to the decoupling of the economic from the political, so to subordinate the latter to the former. A similar logic prevails also in the context of the Economic and Monetary Union, where the promotion of regulatory competition pursues a narrow set of objectives, such as financial stability, at the expense of other competing ones. The post-crisis reforms consolidated the role of this tool, by strengthening the capacity of supranational institutions to advance internal devaluation as a strategy to increase Member States' capacity to compete for the attraction of capital. The *Article* closes by looking at the implications of this evolution of the role and the nature of law in the European integration process. In particular, it casts a critical eye on the commodification of the law, which is no longer the product of a democratic deliberative process, but a commodity. Relying on Polanyi, Menéndez sees this evolution as one of the main flaws of the current phase of the European integration process.

Polanyi represents a key reference point also in the analytical framework worked out by Joerges in the second *Article* of the *Special Section*. Relying on the idea that the economic is inextricably linked with politics and the State, Joerges criticizes the attempt to eliminate the political from the integration process. More specifically, he challenges the assumption according to which markets have a unique capacity to efficiently allocate resources and co-ordinate knowledge. This fallacious premise is at the basis of the choice of promoting regulatory competition as a way to put external pressure on democratic will-formation processes, so to overcome the opposition of political or societal forces. The *Article* criticizes EU institutions' recourse to regulatory competition as a tool to promote uniformity. Looking at the debate between Streeck, advancing the *back to the nation State* option, and Habermas, defending the *more Europe* argument, Joerges proposes a third way, based on his *Unity in Diversity* vision. In this perspective, the EU, rather than using competition to constrain national autonomy, should revert to an institutional setting having the respect for diversity as its defining trait. This proposal builds on the author's well-known work on conflict-law constitutionalism, which he considers as a "counter vision to regulatory competition".

The first part of the *Special Section* is completed by Ferrera's contribution, offering a political science's perspective on regulatory competition. The analysis recognizes the merits of the regulatory competition theory, but, at the same time, it highlights its main shortcomings. According to Ferrera, this theory focuses on the exit dynamics – and, in particular, on the capacity of economic operators to vote with their feet and, by so doing, contribute to counter rent-seeking protectionism –, but it is too dismissive of the

voice side of politics and of the role of loyalty. Regulatory competition acts as an irritant within the EU and it erodes loyalty that Ferrera considers as “the glue that keeps the polity together”. This process has given rise to, once again in Polanyian terms, counter-movements that threaten the stability of the whole edifice. The *Article* sees the rise of *souverainiste* forces as a defensive reaction to the dispersion of nation States’ authority due, at least in part, to a conception of politics just as “a rational selection of public policies in response to regime shopping”.

The second part of the *Special Section* builds on these analytical findings and, in particular, on the idea that regulatory competition is the by-product of political choices made by supranational institutions. These choices, and the institutional dynamics underneath, vary from sector to sector. The *Articles* composing this second part look both at fields where EU law acted as a facilitator of regulatory competition and at fields where it functioned as a buttress against it or, at least, some of its most heinous effects.

*My Article* deals with a scenario falling in the first category, focusing on free movement of companies within the internal market. Here, the Court of Justice has progressively broadened the scope of application of Treaty rules on freedom of establishment with regard to cross-border transfer of companies. According to the Court, these provisions entrust corporation with the right to transfer their statutory seat in another Member State even when their sole objective is to change their legal clothes so to pay less taxes or lower salaries to their workforce. The Court operated in a legislative *vacuum*, filling it with a distinctively pro-market solution. The Commission is now following suit, having tabled a proposal for a Directive that, if adopted, would make law shopping a corporate right in the EU legal order.

Conversely, there are other cases where EU institutions have taken action against regulatory competition, perceiving it as a threat for the stability of the whole edifice. Munari takes into consideration one of the most fitting examples in this regard: environmental policy. The *Article* recalls that avoiding that the differences between national environmental legislations could trigger regulatory competition was the main – if not the only – rationale for granting legislative powers to the then European Economic Community in this field. The ensuing harmonization process was intense and pervasive, progressively levelling up environmental standards and, as clearly put by Munari, excluding that environmental protection could become a competitive factor between different national regimes. Interestingly, the *Article* shows that, in this case, the Court of Justice joined forces with the legislator, adopting an anti-regulatory competition approach when interpreting relevant Treaty provisions that seemingly left some space to Member States to lower their environmental standards. The same happened when it came to the relationship between international standards and EU ones. The Court intervened to ward off any possibility of regulatory competition from the outside, imposing to non-EU companies wishing to carry out their business in Europe to abide by EU environmental standards.

The *Article* by Van Cleynenbreugel focuses on taxation, which represents another case where EU institutions have decided to confront regulatory competition. The analysis shows that tax competition has long been considered as an inevitable consequence of the choice to create an internal market at supranational level, while leaving taxation into Member States' exclusive legislative competence. After the crisis, the Commission changed its attitude, at least with regard to the most aggressive forms of tax competition. First, it proposed to harmonize the corporate tax base for multinational businesses. Second, it began to make a more intense use of its enforcement powers in the realm of State aid to sanction special tax arrangements that, being selective, distort competition. Third, it started to target aggressive tax planning strategies in the context of the European Semester, recommending some Member States to amend certain aspect of the tax legislation. Van Cleynenebreugel argues that the Commission's strategy still falls short of providing a comprehensive and effective response to the problem. According to the author, the failure is not to be attributed to a lack of efforts by the Commission, but to the fact that it is forced to deal with structural imbalances on a case-by-case basis.

The multidisciplinary character of the *Special Section* allows for a more comprehensive understanding of regulatory competition and of its deepest implications on the constitutional architecture of the EU, as well as on the long-term prospects of the European integration process. The *Articles* composing the *Special Section* critically engage with the idea that regulatory competition is just an innocuous consequence of the removal of obstacles to the free circulation of goods and services at supranational level. Moving from different analytical angles, they shed more light on the dangers that the choice to promote regulatory competition as a tool to advance specific policy objectives poses for the constitutional identity of the EU.

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## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## THE FALSE COMMODITY IN THE EUROPEAN GAME OF LEGAL CHAIRS: BETWEEN THE IDEAL OF REGULATORY COMPETITION AND THE PRACTICE OF CAPITALISM TRIUMPHANT

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ABSTRACT: Community law was established as a meta-legal order to provide a systematic solution to conflicts between national legal orders. Integration, and in particular integration *of law*, was required to tackle the functional and normative problems that ensued from the disorganised co-existence of State legal orders in Europe. Integration of law was made compatible with the preservation of autonomy to define the national socio-economic model and structure because early European legislation organised the *co-operation* of national legal orders. The power to regulate and mould the economy was reinforced, at the same time that the sharpest corners of national power were clipped (by reference to the formal principle of non-discrimination). From the late seventies, the point and purpose of European integration was redefined. *L'Europe par le marché* resulted in integration *through* law, making of law the key means through which national regulatory and monetary policies

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were made to compete with each other. The result was the progressive definition of the content of law by the exercise of economic freedoms, a most peculiar process leading to turning law into a false commodity. Since the late 2000s, the role of law in the process of European integration has been increased to the detriment of governance arrangements, but this has only exacerbated the commodification of law and its submission to the imperative of ensuring the store value of money.

KEYWORDS: constitutional law – economic law – regulatory competition – economic freedoms – monetary union – public powers.

## I. FROM THE LEGAL REGULATION OF CROSS-BORDER RELATIONS TO SYSTEMATIC POLICY AND REGULATORY COMPETITION

Economic and cultural relationships tend not infrequently to cut across the normative boundaries that define the territories to which legal orders apply. The perennial mismatch between the geography of legal orders and that of social relations requires both maintaining and transcending normative borders. On the one hand, the subjective interests of those engaging in cross-border relationships require preventing the disruption that may result from the conflictive concurrence of norms from two or more legal orders. To achieve this, it is necessary either to relativize normative boundaries (through appeals so different in form as to those to comity or to the subjective rights of the parties), or to get rid of them. On the other hand, the effectiveness of legal norms requires preventing the artificial arrangement of relationships in space so as to escape any form of legal discipline, or to pick and choose which legal order governs that relationship. This last concern renders necessary to maintain normative borders, which may or may not include physical borders (transit points where the right – of persons, goods and capitals – to enter into the territory is verified).

There are three main techniques to reconcile the maintenance and the transcendence of borders:

a) The oldest expedient is to establish *conflict rules*, i.e. secondary or meta-rules that determine which norm governs a specific cross-border relationship.<sup>1</sup> Conflict rules were first inserted into *municipal* legal orders as norms that took into account that the underlying relations cut across jurisdictional borders (giving at least some consideration to interests that were not located within the jurisdiction called to decide), but which were still unilateral, i.e. decided on its own by each legal order. Functional and norma-

<sup>1</sup> In continental Europe there is a tendency to equate the discipline of “conflicts of law” with that of “private international law”. That implies a far too narrow understanding of the breadth and scope of conflicts of law, which extends not only to conflicts between norms belonging to different legal orders, but also to those part of the same national legal order (typical in federal or quasi-federal States); and not only to conflicts of contract or tort law, but also to administrative, labour or tax law. In this *Article*, I refer to “conflicts of law” and “conflicts” in this wider sense, closer to that prevalent in the United Kingdom and in the United States, and which Christian Joerges has masterly applied to the analysis of European law.

tive reasons favoured moving to *bilateral*, and then, *multilateral* conflict norms, so that the very process of producing the norms would ensure the appropriate weighing in of the interests external to each country. The rise of the nation-state as a political form in the wake of the French Revolution turned conflicts of law into a largely international discipline, as States tended to homogenise the norms applicable within their territory (thus drastically reducing internal conflicts).<sup>2</sup> That was not the case in the United Kingdom and the United States, which kept an internal legal pluralistic structure.<sup>3</sup>

*b)* A second technique is that of enacting specific *substantive norms* applicable to cross-border relations. As is the case with conflict rules, substantive norms can be established unilaterally, bilaterally or multilaterally. In all cases, the purpose is to ensure that cross-border relations are legally disciplined in a homogeneous way, i.e. independently of which is the *side of the border* where eventual conflicts or disputes arise;

*c)* Finally, the relationship between norms can be organised by means of delegating to non-state actors the determination of the applicable norms.<sup>4</sup> The range of choice left to private parties can range from the choice of the specific norm governing one relationship to the capacity to select the legal regime of their socio-economic relationships as a whole (so that they can choose where and according to which law to incorporate a business, where to fill in their tax forms, which social security system to contribute to and so on).

“Policy competition”, “regulatory arbitrage” and “regulatory competition”<sup>5</sup> are specific instances of this third set of techniques. In particular, “policy competition” and “regulatory competition” are said to be processes in which the determination of the applicable norms to cross-border relationships results from a multitude of private choices that resemble, both formally and functionally, the way in which “markets” operate. The difference being that private parties choose not competing goods or services, but competing legal norms, so that the myriad of private choices do not determine the price at which the market clears, but coalesce into defining the substantive content of the applicable legal regime.<sup>6</sup>

<sup>2</sup> The rise of the nation-state also affected the very content of the norms of private international law. Nationality emerged as a powerful rival to domicile/residence as the law governing conflicts. See the classic P.S. MANCINI, *Della nazionalità come fondamento del diritto delle genti*, Torino: Giappichelli, 2000.

<sup>3</sup> W. CORNISH, M. LOBBAN, K. SMITH, *Private International Law*, in W. CORNISH, J.S. ANDERSON, R. COCKS, M. LOBBAN, P. POLDEN, K. SMITH, *The Oxford History of the Laws of England: Volume XI: 1820–1914 English Legal System*, Oxford: Oxford University Press, 2010, p. 279.

<sup>4</sup> N. BOBBIO, *Teoria Generale del Diritto*, Torino: Giappichelli, 1993, p. 173 *et seq.*

<sup>5</sup> See among others: J-M. SUN, J. PELKMANS, *Regulatory Competition in the Single Market*, in *Journal of Common Market Studies*, 1995, p. 67 *et seq.*; S. DEAKIN, *Legal Diversity and Regulatory Competition: Which Model for Europe?*, in *European Law Journal*, 2006, p. 440 *et seq.*; A. SAYDÉ, *One Law, Two Competitions: An Enquiry into the Contradictions of Free Movement Law*, in *Cambridge Yearbook of European Legal Studies*, 2010-11, p. 365 *et seq.*

<sup>6</sup> The characterization of the overlap of legal systems as a market-like competition was first articulated in the pioneering work on what came to be known as fiscal federalism. Cf. C.M. THIEBOUT, *A Pure Theory of Local Expenditures*, in *Journal of Political Economy*, 1956, p. 416 *et seq.*

It is important to notice that the three techniques unleash more or less intense pressures to reconsider the substantive content of *purely internal* norms. While in the short run it is conceivable that the norm applicable to internal and cross-border relations be different, in the mid and in the long runs it is likely that the discrepancy will result in pressure to extend to purely internal solutions the cross-border solution. The combined effect of the principle of equality before the law and, if the cross-border norm is perceived to be more beneficial to its addressees, the political mobilisation of the internal addressees of the norms, might bring about that change.<sup>7</sup> This entails that changes in the discipline of cross-border relationships may play a strategic role in the process of changing the substantive content of the law in general.

## II. EUROPEAN COMMUNITY LAW AS THE DISCIPLINE OF CROSS-BORDER LEGAL RELATIONS

Social, economic, cultural and political relations cutting across national borders increased exponentially in 19th century Europe. Instability and potential conflict were kept in check by a mixture of privately organised and politically-mediated means. Thus, privately owned and largely privately governed central banks played a key role in upholding the gold standard, which constituted the basic infrastructure of cross-border economic activity. In their turn, national legislators tended to increase the scope within which private autonomy could configure socio-economic relations.<sup>8</sup> At the very same time, though, systems of international conflict norms were enshrined in national legal orders; they were to be slowly but steadily replaced by treaty-based conflict norms.

This fragile and unstable system was tested and found failing during the First World War.<sup>9</sup> As a result, the interwar period was characterised by systemic instability, which after 1929 would result in the decrease of cross-border interaction, indeed in a rapid renationalisation of social, economic, political and cultural life. In such a context, the lack of political agreement on the government of cross-border relations fostered the emergence of private forms of organisation, such as cartels.<sup>10</sup>

<sup>7</sup> In such a context, “policy competition” and “regulatory competition” transform themselves into systematic phenomena, pitting legal orders against legal orders as a whole.

<sup>8</sup> See the magisterial reconstruction of K. POLANYI, *The Great Transformation*, Boston: Beacon Press, 1944. More recently, A. MILWARD, S. BERRICK SAUL, *The Economic Development of Continental Europe 1780-1870*, London: Routledge, 1973; Id., *The Development of the Economies of Continental Europe 1850-1914*. London: Routledge, 1977.

<sup>9</sup> C.S. MAIER, *Recasting Burgeois Europe*, Princeton: Princeton University Press, 1975; A. TOOZE, *The Deluge*, London: Allan Lane, 2014.

<sup>10</sup> K.R. MIROW, H. MAURER, *Webs of Power: International Cartels and the World Economy*, Boston: Houghton Mifflin, 1994.

It was against this context that Community law could be interpreted and developed as a politically-mediated means of organising cross-border relations with an explicit view to overcoming the instability of “spontaneous” order.<sup>11</sup>

Through a mixture of conflict norms and substantive norms, Community law was expected to create the framework within which the laws of national legal orders could *cooperate*. In particular, Community law would reinforce the capacity of legal systems to govern their environments, by means of supplementing their capacities regarding cross-border environments. In other words, Community law would contribute to enhance the effectiveness of public power in Europe, in particular creating the conditions under which the Democratic and Social State could become an institutional reality and not only a regulatory ideal (section 1). The stability of such a model was, however, dependent on a strong background consensus on the point and purpose of public action. The monetary and economic crises of the 1970s shattered such consensus, and revealed the limits of Community law not only as a means of political integration, but also as the tool with which to govern cross-border socio-economic relations (section 2).

## II.1. COMMUNITY LAW AS THE EUROPEAN LAW OF CONFLICT: COORDINATING PUBLIC POWER THROUGH LAW

Community law was established as a meta-legal order intended to provide a systematic solution to the organisation of cross-border relationships in Europe. Integration, and in particular legal integration, was needed to tackle the functional and normative problems that ensued from the disorganised co-existence of State legal orders in Europe, as the Europeans had learned the hard way, through the miserable experiences of the interwar period and of two world wars. The odd mix of cartel arrangements and disorganised concurrence of policies and regulatory systems was indeed associated in the minds of post-war Europeans with their recent dismal experiences.<sup>12</sup> A politically-mediated and intentional *discipline* governing cross-border relations was called for, so as to create the conditions under which legal systems could enter into *mutually supporting cooperative* relationships. Community law was expected to be a decisive contribution in that regard.

The Treaties contained three decisive choices.

Firstly, the fundamental norms enshrined in the Treaty establishing the European Economic Community introduced *formal* limits to the way in which each Member States exercised its public powers. The sharpest corners of national public power were thus clipped, while preserving the capacity of each Member State to shape its social and economic policies in line with the historical tradition and actual needs of each State. This bal-

<sup>11</sup> P. REUTER, *La Communauté européenne du charbon et de l'acier*, Paris: LGDJ, 1953.

<sup>12</sup> D. GERBER, *Law and Competition in Twentieth-Century Europe*, Oxford: Oxford University Press, 2001; W. WELLS, *Antitrust and the Formation of the Postwar World*, New York: Columbia University Press, 2002.

ancing act revolved around the principle of non-discrimination and around the granting to all Community nationals of a set of subjective but embedded rights. For one, non-discrimination required Member States of the Communities to *provide* Community nationals the treatment that used to be reserved to nationals.<sup>13</sup> This limited the range of policy choices available to States, albeit without committing States to any specific form of disciplining or regulation of private activity. In other words, non-discrimination imposed the widening of the scope of application of certain rights and duties, but not the acknowledgment of any specific set of subjective rights and duties vis-à-vis the Member States.<sup>14</sup> For two, the creation of a common market was mainly concerned with the elimination of customs duties and measures having an equivalent effect to customs duties, and with the (steered) movement of workers across national borders. In other words, it was about goods and persons moving in a regulated fashion.<sup>15</sup> As a consequence, Community law did not only not tweak the national power to shape and define public socio-economic policies, but actually widened the set of actual policy choices among which Member States could choose, as a result of the creation of institutional structures and decision-making processes that allowed European States to support each other's powers.

Secondly, integration was envisaged as a process of *approximation*, not *unification*, of laws. The point and purpose of Community law was not to reduce to unity the law applicable in the territory of the Communities, but rather to organise the co-existence of the multiplicity of national legal orders. Harmony, not identity, was the objective.<sup>16</sup> Consequently, integration was not about ascertaining one-size-fits-all legal solutions to common challenges, but about figuring out legal solutions that allowed reconciling the

<sup>13</sup> Cf. Art. 7 of the EEC Treaty: "Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited".

<sup>14</sup> Art. 7, para. 2, ruled out a too daring construction of Art. 7, by referring back to secondary legislation the establishment of rules "designed to prohibit such discrimination".

<sup>15</sup> Both freedom of establishment and free movement of capital were conditioned to political agreement being reached regarding the terms and conditions under which it would be acknowledged.

<sup>16</sup> It would go beyond the scope of this *Article* to consider the terminological shift that took place at some point in the seventies, when reference to approximation was substituted by harmonisation; and to consider how the latter came to be identified in everything but in name with unification. It is important to stress, however, that comparative lawyers tended to draw a clear distinction between unification and harmonisation. See, for example, W.J. KAMBA, *Comparative Law: A Theoretical Framework*, in *International and Comparative Law Quarterly*, 1974, p. 501: "Although the idea of a world-wide law exerted a great deal of influence on the development of comparative legal studies and research and on the various movements for the unification which flourished in Europe in the post World War I years, research and experience have demonstrated that it is a 'pious hope' which is neither attainable nor desirable under existing world political and social conditions. It is now readily conceded that unification at the international level is only feasible and desirable in more limited spheres of law such as: commercial law, maritime law, conflicts of laws, and in new areas such as space law, broadcasting law and atomic law. Harmonisation has better prospects because while eliminating or minimising major extant legal obstacles, it allows for a certain amount of variation in matters of detail. It is thus not surprising that since the beginning of this century it has been steadily coming to the fore".

objective of common action with the persistence of different social, political, cultural and economic choices. Substantive supranational law was thus also an example of “embedded” liberalism,<sup>17</sup> not only in politico-economic terms, but also in legal ones. The “federal” nature of Community law was perhaps foremostly reflected in the text of one of the key provisions of the original Treaty establishing the European Economic Community, Art. 100. It read as follows: “The Council shall, acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the common market”.

This fundamental choice was not only in line with the principle of enumerated competences (attribution of competences), but also with the very range of legal instruments which could embody supranational legal norms. The sources of Community law included not only abstract and general norms (*regulations*, “binding” in their “entirety and directly applicable in all Member States”, ex Art. 189 of the EEC Treaty), but also lighter *directives*, defined as binding exclusively in their objectives, and thus leaving States a wide margin of manoeuvre to define the concrete norms through which to meet the set goals. The Treaties did not only not rule out resort to international treaties and agreements, but in certain regards they fostered their use (including in the critical area of the reciprocal recognition and enforcement of judgments and of double taxation, among others, ex Art. 220 of the EEC Treaty).

Thirdly, the motor of substantive legal integration was to be the *political* decision-making process. Regulations and directives were the result of negotiations leading to unanimous consent in the Council of Ministers.<sup>18</sup> The fundamental decisions determining the shape of European integration (think of the Stresa agreement leading to the establishment of the Common Agricultural Policy)<sup>19</sup> and the key decisions concretising the integration programme (from freedom of movement of workers<sup>20</sup> to the harmonisation of customs duties and of indirect taxation)<sup>21</sup> were the outcome of *politically mediated decisions*. It could still be objected that the Court of Justice played a fundamental role in defining the nature of Community law (in particular, in sustaining the “constitutional in-

<sup>17</sup> K. POLANYI, *The Great Transformation*, cit.; J. RUGGIE, *International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order*, in *International Organization*, 1982, p. 79 *et seq.*

<sup>18</sup> The original EEC Treaty foresaw the progressive move to qualified majority voting. But, as is well known, the French government adamantly opposed. The “empty chair” crisis ensued. It was only overcome on the basis of the so-called “Luxembourg agreement”, which entailed retaining, for all practical purposes, unanimous decision-making.

<sup>19</sup> N.P. LUDLOW, *The Making of the CAP: Towards a Historical Analysis of the EU's First Major Policy*, in *Contemporary European History*, 2005, p. 347 *et seq.*

<sup>20</sup> K.A. DAHLBERG, *The EEC Commission and the Politics of the Free Movement of Labour*, in *Journal of Common Market Studies*, 1968, p. 310 *et seq.*

<sup>21</sup> A.J. MENÉNDEZ, Neumark *Vindicated*, in D. CHALMERS, M. JACHTENFUCHS, C. JOERGES (eds), *The Eurocrats' Dream*, Cambridge: Cambridge University Press, 2016, p. 78 *et seq.*

terpretation" of Community law actively proposed by the legal services of the European Commission since at the very least the early sixties, if not before).<sup>22</sup> That the Court was far from a secondary player, it is undisputed. But the decisions which are generally regarded as *transformative* were less so in the short run. *Van Gend en Loos*<sup>23</sup> and *Costa*,<sup>24</sup> while laying the ground for future decisive developments, had a rather limited impact, structurally and substantially, in the short run. The decisions were to become decisive because they planted seeds that would sprout later. But for the time being, the *motor* of integration remained the "institutional triangle",<sup>25</sup> with the Commission and the Council of Ministers playing a key role as co-legislators.

From this perspective, Community law could be characterised (and has indeed been characterised by Christian Joerges)<sup>26</sup> as a paradigmatic example of a *federal* (or quasi-federal) conflict of laws system. That is, as a system of norms that produced substantive and conflict norms that prevented conflict between public powers, and that provided coherent normative solutions when such conflicts arose.

It should be added that Community law was rendered possible by a basic substantive convergence of national constitutional orders (around the regulatory ideal of the Democratic and Social State). This was so because, even in the "little Europe" made up of the six founding Member States, unanimous agreement on the path to be followed required a commonality of views on socio-economic visions and on the role that public institutions should play in bringing such visions about. Otherwise, as Fritz Scharpf would suggest in the early eighties, the supranational institutional and decision-making machinery was likely to lead Europe into blockage, into what he referred acutely as a "joint-decision trap".<sup>27</sup> At the very same time that Community law *complemented*, both functionally and normatively, national Democratic and Social States. As a result, Community law operated as a *framework within which not only States exercised public powers jointly*, but within which they could mutually support the effectiveness of their powers as independent States.

<sup>22</sup> E. STEIN, *Toward Supremacy of Treaty-Constitution by Judicial Fiat: On the Margin of the Costa Case*, in *Michigan Law Journal*, 1965, p. 491 *et seq.*; E. STEIN, *Lawyers, Judges, and the Making of a Transnational Constitution*, in *American Journal of International Law*, 1981, p. 1 *et seq.*; W. MATTLI, A.M. SLAUGHTER, *Revisiting the European Court of Justice*, in *International Organization*, 1998, p. 177 *et seq.*

<sup>23</sup> Court of Justice, judgment of 5 February 1963, case 26/62, *Van Gend en Loos*.

<sup>24</sup> Court of Justice, judgment of 15 July 1964, case 6/64, *Costa*.

<sup>25</sup> E. NOËL, *Les rouages de l'Europe*, Paris: Nathan; Brussels: Labor, 1979.

<sup>26</sup> C. JOERGES, *The Idea of a Three-Dimensional Conflicts Law as Constitutional Form*, RECON Online Working Paper, no. 05, 2010, [www.reconproject.eu](http://www.reconproject.eu).

<sup>27</sup> F. SCHARPF, *The Joint-Decision Trap: Lessons from German Federalism and European Integration*, in *Public Administration*, 1988, p. 239 *et seq.*

## II.2. THE LIMITS OF COMMUNITY LAW AS EUROPEAN LAW OF CONFLICTS: EUROPE ENTRAPPED

Radical change in the background circumstances against which European integration unfolded was brought about by the monetary, economic and fiscal crises of the seventies.<sup>28</sup> In August 1971, the United States abandoned the pledge to convert its currency into gold at a fixed price. This aggravated a looming monetary crisis, plunging Western economies into financial turbulence. In September 1973, the effects of the monetary crisis were amplified by a sharp economic downturn, triggered by a massive increase in the price of oil.<sup>29</sup>

European integration had proceeded far enough as to render necessary a coordinated response to the crises, but not far enough so as to render such response probable, even feasible. As a result, the asymmetric impact of the crises was compounded by the asymmetric effects of the different national policy responses to the crises. In the aftermath of such double divergence, the background consensus on socio-economic visions and on the role of public institutions started to crack. By early 1974, a clear divide was visible among States that assigned preference to the fight against inflation, even at the price of strengthening the forces of deflation (such as Germany or the Netherlands) and States that still regarded full employment as a paramount objective, still to be ensured even if risking an inflationary spiral (such as Italy and the United Kingdom).<sup>30</sup> Moreover, by the time that a certain convergence on the primacy of the fight against inflation emerged (from 1976, and most clearly, from the end of 1978), the European background consensus on the Democratic and Social State was broken, as rendered visible by the election of Margaret Thatcher in 1979 (its effects amplified by the election of Ronald Reagan as US President in 1980).

With the constitutional consensus shattered, the European Communities seemed incapable not only of making a useful contribution to containing and overcoming the crises, but even of maintaining the degree of integration which had been reached so far. It proved simply impossible both to produce new legal norms to govern a rapidly

<sup>28</sup> Although European integration had been effectively launched by the European wide monetary arrangements of the European Payments Union (EPU) in 1950, such arrangements were phased out in 1958. The founding Member States of the Communities, together with other European States, accepted the full convertibility of their currencies under the Bretton Woods monetary arrangements. Such a decision would cast a long shadow over European integration. The role of the dollar as anchor to the system required, both and at the same time, that the United States expanded the offer of dollars in line with the growth of the world economy, and restrained the demand of dollars to ensure the credibility of the promise to convert dollars into gold. By the mid sixties, the soundness of the diagnoses which claimed that the Bretton Woods system was doomed were in the process of being vindicated. On EPU, see B. EICHENGREEN, *Reconstructing Europe's Trade and Payments: The European Payments Union*, Manchester: Manchester University Press, 1993; R. SALAIS, *Le viol de l'Europe*, Paris: Presses Universitaires de France, 2013.

<sup>29</sup> P. ARMSTRONG, A. GLYN, J. HARRISON, *Capitalism Since 1945*, Oxford: Blackwell, 1991; R. BRENNER, *The Economics of Turbulence*, London: Verso, 2006.

<sup>30</sup> P. ARMSTRONG, A. GLYN, J. HARRISON, *Capitalism Since 1945*, cit., p. 233 *et seq.*

changing socio-economic reality, and to amend the already existing norms to adapt them to new circumstances. In other words, Community law was stuck between an impossible *status quo* and the sheer improbability of forging new political agreements.<sup>31</sup> In particular, the very features of European decision-making process that had made major contributions to the legitimacy and efficiency of the Communities (very especially, the symmetric inter-governmentalism reinforced by the Luxembourg compromise) started to be openly criticised. This reflected a combination of views: old-time centralising views that always regarded the Gaullist pluralistic turn with suspicion (reflected in the Commission's criticism of the central role of the Council of Ministers) and growingly neo-liberal views that established an association between "dirigiste" policies and European integration. It was from this latter line of criticism that the very term of "Eurosclerosis" emerged.<sup>32</sup> And it would be from that line of criticism that a radical new understanding of the internal market and of the project of creating a European currency would originate, unleashing a radical transformation of the European Communities.

### III. FROM COMMUNITY TO UNION: FOSTERING NORMATIVE COMPETITION THROUGH EUROPEAN UNION LAW

The crisis which European integration underwent in the seventies fostered new ways of conceiving the government of cross-border relations. Among the upcoming narratives, the ones revolving around the call for a single currency and a single market would underpin the actual transformation of the Communities in the late seventies and early eighties into a European Union (section 1). The government of European integration was deeply affected. New paths of integration were opened by means of organising processes of framed policy competition (regarding monetary and fiscal policy) and regulatory competition (regarding the whole set of socio-economic norms). This resulted in new roles and new tasks for Community law (section 2).

#### III.1. THE NARRATIVES OF THE SINGLE MARKET AND OF THE SINGLE CURRENCY

By the mid-seventies, a new narrative of European integration got hold of European debates: *l'Europe par le marché*, or integration through the creation of a single market and a single currency.<sup>33</sup> This new narrative was based on a two-fold diagnosis of the European malaise.

a) Firstly, Europe was *blocked*, incapable of articulating responses to the several challenges that it had confronted since the late sixties. The monetary crisis confronted

<sup>31</sup> M. GILBERT, *European Integration: A Concise History*, Lanham: Rowman and Littlefield, 2011.

<sup>32</sup> The term was normatively and politically loaded, informed as it was by what we would now characterise as neoliberal views.

<sup>33</sup> G. GRIN, *The Battle of the Single European Market*, London: Kegan Paul, 2003; N. JABKO, *L'Europe par le marché*, Paris: Sciences Po, 2009.

Europe with the need of re-establishing an autonomous monetary infrastructure that could support the internal market. Different visions regarding the role of monetary policy, the relationship between fiscal and monetary policy, and last but not least, the actual instruments through which a common monetary and fiscal policy could be established, rendered consensus simply impossible. By the same token, the 1973 economic crisis impacted European States in a deeply asymmetric manner. Under such conditions, the Communities were incapable of articulating a common response, something that amplified divergences as States opted for following different, and far from compatible, national policies. The most obvious signal of the seriousness of the challenges ahead was the fact that intra-Community trade, which had been constantly growing since the late fifties, stalled and then declined.

b) Secondly, the cause of the incapacity of the Communities to react was to be found in the *overpoliticisation* of the European decision-making processes. The requirement of unanimous decision-making in the Council led to paralysis. The full potential of economic integration required decoupling its unfolding from supranational political decision-making.

To overcome the blockage of the European Communities, it was claimed that it was necessary to establish both a single currency and a single market.<sup>34</sup> A major cause of the appeal of this new narrative is to be found in the peculiar way in which it combined reference to continuity and to radical transformation. On the one hand, the advocates of the creation of a single currency and of a single market claimed that to transcend the trap into which the European Communities were stuck, what was needed was *merely* the full realisation of the original programme of integration. In other words, Eurosclerosis could be cured by finding the courage to realise the original ambitions of the founders. On the other hand, what was presented as the “completion” of the original programme of integration required a radical break with the original design of the Communities. So far, European integration had been premised on the necessary synchronisation of economic and political integration. In other words, economic integration and political integration were expected to go hand in glove, both for prudential and for normative reasons. However, that synchronisation was the root cause of over politicisation. What was needed was to decouple economic from political integration, turning economic integration into the *motor* of integration. Or what is the same, subordinating political to economic integration. This implied accepting the risk that economic integration could proceed *in the absence* of a parallel process of political integration; or to put it differently, of economic integration advancing even in the presence of clear political re-

<sup>34</sup> Commission, *Completing the Internal Market: White Paper from the Commission to the European Council (Milan, 28-29 June 1985)*, COM(85) 310 final; Commission, *One Market, One Money: An Evaluation of the Potential Benefits and Costs of Forming an Economic and Monetary Union*, in *European Economy*, 1990, p. 1 *et seq.*

sistance. In brief, the language of the single market and single currency was conservative, but the means to achieve them could not be but revolutionary.

### III.2. FROM COMMUNITY LAW TO UNION LAW THROUGH POLICY AND REGULATORY COMPETITION

The goals of establishing a single currency and a single market led to a radical transformation of the European Communities and of Community law. The single market *entailed* a radical shift in the role of supranational law in the process of integration, from the form of politically mediated set of norms complementing national Democratic and Social States to steering device of policy and regulatory competition between national legal orders (a). In its turn, the single currency foreclosed the political space within which it would have been possible to articulate alternative policies at either the national or the supranational level (b).

#### a) From common to single market.

The establishment of the single market resulted in a major transformation of the government of the European Union. Instead of a politically mediated definition of the internal market, the contours of the single market were to be defined through a *framed regulatory competition* propelled by the holders of economic freedoms as constructed by the Court of Justice in one decisive ruling after the other.

Three were the key legal steps in the fashioning of this transformation.

Firstly came the redefinition of free movement of goods as a legal category in the late seventies and early eighties. As pointed, in the original, "Treaty" understanding of free movement of goods, the point and purpose of that freedom was to eliminate tariff barriers and measures having an equivalent effect. National norms discriminating goods produced in other Member States, and only norms discriminating goods produced in other Member States, were to be found in breach of Community law. From the ruling in *Cassis de Dijon*, the standard of review was a much wider one.<sup>35</sup> Any national norm, even if not discriminatory, was to be declared invalid if it placed obstacles to the free movement of goods. This entailed that any national norm, independently of its consistence and purpose, could be declared to be in breach of supranational law if it restricted in one way or the other the unimpeded movement of goods. As a result, free movement of goods would stop being the modest operationalisation of the principle of non-discrimination, and would become an ambitious *substantive standard*, the actual content of which would be determined by the Court itself.

Secondly, the distinction between on the one hand free movement of goods and on the other hand the other economic freedoms, enshrined in the structure and literal

<sup>35</sup> Court of Justice, judgment of 20 February 1980, case 120/78 *Rewe v Bundesmonopolverwaltung für Branntwein*.

tenor of the Treaties, was muddled in the rulings in *Luisi and Carbone*<sup>36</sup> and in *Cowan*.<sup>37</sup> Luxembourg judges extended Community rights to the *recipients* of services. This turned *anybody* engaging in cross-border activities into a potential holder of European rights (if only because it is extremely hard in capitalist societies to move around without becoming the passive recipient of services).<sup>38</sup> This widened (and reconfigured) the European personal status (prefiguring the mould that European citizenship would have). Decisively, the two decisions, and very especially *Luisi and Carbone*, pointed to the indivisibility of the different economic freedoms. Even if capital movements had not been liberalised, and States retained the power to set limits to them, the right to move in order to receive services entitled Europeans not only to physical exit, but also to carry with them their capital when leaving their country. The decision was underpinned by the implicit assumption that economic freedoms were indivisible.

Thirdly, in the nineties and early 2000s the CJEU drew the conclusions that stemmed from the new understanding of free movement of goods and from the assumption that economic freedoms were indivisible, namely it generalised the *new* conception of economic freedom established in *Cassis de Dijon* to all other economic freedoms (i.e. freedom of establishment, freedom to provide services, free movement of capital and, last but not least, free movement of workers).<sup>39</sup> The Single European Act, and even more so, the Maastricht Treaty, seem to have been regarded by the Court as a clear political signal backing such a move, which required trumping the literal and systematic interpretation of European primary law with a teleological interpretation of the Treaties not dissimilar to that underpinning the “foundational” rulings of the Court in *Van Gend* and *Costa* (the implications of which were now radically transformed, given the new substantive autonomy of Community law).

This double jurisprudential shift opened the path to the radical transformation of the relationship between law and politics in European integration.

Firstly, *Cassis de Dijon* created the conditions under which the *political motoring* of legal integration could be replaced by the *private initiative* of the holders of Community rights as economic freedoms. In particular, the Commission drew from the *Cassis de Dijon* ruling the conclusion that integration could proceed not only through political decision-making and mediation, but also through what it labelled as “mutual” recogni-

<sup>36</sup> Court of Justice, judgment of 31 January 1984, joined cases 286/82 and 26/83, *Luisi and Carbone*.

<sup>37</sup> Court of Justice, judgment of 2 February 1989, case C-186/87, *Cowan*.

<sup>38</sup> A.J. MENÉNDEZ, E.D.H. OLSEN, *Misunderstanding European Citizenship*, Basingtoke: Palgrave, 2019 (forthcoming).

<sup>39</sup> Court of Justice: judgment of 25 July 1991, case C-76/90, *Säger*; judgment of 30 November 1995, case C-55/94 *Gebhard*; judgment of 15 December 1995, case C-415/93 *Bosman* and after the entry into force of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, judgment of 14 December 1995, case C-163/94, *Sanz de Lera*.

tion.<sup>40</sup> Despite the normative labelling, what was understood by mutual recognition was the combination of the immediate acceptance of all regulatory choices made by Member States by all other Member States, and the transformation of private litigants (not infrequently, multinational companies) in the agents that would decide, through litigation, which regulatory choice would prevail in the Community as a whole. Moreover, once private parties had been recognised as holders of the “new” economic freedoms, they may not need to go to court, but merely *threaten to do so*, in order to render effective their rights. In other words, instead of politically mediated *positive common norms*, integration could now proceed by the case by case removal of national laws in breach of the *new economic freedoms*.

To illustrate the point. The static implication of *Cassis de Dijon* was that German authorities were required to recognise French regulatory standards. But once German authorities had to accept the selling of foreign cassis with a lower alcoholic content than that required by its own legislation, pressure was likely to come from national beverage producers to allow the manufacturing of German cassis which also had a lower alcoholic content. As a result, Germany would be most likely forced to change its own legislation to prevent German producers relocating to France so as to be able to produce a cassis that remained price-competitive with the French cassis. Thus, the dynamic implication of mutual recognition was to unleash a process of change of national regulatory standards led by the holders of economic freedoms.

While *Cassis de Dijon* was circumscribed to free movement of goods, the Commission soon argued in favour of extending mutual recognition to the provision of services (and indirectly, to the free movement of capital). Revealing is the way in which the crucial White Paper on the single market does so, while at the same time making for the first time use of the concept of “regulatory competition”. It is worth quoting at length:

“Goods and people moving within the Community should not find obstacles inside the different Member States as opposed to meeting them at the border. This does not mean that there should be the same rules everywhere, but that goods as well as citizens and companies should be able to move freely within the Community. Subject to certain important constraints [...], the general principle should be approved that, if a product is lawfully manufactured and marked in one Member State, there is no reason why it should not be sold freely throughout the Community. Indeed, the objectives of national legislation, such as the protection of human health and life and of the environment, are more often than not identical. It follows that the rules and controls developed to achieve those objectives, although they may take different forms, essentially come down to the same thing, and so should normally be accorded recognition in all Member States, not forgetting the possibilities of cooperation between national authorities. *What is true for goods, is also true for services and for people*. If a Community citizens or a company

<sup>40</sup> Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in case 120/78 (“Cassis de Dijon”).

meets the requirements for its activity in one member State, there should be no valid reason why those citizens or companies should not exercise their economic activities also in other parts of the Community.”<sup>41</sup>

In brief, the re-characterisation of economic freedoms as self-standing rights implied that the move from the common market to the single market set in motion a process in which Community law served as an “irritant” of national policies and regulations. This was found necessary to ensure that integration followed its proper dynamics and course.<sup>42</sup>

Secondly, the jurisprudential shift created new functional reasons why the move towards qualified majority voting could be regarded as an urgent priority. Indeed, the Single European Act (re)introduced qualified majority voting in the Council.<sup>43</sup> Despite the rather tortuous literal tenor of the amended drafting of the Single European Act, successive rounds of Treaty amendment resulted not only in the widening of the policies regarding which decisions could be taken by qualified majority voting, but also the granting in such cases of “co-decision” powers to the European Parliament (expected to vote in most cases by simple majority).

However, it should be emphasised that it was not intended in the Single European Act, or for that matter at any later stage, that qualified majority voting would become the standard decision-making rule in supranational decision-making. There was, and there remains, a set of policies regarding which unanimity in the Council is still required. This entails that alongside qualified majority voting came (implicit) rules dividing law-making labour between different decision-making processes. In very broad terms, the “new” process (qualified majority) were to be applicable when taking decisions concerning the realisation of the “single market” programme (market-making policies). On the other hand, unanimity in the Council was and is still required when “positive” measures rectifying the pattern of distribution of economic burdens and benefits resulting from the operation of markets (market-correcting policies). This division of labour resulted in the artificial splitting of issues alongside the division of labour between decision-making procedures. As a result, the move to qualified majority voting facilitated the adoption of measures reinforcing the new understanding of economic freedoms favoured by the

<sup>41</sup> Commission, *Completing the Internal Market*, cit., paras 57-58 (emphasis added).

<sup>42</sup> Whether such dynamics would end being a race to the bottom or a race to the top is highly relevant in substantive terms, but what is clear is that “mutual recognition” was not a recipe for normative stability. It was, in the best of cases, a pathway that led to the creative destruction of national legal systems.

<sup>43</sup> The move to qualified majority voting, as has been highlighted among others by Weiler, results in a key, if not the key, piece of the belt transmitting indirect national democratic legitimacy into supranational law being removed. The “loss” in indirect democratic legitimacy was said to be more than compensated by the emergence of the European Parliament as co-decider. Still, the move to qualified majority deeply transformed the relationship between European law and Member States, which could not be imposed supranational laws that they had rejected. J. WEILER, *The Constitution of Europe*, Cambridge: Cambridge University Press, 1999, p. 68 *et seq.* and p. 232.

Court of Justice, while *de facto* hampering legislation aiming at reregulating economic activity at the supranational level. Successive enlargements would only amplify this bias.<sup>44</sup> Moreover, the artificial splitting of issues ended up being projected to the way in which socio-economic questions were regarded, emphasising for example the two-pronged understanding of the relationship between the “economic” and the “social” sides of the socio-economic structure, a dichotomy that would percolate also to the national level (preparing the ground for the distinction between fiscal and monetary policy that would be built into the Economic and Monetary Union, EMU).

*b) From common to single currency: framed policy competition.*

If the single market was introduced through a *framed regulatory competition* propelled by the holders of economic freedoms as constructed by the Court of Justice from *Cassis de Dijon* onwards, the road towards the single currency was paved by a peculiar form of *policy competition* in which *financial markets* were (further) empowered to determine the policy alternatives available to national governments when implementing monetary and fiscal policy.

The single currency was created in two steps. Firstly, the European Monetary System (EMS) was agreed in late 1978, and introduced in early 1979. Secondly, EMU was agreed in 1992 and implemented in 1998. While most attention is usually given to the second step, the fact of the matter is that, with the benefit of hindsight, the decisions that shaped the course that the European Union would follow were already taken in 1978.

As already pointed, the Bretton Woods monetary system entered the last stages of its final crisis in August 1971. It was then that the US President put an end to the role of the US as anchor of the system by discontinuing the convertibility of dollars into gold at a fixed rate. As a result, the European internal market was left without a monetary infrastructure. Both the trade of goods and common agricultural policy were affected, as both depended on a modicum of monetary stability.<sup>45</sup> The consequence of the demise of Bretton Woods vindicated those Cassandras that had been urging supranational and national institutions to establish an autonomous European monetary infrastructure.<sup>46</sup> Monetary and financial turbulence ensued. In their midst, several attempts were made to coordinate the national monetary policies of the Member States of the Communities. Until 1978, all such efforts failed. In the process, the growing influence exerted by key actors in financial markets shifted the balance of power among States and among social

<sup>44</sup> The higher the number of Member States, and the more diverse the socio-economic structures of the Member States, the more difficult it has become to take unanimous decisions.

<sup>45</sup> An argument that was to be repeated once and again. See P. WERNER, *Report to the Council and the Commission on the realisation by stages of Economic and Monetary Union in the Community – “Werner Report”*, 8 October 1970, ec.europa.eu, p. 7; see also J.C. INGRAM, *The Case for European Monetary Integration*, Princeton: Princeton University Press, April 1973.

<sup>46</sup> R. TRIFFIN, *Europe and the Money Muddle*, Oxford: Oxford University Press, 1957. A *post mortem* in R. TRIFFIN, “*Europe and the Money Muddle*” Revisited, in *PSL Quarterly Review*, 1978, p. 49 *et seq.*

classes in each State. In particular, policies favouring price stability, even at the cost of sacrificing full employment and (some of) the social achievements of the Democratic and Social State, were favoured by the markets. By the same token, States that persevered in making use of their powers to prop employment and to shelter workers from the worst outcomes of the crises experienced serious difficulties to stabilise the value of their currencies.<sup>47</sup> Slowly but steadily, a consensus of sorts emerged among European governments assigning primacy to the fight against inflation in pursuit of price stability.<sup>48</sup> In the autumn of 1978, political events would favour that such consensus would render possible the establishment of the EMS.

In formal terms, the EMS was a rather modest agreement, with a similar objective to that of other failed attempts at establishing a European monetary infrastructure: the fixation of thresholds (parity pegs) within which European currencies would fluctuate, thus preventing too wide oscillations. Formally speaking, the EMS seemed to engage all States, both those with strong and weak currencies, to ensure that all currencies moved around their rate targets. Thus, a currency made up of all national currencies, the ECU (European Currency Unit), was introduced, with a view to rendering visible the extent to which each currency diverged from its central parity, and thus, how big the effort to be made by each State should be.

In substantive terms, however, joining the EMS, and above all, staying within the EMS, required accepting that price stability was a necessary condition for *any* sound economic policy. Objectives other than price stability could be pursued, but only *once* price stability had been achieved. This implied reversing the wide post-war consensus around the primacy of fiscal over monetary policy.

This was so due to two structural implications of the EMS.

Firstly, and despite formal proclamations to the contrary, the efforts to keep the relative parities of currencies were not only unevenly distributed (with countries with weak currencies bearing the brunt of the effort),<sup>49</sup> but also that the EMS “froze” the perception

<sup>47</sup> A. GLYN, *Unleashing Capitalism*, Oxford: Oxford University Press, 2006.

<sup>48</sup> E. MOURLON-DRUOL, *A Europe Made of Money: The Emergence of the European Monetary System*, Ithaca: Cornell University Press, 2012.

<sup>49</sup> The agreement leading to the ESM was premised on the assumption that EMS States would pool their currency reserves to a considerable extent. However, there were from start good reasons to doubt the Bundesbank feel obliged by any political agreement to that effect. In 1992, as the crisis of the EMS unfolded, it would become clear that the German central bank did not feel compelled to make use of its reserves to contribute to keeping the parity of other currencies if doing so endangered the German national interest. It would later come to be known that the Bundesbank had only accepted ESM under the condition of indeed not being obliged to intervene. The so-called Emminger letter (where this condition was specified) remained secret, because as Federal Chancellor Helmut Schmidt put it to the Council of the Bundesbank in autumn of 1978: “Let us imagine that this appeared in a French or Italian newspaper tomorrow. The editorials would criticise their own governments for believing such a shallow promise from the Germans. A [German] government promises to intervene to uphold certain rules of the game but then writes in an internal paper that it intends to act differently at times of emergency”. D. MARSH, *The*

of currencies as weak and strong. As a result, the EMS *entrenched* the difference in structural power in favour of countries with strong currencies.<sup>50</sup> Moreover, the net result was a major reinforcement of the power of the Bundesbank. As the Deutsche Mark became the anchor currency of the EMS, the Bundesbank became the key actor in the shaping of monetary policy in the whole of Europe.<sup>51</sup> Thus, not only national fiscal policy was subordinated to monetary policy, but all national monetary policies were subordinated to the only central bank whose independence was legally – though not constitutionally – enshrined, and which had recently proven to what extent it had the means to define the overall shape of policy (monetary *and* fiscal) even against a reluctant government.

Secondly, States were *de facto* required to renounce the powers which allowed them to establish the terms according to which they became indebted, outstandingly the power to require the central bank to act as lender of last resort of the State, and the

*Euro. The Battle for the New Global Currency*, New Haven: Yale University Press, 2009, p. 91. Schmidt went on to reassure the Bundesbank of the tradition of not keeping commitments on the monetary side: “In spring 1973, we contravened ruling international constitutional law, the [International Monetary Fund] IMF agreement, in several ways. We adhered neither to the overall rules of the game, the procedural rules, nor to the material legal regulations. We freed the Bundesbank from the obligation to intervene against the dollar, solely with the motive of gaining manoeuvring room within our country for a stable policy, one that was geared to stability. In accord with the Bundesbank leadership and with the finance minister, the then German government, the then Chancellor approved this. We did not notify previously, when the Federal Republic became a member of the IMF that we would apply *clausula rebus sic stantibus*. We did not even write it down. We did it when it was the only way out”.

<sup>50</sup> When the EMS was agreed, there were still plans to ensure a coherent development of monetary and fiscal policy, including a supranational fiscal capacity, intended as the means to undertake a supranational stabilisation policy. However as some actors pointed (and perhaps suspected) that was never to be realised. This makes especially prescient the very critical assessment made by then Governor of the Bank of Italy, Paolo Baffi, before the Senate Commission on October 26, 1978: “I also believe Italian participation in the EMS will prove valuable, provided it is possible to realise the three conditions announced in Parliament by Mr Pandolfi and repeated here: [1] that the System shall be immediately operational in the three aspects originally foreseen with regard to the exchange rate agreements, the credit facilities, and the measures in support of the less prosperous economies; [2] that each of these aspects shall be acceptable (so that, for example, an unsatisfactory exchange agreement cannot be offset by more extensive credit facilities); and [3] finally, that the system shall be sufficiently flexible to allow Italy to come back into line with the stronger countries, without upheavals, as regards economic conditions and especially inflation. The basic reason why each of these conditions must be realised separately, with no scope for off-sets, lies in the enormous difference in the situation of a country which maintains an unrealistic exchange rate or undermines its development potential with a series of exchange-rate crises, and which receives aid from its partners, or some of them, to ‘compensate’ for this loss of competitiveness and potential, and that of a country which, partly because of a suitable exchange-rate policy, stays afloat and advances under its own steam” (P. BAFFI, *The European Monetary System and Italian Participation*, in P. CIOCCA (ed.), *Money and the Economy*, Basingstoke: Palgrave, 1987, p. 275).

<sup>51</sup> D. MARSH, *Bundesbank: The Bank that Rules Europe*, London: Mandarin, 1993; J. LEAMAN, *The Bundesbank Myth*, Basingstoke: Palgrave, 2001, p. 220 *et seq.*

power to impose forced loans to the State on banks.<sup>52</sup> While (contrary to what would be the case in EMU) there was no formal clause forbidding such practices, financial markets were very likely to exert downward pressure on the currency of any State applying such policies. Very especially given that the countries with “strong currencies” (Germany and the Netherlands) had made a policy out of not making use of that possibilities. Public debt was thus symbolically and legally downgraded. This resulted in a new understanding and a new approach to the issue of public debt.

By the end of 1978, EMS had been agreed, just in time for the first direct elections to the European Parliament. The EMS provided (relative) stability, only at the price of becoming the vehicle of a peculiar form of monetary hegemony. Disinflation, which was a priority for different policy reasons, became now an objective to be pursued through the means dictated by the Bundesbank.<sup>53</sup> Keeping the parity of the currency required mimicking not only German monetary policy (something that implied renouncing the use of the central bank as lender of last resort, or imposing compulsory loans on private banks) but also converging with German social policy (which implied abandoning a policy focused on internal demand, and finding the way of turning external demand the exclusive engine of economic growth). The former was indeed implemented quite quickly, among other things because its implications were not properly understood by political actors (and keep on not being understood, failing to establish a relationship between the growth of public debt and the renunciation of the role of the central bank as lender of last resort). The latter were much harder to implement, and resulted in half-way measures. Wages were de-indexed in some States, but the transformation of the socio-economic model proved, as could not be otherwise, an impossible mission to achieve.<sup>54</sup>

As a result, the EMS became a powerful constraint on all national monetary and fiscal policies. All national monetary policies were largely constrained by German monetary policy, which in its turn was anchored, thanks to the reinforced “independence” of the Bundesbank into a conception of “sound money” that ruled out the use of monetary policy for any purpose but the keeping of the value of money as a stock of value, i.e. the value of money. In such a way, the “neutral” conception of money characteristic of the old days of the gold standard made a comeback. And with it the fetters (even if now not golden) not only on stabilisation policy, but on economic and social policy as a whole. EMS was premised on the “divorce” of monetary and fiscal policy.<sup>55</sup> A different set of

<sup>52</sup> For the paradigmatic Italian case, this entailed a neat separation between central bank and Treasury (the so-called “divorce”). A critical analysis in A. GRAZIANI, *Lo sviluppo dell'economia italiana*, Torino: Bollati Boringhieri, 1998, p. 141 *et seq.*

<sup>53</sup> J. LEAMAN, *The Bundesbank Myth*, cit., p. 181 *et seq.*

<sup>54</sup> As it is to this day, see F. SCHARPF, *Forced Structural Convergence in the Eurozone – Or a Differentiated European Monetary Community*, MPIfG Discussion Paper 16/15, [www.mpi-fg-koeln.mpg.de](http://www.mpi-fg-koeln.mpg.de).

<sup>55</sup> Something regarded at the time as a necessary means to either curb high inflation (ERM) or to ensure a sustained low level of inflation (EMU).

institutions, procedures and substantive norms should apply to the making and implementation of on the one hand monetary policy and on the other hand economic and fiscal policy.<sup>56</sup> Monetary policy was to be steered by national central banks enjoying a reinforced autonomy from political institutions (in the Exchange Rate Mechanism, ERM), or by a fully independent central bank (in the EMU). Fiscal policy was to remain in the hands of national political authorities, but subject to major constraints. States renounced using the levers through which they controlled the terms according to which they issued debt. In particular, central banks were expected to stop acting as lenders of last resort of States, while States were expected not to (and later in EMU formally forbidden to) impose on financial institutions coerced loans.<sup>57</sup>

As a result, monetary coordination reduced the scope of fiscal and socio-economic policy choices that national governments could actually make. Moving from a common to a (quasi) single currency created a powerful *constraint* that reinforced the bias in favour of a maximalistic interpretation of economic freedoms, resulting, as we already saw, from the division of labour between supranational decision-making processes.

As we saw in the previous section, the EMS led to a framed form of policy competition on what concerned both fiscal and monetary policy. Still, policy competition had several limits. Not only the collective of governments might decide to intervene to realign exchange rates at any moment, but States retained in full their formal powers over fiscal and monetary policy, which they could turn into something rather material by leaving the EMS. These two limits to policy competition were closely related. The tacit decision not to realign currencies from 1987 resulted in the building of tensions that would eventually result in not only Italy and the United Kingdom leaving the EMS in September 1992, but in the virtual abandonment of the arrangement.<sup>58</sup>

With the benefit of hindsight, EMU codified and entrenched the fundamental choices implicit in the design of the EMS, and at the same time rendered such choices much harder to revert.

This had ambivalent consequences when it came to policy competition.

<sup>56</sup> In the case of EMU this was explicitly codified into the Treaties. In the case of ERM, it was the result of how the system of “managed currencies” was operated, very especially since the second half of the eighties, in which the combination of *de facto* German monetary hegemony and lack of adjustment to exchange rates created the conditions under which all States were forced to follow German monetary policy and renounce to stabilise the economy through monetary policy. The failure to do that (which was a reasonable failure given the political, social and economic implications of “succeeding”) accounts for the *de facto* collapse of ERM in 1992.

<sup>57</sup> Under EMU, Eurozone States were also prohibited from extending loans to each other and/or to assume financial responsibilities of other Member States. The “no-bailout pact” was the reverse image of the explicit reference to the mutual provision of financial assistance in case of acute balance of payments imbalances in the original Treaties.

<sup>58</sup> D. MARSH, *Bundesbank*, cit.

On the one hand, federal unified rule replaced doctored<sup>59</sup> policy competition as the governing mechanism of monetary policy. The System of European Central Banks, with the European Central Bank (ECB) at its apex, was empowered to define and implement the monetary policy of the Eurozone, i.e. of the States that would join Economic and Monetary Union. The defining features of the ECB and the mandate that it was given in the Treaties revealed, however, the clear continuities between EMS and EMU. The preservation of the store value of capital was no longer to be the product of the pressure exerted by financial markets over central banks to follow the policy of the Bundesbank, but was to be guaranteed by the establishment of a Eurozone independent central bank, formally (and only formally)<sup>60</sup> moulded in the semblance of the Bundesbank, which was mandated first and foremost to maintain price stability.

On the other hand, policy competition was reinforced on what regarded fiscal policy. Formally speaking, States retained full control over their fiscal policy.<sup>61</sup> Moreover, the functional coherence of the single monetary policy and the plurality of fiscal policies was to be fostered through *informal political coordination arrangements*, what would come to be known as *fiscal governance*. "Guidelines", "benchmarks" and "targets" ("soft law", not law proper) were to be worked out through "deliberation", "peer review" and the development of "best practices". However, it was also the case that all capital movements within the European Union had been liberalised *in the name of preparing for Monetary Union*, but that an integral part of the design of EMU was the extension of such freedom to *third countries*.<sup>62</sup> This created the conditions under which financial markets could exert considerable pressure over the Member States of the European Union, and particularly, of the Eurozone, when it came to the design of their fiscal policies. Markets would exert that pressure not through the pricing of the national currencies (by definition transcended by EMU) but through the assignment of value to the sovereign debt of the different States (in concrete, by "demanding" differentiated interests rates for lending to each Member State). The role of markets was amplified by the codification of rules that forced States to depend for their financing on capital markets. The monetisation of public debt through central banks was forbidden.<sup>63</sup> As were the mutualisation of debts<sup>64</sup> and forced loans.<sup>65</sup> Moreover, it was also decided that no mechanism of financial assistance among States would be created. This implied re-

<sup>59</sup> Doctored because there were massive structural forces at play which forced all national central banks to follow the cue of the Bundesbank.

<sup>60</sup> C. JOERGES, *The Overburdening of Law by Ordoliberalism and the Integration Project*, in J. HEIN, C. JOERGES (eds), *Ordoliberalism, Law and The Rule of Economics*, Oxford: Hart, 2018, p. 179 *et seq.*

<sup>61</sup> *A contrario*, Art. 98 of the EC Treaty.

<sup>62</sup> Art. 56.

<sup>63</sup> Art. 101.

<sup>64</sup> Art. 103.

<sup>65</sup> Art. 102.

nouncing to adapt the facility that already existed (and which had been made use of several times) for tackling balance of payments crises.

Moreover, as was the case with the EMS, policy competition was framed. The Treaties contained the key elements of such a frame. In particular, *fiscal rules* were written into the Treaties that established the “limits” to national discretion in the implementation of fiscal policy (60 per cent GDP public debt, 3 per cent public deficit).<sup>66</sup> Such rules were formally supported by sanctions (even if the very content of the sanctions implied that they would only be effective *were they not to be applied*). The Stability and Growth Pact of 1997 fleshed out, both procedurally and substantially, the just referred fiscal rules.

It is important to reiterate here that the move to EMU seems to have been perceived by the Court of Justice as a very strong signal, which it interpreted as licensing the further *strengthening* of its case law on economic freedoms. This was not an illogical conclusion. The socio-economic model underpinning and powering both framed policy competition and framed regulatory competition was roughly the same.

#### IV. AFTER THE CRISES: THE UNHIDDEN HAND OF SUPRANATIONAL POWER

During the first two decades of the single market and the first decade of EMU levels of employment and consumption were maintained or increased. Framed policy competition and framed regulatory competition seemed to bring about widespread welfare gains, even if unevenly distributed. (section 1). The economic, financial and fiscal crises burst the unsustainable bubbles generated by the phenomenal growth of private debt that had mediated the contradictions of the European socio-economic model. This has resulted in a long series of decisions and structural reforms through which European institutions have tried to govern the overlapping and mutually reinforcing crises. The result has been a massive transformation, which has consolidated regulatory and policy competition, by means of changing of the means through which it is organised and managed. Governance mechanisms have been (partially) replaced by legal norms (section 2).

##### IV.1. THE GATHERING OF THE CRISES: PRIVATE DEBT AS MACRO-ECONOMIC STABILISER

Policy competition and regulatory competition unleashed a process of fragmentation and pulverisation of public power in the European Union, which was even more marked in the Eurozone.

It took quite some time for such effects to be fully visible. *L'Europe par le marché* came hand in hand (and was in itself part) of a process of economic globalisation that

<sup>66</sup> Art. 104 of the EC Treaty plus the protocol on excessive deficits.

altered the international division of labour.<sup>67</sup> Cheap imported goods seemed to increase the purchasing power of Europeans. Thus, regulatory competition appeared to be associated with increased welfare. At the very same time, policy competition facilitated the expansion of financial activities, resulting in a rapid (but uneven) growth of private debt.<sup>68</sup> Such new opportunities to get indebted compensated in some countries the combined effects of the shrinking income share of wages and the steady increase of wage and wealth inequality. By the same token, the structural divergences between Eurozone States were cloaked by massive flows of capital that created the illusion of the Eurozone periphery catching up with the Eurozone core.<sup>69</sup> This compensated both the deflationary impact of growing inequality and the erosion of the taxing capacity of Eurozone States (in itself resulting from the new understanding of free movement of capital).<sup>70</sup> It can be concluded, thus, that the long-term social, economic and political costs of fragmenting public power were *postponed*. Time, in the terms argued by Wolfgang Streeck, was bought.<sup>71</sup>

#### IV.2. OLD GOVERNANCE IN NEW RULES: THE EUROPEAN SOCIO-ECONOMIC MODEL AS A ZERO-SUM GAME

The bill will be dear, but will be collected in full only *in the future*. Only *the future* suddenly arrived in 2007. Starting then, financial, economic and then fiscal crises hit the European Union and its Member States and revealed the full implications of resort to private debt as *the* macroeconomic stabiliser.<sup>72</sup>

The challenge was met by accelerating and radicalising the principles at the core of the single market and the single currency.<sup>73</sup> Despite the considerable extent to which improvisation and on-the-hoof decision-making were characteristic of the post-2007 period, the government of the crises was consistently oriented towards the preservation of the capacity of money to serve as a store of value, and the maintenance of the mechanisms through which further capital accumulation could take place.<sup>74</sup> Keeping

<sup>67</sup> F. SNYDER, *Globalisation and Europeanisation as Friends and Rivals: European Union Law in Global Economic Networks*, in EUI LAW Working Papers, no. 8, 1999, cadmus.eui.eu.

<sup>68</sup> C. CROUCH, *The Strange Non-Death of Neo-Liberalism*, London: Polity, 2012; W. STREECK, *Buying Time*, London: Verso, 2014.

<sup>69</sup> A. BAGNAI, *Il Tramonto dell'euro*, Reggio Emilia: Imprimatur, 2012.

<sup>70</sup> See S. KEEN, *Can We Avoid Another Financial Crisis?*, London: Polity, 2017.

<sup>71</sup> W. STREECK, *Buying Time*, cit.

<sup>72</sup> Details in A.J. MENÉNDEZ, *The Existential Crisis of the European Union*, in *German Law Journal*, 2013, p. 453 *et seq.*

<sup>73</sup> A.J. MENÉNDEZ, *A European Union in Constitutional Mutation?*, in *European Law Journal*, 2014, p. 127 *et seq.*

<sup>74</sup> More extensively, A.J. MENÉNDEZ, *The Crisis of Law and the European Crises: From the Social and Democratic Rechtsstaat to the Consolidating State of (Pseudo-)technocratic Governance*, in *Journal of Law and Society*, 2017, p. 56 *et seq.*

States competing with each other to achieve such goals remained essential. Still, achieving such goals in a shifting environment required recalibrating again the role of law in the process of European integration. Competition is now enforced not only through governance mechanisms, but has been in-built into European Union law.

Supranational institutions have acquired new powers through which they exert massive influence over the design of national fiscal and social policies, so that the only way that States can compensate the fluctuations of the economic cycle or the vagaries of the external change of the currency is by means of taking measures aimed at increasing the competitiveness of the external sector of the economy.

a) For one, new fiscal rules (including the deficit and debt trajectory objectives) have been enshrined into the Stability and Growth Pact. They revolve around the new concept of “medium-term budgetary objective”, defined by reference to the “cyclically adjusted” deficit or “structural deficit”.<sup>75</sup> At the same time, the fiscal rules already set in the Maastricht Treaty have been made more demanding. Not only the fiscal targets to be met by States are tougher, but Member States are now obliged to patriate into their constitutions (or constitutional laws) one of the European fiscal rules, the deficit ceiling (wrongly referred as “golden rule” or “debt brake” in media parlance).<sup>76</sup>

b) For two, an emerging constitutional convention forbids Eurozone States from defaulting on their debts. The different stages in the Greek fiscal crisis, especially in the spring of 2015, constitute evidence in that regard.<sup>77</sup> Member States have been encouraged to make constitutional commitments to the absolute priority of the payment of principal and interest of debt over any other State expenditure (the pressure has been successful in the case of Spain, see the amended text of Art. 135, para. 3, of the Spanish Constitution).

c) For three, a set of “macroeconomic indicators” has been established with a view to limiting the discretion of Member States in the overall design of their social and economic policies.<sup>78</sup>

<sup>75</sup> Art. 3 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012; Art. 2a of Council Regulation (EC) 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended by Regulation (EU) 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

<sup>76</sup> See Art. 3, para. 2, of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union; see also Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

<sup>77</sup> See for example, D. SCALLY, *Schäuble Says Greece Default, Euro Exit Looks Inevitable*, in *Irish Times*, 28 June 2015, [www.irishtimes.com](http://www.irishtimes.com).

<sup>78</sup> Regulation (EU) 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances; Regulation (EU) 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area; the scoreboard can be found at [ec.europa.eu](http://ec.europa.eu).

Moreover, the efficacy of the new fiscal rules is expected to have been increased by the increasing monitoring and disciplinary powers that European institutions have been assigned.

*a)* For one, the Commission has seen its powers to monitor and discipline national fiscal and macroeconomic policy strengthened, given the increased authority of its proposals, deemed to be approved if a qualified minority of the Council concurs.<sup>79</sup>

*b)* For two, compliance with the obligation to patriate the deficit ceiling has been assigned to the Court of Justice; a review of “European constitutionality” of the actual national reforms (including constitutional reforms) adopted to comply with the obligation could be conducted, and the reform declared in breach of European law.<sup>80</sup>

By the same token, supranational institutions have been recognised, and have also arrogated to themselves, powers through which they can provide funding to Eurozone States alternative to those available in financial markets. The granting of such funding is, however, conditional upon States designing their fiscal and social policies in line with the requests of supranational institutions which, so far, have required States to preserve the store value of money, very especially financial capital. As a result, supranational institutions (most significantly the ECB and the Commissioner for Economic and Financial Affairs) and some national institutions (outstandingly, the presidents and chancellors of the exchequer of the main creditor States, and foremostly Germany) have acquired the power to activate or deactivate the power of financial markets to influence the shape of national fiscal and social policy. Moreover, the ECB has assumed the role of lender of last resort of Eurozone States, a power that it has pledged to exert by reference to the terms of the financial assistance provided by the Eurozone, and consequently, by reference to their underlying *conditionality*.

The return of rules has not entailed, however, a change in the set of objectives that define EMU. Rules are now preferred to governance mechanisms not because there is a new willingness to preserve the discretionality of political organs, but rather because “governance” mechanisms were found to be of limited value in effectively limiting such discretionality. The purpose remains to subordinate all possible objectives of fiscal policy to the maintenance of the store value of money (i.e. of capital). The net result of this further transformation of the organisation of public power in Europe is the further fragmentation, pulverisation and discipline of public power. But, contrary to what was largely the case in the road to the single market and the single currency, supranational institutions have acquired relevant new powers. Such powers, however, do not facilitate collective action at the supranational level, as the further disciplining of national public power. The latter development has come hand in hand with the further devaluation of

<sup>79</sup> Art. 7 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

<sup>80</sup> Art. 8, para. 1, of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

democratic law as a means of integration. The new competencies attributed to the European Union have all resulted in gains by institutions whose legitimacy is indirectly democratic or are by design non-representative (the ECB) while the competencies and authority of both the European Parliament and of national parliaments (with the rather more formal than substantive exception of some national parliaments, as just indicated) have largely stalled. The clear “institutional” winner is the ECB, an institution that is by design insulated from democratic politics. The same reasoning applies to the Court of Justice, the European Monetary Stability Fund, the already created national fiscal authorities, the envisaged European Fiscal Authority and the planned national competitiveness authorities. The “Euro Summit” and the “Eurogroup” have become relevant institutions when it comes to the exercise of a good deal of the (old and new) economic powers in the hands of the European Union. But as was pointed in the previous section, the way in which the said institutions actually operate has itself been transformed during the crises. What some political scientists call the “new” intergovernmentalism<sup>81</sup> is based not on the equality between Member States, but actually on the (formalised) inequality among States. On the other hand, only with a considerable degree of optimism can it be said that representative institutions have merely not gained power. It is indeed telling that while the European Parliament and national parliaments have been assigned mere “debating” powers, an institution external to the EU, the IMF, has been acknowledged, both *de jure* and even more so *de facto*, key powers in the process of granting financial assistance to Eurozone States, and monitoring compliance with the economic programmes to which the said assistance is conditioned.

As a consequence, the law has been brought back, but only because it is a law very different from that characteristic of post-war Democratic and Social States. This is reflected in the fact that the new and the revamped fiscal rules are not supported by a wide democratic legitimacy; rather they were decided by reference to allegedly *objective* (and thus pre-political) standards (monetary stability, financial stability), to be *applied* by non-representative institutions (the Commissioner for Economic and Financial Affairs, the ECB) and through non-democratic decision-making procedures (paradigmatically, minoritarian decision-making in the Council).

## V. CONCLUSIONS

The disastrous experience of the disorganised concurrence of legal orders that marked the interwar period paved the way for the constitution of the European Communities. Community law was fashioned as a mixture of politically-mediated conflict norms and

<sup>81</sup> C. J. BICKERTON, D. HODSON, U. PUETTER, *The New Intergovernmentalism: European Integration in the Post-Maastricht Era*, in *Journal of Common Market Studies*, 2014, p. 703 *et seq.*; C. J. BICKERTON, D. HODSON, U. PUETTER, *The New Intergovernmentalism: States and Supranational Actors in the Post-Maastricht Era*, Oxford: Oxford University Press, 2015.

substantive norms that provided a balanced organisation of the relationships between national legal orders. Community law clipped the sharpest corners of public power, while not only preserving, but reinforcing the *actual* political leeway that Member States had in the choice of their social and economic policies.<sup>82</sup>

The functionality of European integration in general and of Community law in particular was crucially dependent on the background consensus on the purpose of public power and on the goals of integration, basically corresponding to the regulatory ideal of the Democratic and Social State that was also open and cooperative. Such consensus was however shattered in the early seventies. The asymmetric impact of the monetary (1971) and economic crises (1973 and 1979) was amplified by the lack of coordination of the national policy responses. Economic and political divergence led to the blockage of a political system revolving around unanimous decision-making in the Council of Ministers.

European paralysis favoured the emergence of a radically new narrative and conception of European integration. The objective of creating a single currency and a single market was presented as the completion of the original political and economic project of the Communities, but as a matter of fact implied a radical transformation of its objectives. Economic borders were no longer to be rendered permeable, but to be abolished. The economic rights stemming from Community law were no longer to be constructed as operationalisations of the principle of non-discrimination, but as manifestations of the right to private property and of entrepreneurial freedom.

The establishment of the single market and the single currency was to be brought about through law, but the role of law in society was to change. In particular, law was to become key in the organisation of processes of regulatory competition (the single market) and policy competition (the single currency), in which the choices made by private actors (entrepreneurs and consumers, investors in financial markets) would end up determining the substantive content of the norms organising cross-border relations. In both cases, the processes of "competition" were "framed", "programmed" in their unfolding by a legislative process *biased* in favour of private property and entrepreneurial freedom (single market) and by institutional and substantive norms making of the preservation of the store value of money a fundamental objective of both monetary and fiscal policy. The result was a double *commodification of law*. In static terms, European law empowered market actors to impose their economic power over the political

<sup>82</sup> This does not entail that European Union law did not limit the range of possible socio-economic policies that could be implemented. Not only any set of fundamental laws has that effect, but in concrete, it could be argued that Community law, even in its original format, was more constraining than post-war national constitutional orders. The question cannot be tackled here. But it is definitely worth pursuing. C. KAUPA, *The Pluralist Character of the European Economic Constitution*, Oxford: Hart, 2016 sets the agenda, even if it seems to me overoptimistic regarding the ecumenical character of the fundamental norms organising power in the founding Treaties of the Communities.

will of national representative institutions through their strategic use of economic freedoms. In dynamic terms, the very content of regulatory norms came to be left in the hands of economic actors. The process resembled *market competition*, in that States bade for economic activity through different offers of regulatory norms. But this was not an ideal market where all actors had equal power, but a game of legal chairs in which only the most powerful and most mobile economic actors had a real say. Law was literally turned into *another* commodity.

It was in such a way that regulatory competition and policy competition came to play a fundamental role in European integration, that indeed they have become fundamental sources of the substantive norms applicable to cross-border relations. Such competition has not only been planned, but actually orchestrated. Regulatory and policy competition were not brought about by the decentralised force of private actors, but designed by political fiat. By the same token, the outcome of the “competition” has been largely predetermined to result in the maximisation of the right to private property and entrepreneurial freedom in the case of the single market, of the protection of financial capital in the case of the single currency. Heads, private property wins. Tails, entrepreneurial freedom prevails.

This reveals the extent to which the *market in laws* has been everything but a market. In his seminal *Great Transformation*, Polanyi argued quite forcefully that one of the fundamental flaws of self-regulated capitalism was to mistake the character of land, labour and money, to conclude that these were commodities. But they were not: they were and they could not but be *fictitious commodities*.<sup>83</sup> A fundamental flaw of the prevailing understanding of European integration and of European law is to believe that law can become a commodity, in the sense that its content can and should be ascertained through a *market-like* process.

Europeans once learned from disaster (one is tempted to say from *disasters*) that it is extremely risky to renounce to define and shape the relationship of the State legal order with other normative orders, and very especially, with other State legal orders. Trusting in the emergence of a spontaneous meta-order governing cross-border legal relations might result not only in major social and economic losses, but may undermine the very basis of political and social stability. In particular, we cannot expect to enjoy the necessary modicum of social and economic stability if we leave the relationships between legal orders to be determined through functional equivalents of market relationships, that is, through some form of normative *competition*. Conceptualising the relationship between legal orders in terms of a market for laws entails not only endangering the capacity of social integration of the law, but overstretching the very institution of the market.

<sup>83</sup> K. POLANYI, *The Great Transformation*, cit., p. 71 *et seq.*; C. JOERGES, J. FALKE (eds) *Karl Polanyi, Globalisation and the Potential of Law in Transnational Markets*, Oxford: Hart Publishing, 2011.

The ultimate proof of the failure of false marketisation is to be found in the way in which European institutions have tried (and failed) to govern the crises. On the one hand, the massive changes introduced since 2007 are underpinned by the assumption that financial markets cannot be trusted to adequately police the discretion enjoyed by States in the implementation of their fiscal policies. Thus the granting of new and formidable competences to supranational institutions, which can now not only monitor and sanction national fiscal policies, but also provide sources of funding alternative to financial markets. On the other hand, the powers that supranational institutions have been granted are not so much positive powers, as disciplinary powers. To make things even worse, such programmes are “programmed” by reference to the standards that would result from the unimpeded functioning of markets. We run the risk of multiplying the damage caused by regarding the law as a false commodity by the damage bound to be generated by a peculiar form of *dirigisme* on the hoof.





## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## SOCIOLOGICAL SHORTCOMINGS AND NORMATIVE DEFICITS OF REGULATORY COMPETITION

CHRISTIAN JOERGES\*

TABLE OF CONTENTS: I. Back to the beginnings: the origins of a new paradigm. – II. The conceptual gist of the controversy. – III. “Back to the Nation State” or “More Europe”: Wolfgang Streeck v. Jürgen Habermas. – IV. Institutionalising the united in diversity vision. – V. Instead of an epilogue.

ABSTRACT: This *Article* proposes a counter-vision to the regulatory competition model, by building upon conflict-laws constitutionalism. This counter-vision seeks to replace the governance via competitive processes with deliberative political interactions. The approach institutionalizes the *United in Diversity* slogan, representing a sort of third way between the “back to the nation State” idea, strongly supported by Streeck and other commentators, and the Habermasian “More Europe”.

KEYWORDS: regulatory competition – united in diversity – European social model – varieties of capitalism – Streeck – Habermas.

### I. BACK TO THE BEGINNINGS: THE ORIGINS OF A NEW PARADIGM

All academic disciplines engaged in *European studies* are by now prepared to concede that the integration project is entangled in a plethora of difficulties. This, however, is but a principled transdisciplinary consensus. The perceptions of the disciplines and their recipes remain distinct and their ensemble incoherent. The noted commonality is an underspecified commitment, which comprises the willingness to defend the integration project with its “ever closer Union” mantra. A highly selective sample in the concert of

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pertinent voiced on these observations may suffice here. The financial crisis should, and could, be overcome by a further refinement of the new modes of economic governance; this is what economists who understand the present difficulties as functional challenges tend to suggest – without explaining, however, what kind of polity these arrangements would constitute and what kind of constitutional legitimacy they might deserve.<sup>1</sup> What we observe is steady transfer of ever more core State functions to the European level; this looks like progress and business as usual hence – and how about the democratic quality of the processes through which all this is accomplished?<sup>2</sup> After a decade of *de facto* transformation of the state of the European Union, we are well advised to treat this outcome as Europe’s “new normalcy” this is the view of eminent jurists<sup>3</sup> – a normalcy, however, in which the European commitment to democracy and the rule of law has been suspended in essential respects by allegedly purely functional necessities defined by unaccountable bodies.

The crisis came as a surprise but it did not come out of the blue. Especially we lawyers who have once been on the driver seat of European studies have every reason to reconsider the viability of what we have once recommended or tolerated. In the case of *regulatory competition* this juridical foundational moment was the seminal *Cassis de Dijon* judgment handed down by the Court of Justice back in 1979.<sup>4</sup> The judgment has received a variety of both benevolent and critical comments. My own suggestion was to read it in conflicts-law perspectives.<sup>5</sup> The Court had declared the German ban on the marketing of a French liqueur – the alcohol content of which was lower than its German counterpart – to be incompatible with the principle of free movement of goods (Art. 30 EC Treaty, by now Art. 28 TFEU). This holding, I suggested, could be translated into the language of conflict of laws: what the Court had done was to identify a commonality, a *meta-norm* that both France and Germany had subscribed to. Their common commitment to the free trade objective implied that their readiness to accept that restrictions of free trade must be based on credible regulatory concerns. The Court had convincing-

<sup>1</sup> H. ENDERLEIN, *Economic and Monetary Union as a Showcase of Exploratory Governance: Why “muddling through” Is both Rational and Dangerous*, in M. DAWSON, H. ENDERLEIN, C. JOERGES (eds), *Beyond the Crisis. The Governance of Europe’s Economic, Political and Legal Transformation, Hertie Governance Report 2015*, Oxford: Oxford University Press, 2015, p. 25 *et seq.*, and much earlier H. ENDERLEIN, *Das erste Opfer der Krise ist die Demokratie: Wirtschaftspolitik und ihre Legitimation in der Finanzmarktkrise 2008-2013*, in *Politische Vierteljahresschrift*, 2013, p. 714 *et seq.*

<sup>2</sup> P. GENSCHEL, M. JACHTENFUCHS (eds), *Beyond the Regulatory Polity? The European Integration of Core State Powers*, Oxford: Oxford University Press, 2014.

<sup>3</sup> See, prominently, T. BEUKERS, C. KILPATRICK, B. DE WITTE, *Constitutional Change Through Euro-Crisis Law: Taking Stock, New Perspectives and Looking Ahead*, in T. BEUKERS, C. KILPATRICK, B. DE WITTE (eds), *Constitutional Change Through Euro-Crisis Law*, Cambridge: Cambridge University Press, 2017, p. 1 *et seq.*

<sup>4</sup> Court of Justice, judgment of 20 February 1979, case 120/78, *Cassis de Dijon*.

<sup>5</sup> C. JOERGES, *Rethinking European Law’s Supremacy: A Plea for a Supranational Conflict of Laws*, in B. KOHLER KOCH, B. RITTEBERGER (eds), *Debating the Democratic Legitimacy of the European Union*, Lanham, MD: Rowman & Littlefield, 2007, p. 311 *et seq.*, available also as EUI Working Papers, no. 12, 2005.

ly rejected the German argument about the protection of German drinkers: any confusion on the part of German consumers could be avoided, and a reasonable degree of protection against erroneous decisions by German consumers could be achieved by disclosing the low alcohol content of the French liqueur.<sup>6</sup>

My re-reading of *Cassis de Dijon* in the language of another legal sub-discipline was an outlier. What most commentaries suggested instead was a radical shift from legal to economic rationality criteria. This paradigm shift occurred within European law<sup>7</sup> and was in line with what economists had suggested<sup>8</sup> and policy makers were eager to take up. Prominent actors from Germany include Advisory Board of the German Ministry of the Economics<sup>9</sup> and Germany's Monopolies Commission.<sup>10</sup> The arguments which they invoked were much older than we were aware of at the time. Two decades after the move towards regulatory competition, Fritz W. Scharpf<sup>11</sup> has made us aware of a very prominent forerunner. Writing in 1939, Friedrich August von Hayek had anticipated post-war European integration. He predicted that integration occurs as a political endeavour, albeit one, which would promote market-liberalism because the difficulty of coming to terms with political disagreements would hence reduce the institutional capacity to govern the capitalist economy and transform Europe into a welfare State.<sup>12</sup>

<sup>6</sup> This is much too simplistic, Damian Chalmers has argued in his comment to my essay cited in the previous note. "*Cassis de Dijon* is not a widely sold drink. Instead, it was used as the touch paper to resolve a wider redistributive question between German distributors and German producers: namely, whether the former could increase their profits through selling a wider array of alcoholic drinks at the expense of the latter's profits". This was a conflict between German authorities and economically powerful distributors. This is a powerful argument to which I would add a related concern, namely the affinities between *Cassis* and the regulatory restrictions imposed upon State legislatures in the seminal *Lochner* judgment of the American Supreme Court (US Supreme Court, judgment of 17 April 1905, *Lochner v. New York*). Restrictions of economic liberties are legal only in the realm of the so-called police powers (safety, health, morals and general welfare of the public). As Justice Holmes has objected in his legendary dissent, such judicial prescriptions amount to an intrusion into the powers of democratically legitimated legislators. Holmes' dissent reveals the crux of the matter as we will explain in the subsequent section.

<sup>7</sup> See in particular N. REICH, *Competition Between Legal Orders: A New Paradigm of EC Law?*, in *Common Market Law Review*, 1992, p. 861 *et seq.*

<sup>8</sup> E.g., H. SIEBERT, *The Harmonization Issue in Europe: Prior Agreement or a Competitive Process?*, in *Kiel Working Papers*, no. 377, 1989.

<sup>9</sup> Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft, *Stellungnahme zum Weißbuch der EG-Kommission über den Binnenmarkt*, Schriften-Reihe 51, 1986.

<sup>10</sup> Monopolkommission, *Achtes Hauptgutachten der Monopolkommission 1988/1989*, BT-Drucksache 11/7582, 16 July 1990, p. 401

<sup>11</sup> F.W. SCHARPF, *The Asymmetry of European Integration, or Why the EU Cannot Be a "Social Market Economy"*, *Socio-Economic Review*, 2010, p. 211 *et seq.*

<sup>12</sup> F.A. VON HAYEK, *The Economic Conditions of Interstate Federalism*, in F.A. VON HAYEK (ed.), *Individualism and Economic Order*, Chicago: University of Chicago Press, 1949, p. 255 *et seq.*, reprinted from the *New Commonwealth Quarterly*, 1939, p. 131 *et seq.*

## II. THE CONCEPTUAL GIST OF THE CONTROVERSY

Unsurprisingly, the promotion of *regulatory competition* met with opposition of the defenders of Europe's welfare State legacy and the quest for a *European social model*. This schism between proponents and opponents of market governance is part of a wider debate concerning the benefits and the costs of market governance.<sup>13</sup> This debate is of course illuminating. What von Hayek has added to it is a specific European twist. And precisely this move constitutes a serious fallacy. On what conceptual basis can we assume that States will enter into, or be exposed to, competitive processes which incentivise them to adopt pro-competitive regulatory frameworks, or in the parlance of crisis politics, efficiency enhancing structural reforms? One such assumption is the expectation that within the will-formation processes of constitutional democracies external competitive pressures will overcome the objections of political and societal opponents. This assumption is dubious for both normative and sociological reasons. States will continue to define and pursue what they perceive as their interests. The ensuing *competition* will have little resemblance with von Hayek's "discovery procedure" or any other modelling of competition processes. The second assumption concerns the potential of competitive process to proceed the type of knowledge regulatory bodies and governments would need where they who seek to promote efficiency.

Von Hayek is once more an important source for the discussion of this query. In his seminal essay on *The Use of Knowledge in Society*, he has tried to make us believe that markets are unique in their capacity to collect, process and co-ordinate knowledge which is dispersed in society.<sup>14</sup> This thesis may capture a great potential of markets but it fails to deliver convincing arguments on the adequacy of that type of knowledge. As Lisa Herzog has argued convincingly,<sup>15</sup> the knowledge which markets can communicate is not the knowledge public authorities need when they have to assess the performance of complex economic orders. Hayek's "competition as a discovery procedure"<sup>16</sup> will not deliver what we should know. Such failings, we have been assuaged, will be compensated by highly professionalised rating agencies which produce and offer such advice under competitive conditions. This, again, is all too wishful thinking. The famous three big ratings agencies embody expert knowledge which remains affected by loads of uncertainties – and unaffected by the ethics which guides the *praxis* of the classical pro-

<sup>13</sup> For a great summary see S. LUKES, *Invasions of the Market*, in M. MILLER (ed.), *Worlds of Capitalism*, London-New York: Routledge, 2005, p. 298.

<sup>14</sup> F.A. VON HAYEK, *The Use of Knowledge in Society*, in *American Economic Review*, 1945, p. 519 *et seq.*

<sup>15</sup> L. HERZOG, *Markt oder Profession? Die Politik zweier Wissenslogiken*, Lecture at the Institute of Advanced Study Berlin of 18 January 2018, available at [www.wiko-berlin.de](http://www.wiko-berlin.de); L. HERZOG, *The Epistemic Division of Labor in Markets. Hayek, Global Trade, and the Preconditions of Responsible Agency*, Lecture at the Hertie School of Governance, Berlin, 18 April 2018, available at [www.hertieschool.org](http://www.hertieschool.org).

<sup>16</sup> F.A. VON HAYEK, *Competition as Discovery Procedure (Wettbewerb als Entdeckungsverfahren, 1968)*, in *The Quarterly Journal of Austrian Economics*, 2002, p. 9 *et seq.*

fessions. Can we then really expect expertise to accomplish what markets fail to do? In the case of the ratings agencies and the supervision of States by financial markets, one can cite a case of exemplary importance, namely Mario Draghi's famous defence of the Outright Monetary Transactions (OMT) programme of the European Central Bank (ECB) on 26 July 2012.<sup>17</sup> The markets got it wrong, Draghi submitted; this is why the ECB had to step in and to correct their assessments.

Such anecdotal evidence is of course insufficient. The main source on which I rely in my more principled explanation of the limits of competitive processes is Karl Polanyi's economic sociology.<sup>18</sup> Polanyi refutes the conceptualisation of the economy as a self-sustaining system in general and the idea of a self-regulating markets in particular. The economy and its markets are always *socially embedded*, he submitted;<sup>19</sup> *the economic* is inextricably interwoven with politics and States. Polanyi's *Great Transformation* spells this out in much detail. A particularly helpful elaboration is to be found in a later essay entitled *The Economy as Instituted Process*. There Polanyi distinguishes between "a formalist perspective", an understanding of "the market as an idealized, counterfactual construct, to be approximated in reality, for managing scarcity through the price mechanism" on the one hand and a "substantivist" perspective on the other. Both create a tension: "[T]he full marketization of society is not only impossible in principle, but efforts at marketization will produce a reactive self-organization of actors in the economic domain".<sup>20</sup> The tensions between the formalist and the substantivist perspective are not just to illustrate the political dimension inherent in the efforts of economic ordering but also of its political characteristics. We conclude: the neo-liberal conceptualisation of inter-state relations and controversies as competitive processes striving for economic efficiency of the discovery new options is a *stark utopia*. We cannot eliminate *the political* from the integration process. This is in itself but a sociological truth. It is by the same token in particular in the European context anything but a comforting insight. Does it indicate an unruliness of the integration process? Is it instead conceivable to channel and tame this political dimension? Which kind of institutional framework might foster its legitimacy? These are thorny issues. We submit that they must nevertheless be addressed. For our defence of this assertion we will take a detour.

<sup>17</sup> *Verbatim* at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>18</sup> K. POLANYI, *The Great Transformation: The Political and Economic Origins of Our Time*, Boston, MA: Beacon Press, 2001.

<sup>19</sup> For a reconstruction of the debate see S. FRERICHS, *The Rule of the Market: Economic Constitutionalism Understood Sociologically*, in P. BLOKKER, C. THORNHILL (eds), *Sociological Constitutionalism*, Cambridge: Cambridge University Press, 2017, p. 261 *et seq.*

<sup>20</sup> K. POLANYI, *The Economy as Instituted Process*, in C.M. ARENSBERG, H.W. PEARSON (eds), *Trade and Market in the Early Empires*, Glencoe, IL: Free Press, p. 243 *et seq.*

### III. “BACK TO THE NATION STATE” OR “MORE EUROPE”: WOLFGANG STREECK V. JÜRGEN HABERMAS

The debate to which the title of this *Special Section* refers concerns the potential of Europe to defend the legacy of the democratic social State: two master thinkers are engaged in that controversy since many years.<sup>21</sup> Streeck's argument in a nutshell: under the impact of European integration the *democratic Rechtsstaat* experiences an irresistible decline; we should therefore save what can be saved through a defence of the nation State and its institutions against a deepening of economic integration.<sup>22</sup> The nation State and its welfare accomplishments, so Habermas counters, is but a nostalgic option, a hideaway in the sovereign powerlessness of the overrun nation (*eine nostalgische Option für eine Einigelung in der souveränen Ohnmacht der überrollten Nation*).<sup>23</sup>

The controversy can be rephrased in the parlance of constitutionalism. Streeck questions the potential of Europe to establish, at a transnational level, an equivalent to the democratic constitutional State. In Streeck's understanding, which is informed by the constitutional theory of Hermann Heller,<sup>24</sup> *Sozialstaatlichkeit*, as it has been endorsed by the eternity clause of the Basic Law, is a democratic essential, of constitutive importance for the legitimacy of public rule.<sup>25</sup> Habermas shares a commitment to Hermann Heller – small wonder, as Wolfgang Abendroth, with whom he wrote his habilitation thesis, wrote a famous defence of Heller's constitutional theory in the first great post-war *Verfassungsstreit*.<sup>26</sup> *The social* became then more deeply engrained in the discourse theory of law and democracy.

There is hence some unity in the diversity of the two opponents. Both invoke the interdependence of facticity and validity. They share the premise that economic liberalism is far too insensitive to the quests for social justice and should therefore be subjected to political corrections. They disagree about *the level of governance* at which such corrections can be realised. This is anything but a trivial disagreement. It is one which reveals a deep *lacunae* in extensive legal debates on what has been characterised in ever more intensity

<sup>21</sup> The earliest encounter of which I am aware is Streeck's – unpublished – reaction to Habermas' plea for a European constitution in his Hamburg Lecture of 26 June 2001 on *Warum braucht Europa eine Verfassung?*, published in *Die Zeit* and still available at [www.zeit.de](http://www.zeit.de). “Voluntarism” is the core objection in Streeck's paper (*Das 'soziale Europa' und seine Verfassung: Fragen zu einem politischen Projekt*, on file with author).

<sup>22</sup> W. STREECK, *Small-State Nostalgia? The Currency Union, Germany, and Europe: A Reply to Jürgen Habermas*, in *Constellations*, 2001, p. 213 *et seq.*

<sup>23</sup> J. HABERMAS, *Demokratie oder Kapitalismus. Vom Elend der nationalstaatlichen Fragmentierung in einer kapitalistisch integrierten Weltgesellschaft*, in *Blätter für deutsche und internationale Politik*, 2013, p. 59 *et seq.* (“*nostalgische Kleinstaaterei*”) at p. 62).

<sup>24</sup> See, e.g., W. STREECK, *Heller, Schmitt and the Euro*, in *European Law Journal*, 2017, p. 361 *et seq.*

<sup>25</sup> Art. 79, para. 3, Basic Law.

<sup>26</sup> See C. JOERGES, *The Rechtsstaat and Social Europe: How a Classical Tension Resurfaces in the European Integration Process*, in *Comparative Sociology*, 2010, p. 65 *et seq.*

as “Europe’s Justice Deficit”.<sup>27</sup> This notion is of a revealing vagueness. What exactly is Europe supposed to do? Should it compensate justice failures within the Member States, for example, by imposing a uniform *European Social Model*? Should it, instead, supervise the inter-state relations and ensure *justice between* the Member States?

Streeck’s political and normative conclusion builds coherently on his sociological analysis – including his extensive discussion of the varieties of capitalism.<sup>28</sup> His logic is both sociologically and legally compelling: under European rule, the social state cannot survive. We have hence to replace the supremacy of European law by a primacy of the nation State. His argument is also richer than the usual rejection of European claims to supremacy: “[W]hat I would suggest to call the *acquises démocratiques* of the national *demos* in Europe [...] importantly comprises a wide range of political-economic institutions that provide for democratic corrections of market outcomes – for democracy as *social* democracy”.<sup>29</sup>

This is one of the very few suggestions to take the insights of the studies of the varieties of capitalism normatively seriously. I am aware of only three German jurists – there will be more! – who have submitted like arguments, namely Anna Beckers,<sup>30</sup> Ulrich K. Preuß<sup>31</sup> and Gunther Teubner.<sup>32</sup> They have all underlined the legal implications of the varieties studies. Legal rules and institutions do not operate in splendid insulation, but constitute interdependencies. Their coordinated functioning can easier be deconstructed than wilfully established. The deeper level of the gist of the matter can be explained with the help of a famous *dictum* of the German constitutional scholar and Judge Ernst-Wolfgang Böckenförde: secularised democracies, he held, live on normative resources, which they cannot generate themselves.<sup>33</sup> In the European context, the integration project lives on cultural and normative resources, which cannot be produced wilfully or by some political or legislative fiat. In a more mundane version, democratic legitimacy in the EU lives on the quality of the democracies in the Member States, their historical experiences, ideational traditions, and political preferences. Europe can pro-

<sup>27</sup> D. KOCHENOV, G. DE BÚRCA, A. WILLIAMS (eds), *Europe’s Justice Deficit?*, Oxford: Hart, 2015.

<sup>28</sup> E.g., W. STREECK, *E Pluribus Unum? Varieties and Communalities of Capitalism*, in *Max Planck Institute for the Study of Societies Discussion Paper*, no. 10, 2012.

<sup>29</sup> W. STREECK, *How Will Capitalism End?*, London: Verso Books, 2016, p. 198.

<sup>30</sup> A. BECKERS, *Enforcing Corporate Social Responsibility Codes. On Global Self-Regulation and National Private Law*, Oxford: Hart, 2015, p. 50 *et seq.*

<sup>31</sup> C. OFFE, U.K. PREUß, *The Union’s Course: Between a Supranational Welfare State and Creeping Decay*, in C. OFFE, U.K. PREUß (eds), *Citizens in Europe. Essays on Democracy, Constitutionalism and European Integration*, Colchester: European Consortium for Political Research Press, 2015, p. 15 *et seq.*

<sup>32</sup> G. TEUBNER, *Transnational Economic Constitutionalism in the Varieties of Capitalism*, in *Italian Law Journal*, 2015, available at [www.theitalianlawjournal.it](http://www.theitalianlawjournal.it).

<sup>33</sup> E.-W. BÖCKENFÖRDE, *Die Entstehung des Staates als Vorgang der Säkularisation*, in E.-W. BÖCKENFÖRDE (ed.), *Staat, Gesellschaft, Freiheit. Studien zur Staatstheorie und zum Verfassungsrecht*, Frankfurt am Main: Suhrkamp, 1975, p. 42 *et seq.*

mote and protect these accomplishments. To replace national endeavours by the prescription of some uniform political rule risks their destruction.

#### IV. INSTITUTIONALISING THE UNITED IN DIVERSITY VISION

The observations just submitted are somewhat emphatic and abstract. I should not proceed with their defence without mentioning Habermas' objections. His three main points are (I reproduce only the substance of his messages; his command of the German language is at a level which I cannot equate in English):

a) There is a concession to the diversity vision in his plea for the protection of minority cultures: *"In keinem demokratischen Gemeinwesen darf das historisch gewachsene politisch-kulturelle Selbstverständnis nationaler Minderheiten der Assimilation an die Mehrheitskultur geopfert werden"*.

b) However, he continues, we should not equate cultural identities with economic cultures: *"Aber können wir den wohlbegründeten Rechtsschutz für kulturelle Identitäten umstandslos auf Wirtschaftskulturen, auf die, wie Wolfgang Streeck sagt, 'parochialen' Formen des Kapitalismus, z.B. auf Systeme von Arbeitsbeziehungen oder auf sozialpolitische Regime ausdehnen? Ich sehe nicht, wie sich ein kultureller Naturschutz für ein jeweils bestehendes Ensemble von sozioökonomischer Praktiken begründen ließe"*.

c) We should instead trust that a post-national identity and solidarity will emerge: *"Es ist nicht unrealistisch anzunehmen, dass sich die, im Laufe der Nationalstaatsbildung sehr allmählich etablierte staatsbürgerliche Solidarität in dem Maße über die Grenzen des Nationalstaates hinaus erweitert, wie die Bürger von supranationalen Entscheidungen nicht nur betroffen, sondern daran nach demokratischen Verfahren auch beteiligt werden"*.

Never take Habermas lightly. And yet, his categorical distinction between minority cultures and economic cultures is untenable, at least if there is a kernel of truth in Polanyi's analyses of the emergence of "market societies", where "instead of the economy embedded in social relations, social relations are embedded in the economy".<sup>34</sup> His work can be understood as a manifesto urging us to take the interdependence of *the economic* and *the political* seriously. Writing at the end of the Second Great War, Polanyi had witnessed the destruction of liberal economic ordering by Fascism and Nazism. At the end of the War, the rebirth of alternative counter-movements was in sight and nurtured hopes in a better national and international future; alternatives to the Fascist transformation, namely, social counter-movements which would correct the unfettered working of the market system. In a particularly optimistic passage of his concluding chapter Polanyi considers that

"with the disappearance of the automatic mechanism of the gold standard, governments will find it possible to [...] tolerate willingly that other nations shape their domestic institu-

<sup>34</sup> K. POLANYI, *The Great Transformation*, cit., p. 57.

tions according to their inclinations, thus transcending the pernicious nineteenth century dogma of the necessary uniformity of domestic regimes within the orbit of world economy. Out of the ruins of the Old World, cornerstones of the New can be seen to emerge: economic collaboration of governments and the liberty to organize national life at will".<sup>35</sup>

Was this just wishful thinking? The passage was written at a time when Keynes and the like-minded American economist and politician Harry Dexter White were working towards the post-war settlement of Bretton Woods. There were reasons to envisage a better future. Polanyi's considerations deserve attention for three additional and interrelated reasons. For one, he re-states his foundational argument that the capitalist market economy is not an evolutionary given, but a political product, which requires institutional backing and continuous political management. To put it slightly differently, *the political* is inherent in *the economic*; market economies "are polities".<sup>36</sup> A second insight of topical importance follows from this: capitalist market economies will exhibit varieties which mirror a variety of political preferences, historical experiences, and socio-economic configurations. This is what we can expect, and, so I conclude, *should respect, once our societies have gained the liberty to organise national life at will*. The third point is only alluded to in half a sentence. It is an implication of the new freedom. Polanyi predicts and advocates "collaboration"; diversity, we can assume, is there to stay.

Three follow-up queries, which all concern directly the notion of regulatory competition have to be addressed:

a) Even if we concede that the diversity of the institutional infrastructures of the European economies deserves, in principle, recognition, we have to concede that these infrastructures are not written in stone. Endogenous democratic change must remain possible, and insulation against the impact of Europeanisation and globalisation is inconceivable. What precisely distinguishes a variety of an economic culture from a Habermasian "*Schrebergarten*"?

b) It seems safe to assume hence that both Streeck's defence of the nation State and Habermas' defence of European rule are going a step too far. What we need instead is a channelling of change which institutionalises the united-in-diversity vision, thereby offering an alternative to both Streeck's nation State nostalgia and Habermas' European utopia. Polanyi's plea for cooperation may have been a mere signal of hope. In view of the ever deepening interdependencies cooperation has become a must.

c) The ensuing challenge is to provide a framework within which such cooperation can function and at the same time generate legitimacy. "Autonomieschonend und ge-

<sup>35</sup> *Ibid.*, p. 253 *et seq.*

<sup>36</sup> For a very dense re-construction, see F. BLOCK, *Towards a New Understanding of Economic Modernity*, in B. STRÄTH, P. WAGNER, C. JOERGES (eds), *The Economy as Polity: The Political Constitution of Contemporary Capitalism*, London: University College London Press, 2005, p. 3 *et seq.*

meinschaftsvertraglich" is the formula Fritz Scharpf has coined back in 1993.<sup>37</sup> His intuitions and mine are very similar. My version of such a "third way" is the vision of "conflicts law as Europe's proper constitutional form".<sup>38</sup>

I cannot repeat here what I have explained so often. Suffice it to underline three essentials:

a) The conflict-approach is sensitive to what Streeck has characterised as the "democratic *acquis*"<sup>39</sup> of the institutional infrastructure of the economies of democratic polities. This is inherent in the horizontal deliberative quality of the European constitutional constellation.

b) The legitimacy of conflict-resolution must be generated by the deliberative quality of cooperative problem-solving.<sup>40</sup>

c) It is the vocation of EU law to foster such co-operation by the imposition of constraints on the exercise of national policy-making and the control of their "external effects".<sup>41</sup>

Jürgen Neyer and I have, in the elaboration of our "deliberative supranationalism" built upon Habermasian premises, in particular his discourse theory of law and democracy: we, the citizens, must be able to understand ourselves as the authors of the legal provisions with which we are expected to comply. Under conditions of Europeanisation and globalisation and ever more growing interdependences, this is no longer conceivable within a national framework. Nor is this conceivable in the orthodox understanding of European rule. *Deliberative supranationalism* as elaborated in conflicts-law constitutionalism builds upon European law's potential to compensate for the legitimacy deficits of national rule. European law can derive its own legitimacy from this function: its mandate is to implement the commitments of the Member States towards each other by two legal claims, namely, the requirement to take the interests and concerns of their

<sup>37</sup> F. SCHARPF, *Autonomieschonend und gemeinschaftsverträglich: Zur Logik einer europäischen Mehrebenenpolitik*, in W. WEIDENFELD (ed.), *Reform der Europäischen Union: Materialien zur Revision des Maastrichter Vertrages*, Gütersloh: Verlag Bertelsmann Stiftung, 1996, p. 75 *et seq.*, available also as *Max Planck Institute for the Study of Societies Discussion Paper*, no. 9, 1993.

<sup>38</sup> C. JOERGES, *Unity in Diversity as Europe's Vocation and Conflicts Law as Europe's Constitutional Form*, in R. NICKEL, A. GREPPI (eds), *The Changing Role of Law in the Age of Supra- and Transnational Governance*, Baden-Baden: Nomos, 2014, p. 125 *et seq.*

<sup>39</sup> Cf. *supra*, footnote 29.

<sup>40</sup> As repeated *ad nauseam* ever since C. JOERGES, Jürgen Neyer, *From Intergovernmental Bargaining to Deliberative Political Processes: The Constitutionalisation of Comitology*, in *European Law Journal*, 1997, p. 273 *et seq.*

<sup>41</sup> This is a request which has received Habermas' blessings: "Nation-states [...] encumber each other with the external effects of decisions that impinge on third parties who had no say in the decision-making process. Hence, States cannot escape the need for regulation and coordination in the expanding horizon of a world society that is increasingly self-programming, even at the cultural level [...]", see J. HABERMAS, *Hat die Konstitutionalisierung des Völkerrechts noch eine Chance?*, in J. HABERMAS, *Der gespaltene Westen*, Frankfurt am Main: Suhrkamp, 2004, p. 175.

neighbours into account when designing national policies, and by imposing a duty to co-operate. The very notion of co-operation indicates that this kind of rule cannot be some “command and control” exercise, but must rely on the deliberative quality of co-operative interactions.

Two important implications should be underlined. The first: there is no in-built guarantee that such co-operative efforts will, in the end, be successful; but such limitations need not be damaging *per se*; quite to the contrary, they may document mutual respect of essential, yet distinct, values and commitments of the other (the *ordre public* in the parlance of conflict of laws and private international law). The second implication is more drastic: socio-economic, institutional, political and cultural diversity is particularly strong and difficult to overcome. This, however, is by no means a plea for inactivity; it is, instead, a reminder that we have to distinguish between *justice within* consolidated polities, on the one hand, and *justice among* them, on the other, and that we have to work in both spheres.<sup>42</sup>

All this should be only seemingly idiosyncratic. As long as there is diversity in the EU, the law will have to cope with differences. Conflicts-law is simply the name of the discipline doing this. Europe can, in the foreseeable future, not live without it. The normative intuitions which my conflicts-law constitutionalism seeks to institutionalise are certainly outside the mainstream of European studies. But I can point to similar approaches. Among them is Daniel Innerarity's concept of “inter-democracy”.<sup>43</sup> Two of his insights are particularly important for my argument. The first concerns Europe's heterogeneity, which excludes all one-size-fits-all recipes. Innerarity argues instead: “If the EU is going to be more democratic, it will be so in the style of complex democracies. And that complexity is not only related to the diversity of its citizens but to the variety of issues about which it needs to decide, some of which may require proximity, but others that demand a certain distance”. *Inter-democracy* is his key concept: the democratisation of interdependencies must replace State-like or federal hierarchical models.

A second ally, so it seems to me, is Damian Chalmers with his still unpublished essay on the *Democratic Authority and the Resettlement of EU Law*.<sup>44</sup> His quest for a resettlement deserves to be cited at some length:

“EU law allows [Chalmers departs from Article 2 TEU] [...] for another approach in which the European Union's mission become resettled around the promotion of democratic authority within Europe. The central question would be whether a measure has sufficient democratic credentials to warrant obedience over its alternatives, with EU law only justified where it would promote the quality of democracy within a Member State. EU law would,

<sup>42</sup> See C. JOERGES, *Social Justice in an Ever More Diverse Union*, in F. VANDENBROUCKE, C. BARNARD, G. DE BAERE (eds), *A European Social Union After the Crisis*, Cambridge: Cambridge University Press, 2017, p. 92 *et seq.*

<sup>43</sup> D. INNERARITY, *Democracy in Europe. A Political Philosophy of the EU*, London: Palgrave Macmillan, 2018.

<sup>44</sup> On file with author.

thereby, become an instrument for the cultivation of politics and the values of political community rather than something which suppresses these to secure a policy".<sup>45</sup>

## V. INSTEAD OF AN EPILOGUE

"United in Diversity through conflicts-law constitutionalism" is an anti-centralist, a confederal, rather than federal vision, a defence of political autonomy against imposed convergence, combined, however, with duties to co-operative problem-solving. This is a counter-vision to regulatory competition which seeks to replace the governance via competitive processes by deliberative political interactions. How much realism is in this vision? It is no less realistic than the assertion that Europe's present emergency condition has to be understood as a *new normalcy* with a sustainable future.

<sup>45</sup> *Ibid.* (italics in the original).



## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## LOYALTY MATTERS: THE DELICATE BALANCE BETWEEN JURISDICTIONAL COMPETITION AND POLITICAL ORDER

MAURIZIO FERRERA\*

TABLE OF CONTENTS: I. Introduction. – II. Jurisdictional competition and the virtues of exit. – III. Democratic competition and the virtues of voice and loyalty. – IV. Too much opening? The EU's political predicament. – V. Conclusion.

ABSTRACT: Supporters of regulatory competition typically claim that cross-system “free”, “unbounded” competition (such as in the EU) is capable to select the best regulations (institutions/policies/practices/jurisdictions). The posited causal mechanism runs somewhat like this: if “customers/consumers/citizens” can shop around, governments have an incentive to keep/attract them through better regulations – precisely. There are at least two hidden assumptions in such reasoning: *a*) politics is about producing efficient regulations; *b*) regulatory boundaries operate as obstacles, boundary removal as advantages. This *Article* will challenge such assumptions, arguing that they rest on a limited and narrow conception of what politics is all about. Building on the well-known “exit-voice-loyalty” of Albert Hirschman as well as on classical State theory, I will show that the prime and “absolute” objective of politics as a value-sphere is the maintenance and cultivation of political community. Pursuing this objective is a delicate balancing act between “opening” and “closure”. By looking exclusively on the benefits of opening and boundary removal, theories of regulatory competition entirely neglect the potentially destructive spiral that the latter may trigger of for the institutional foundations of political community.

KEYWORDS: jurisdictional competition – European integration – exit – voice – loyalty – boundaries.

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## I. INTRODUCTION

The idea that competition among institutional systems (also known as *regulatory* or *jurisdictional* competition: from now on JC) is an effective mechanism to select or deselect laws, rules and policies has a long pedigree in the disciplines of public finance, public choice, law and economics, and is a tenet of theories of fiscal federalism and constitutional economics.<sup>1</sup> Through the influence of Hayek,<sup>2</sup> JC has also influenced neo- and ordo-liberalism. According to one of its earliest and still much quoted formulation, that of Charles Tiebout,<sup>3</sup> JC is about attracting and retaining scarce and valuable economic resources on the side of governments (typical sub-national units within a federation) in a context which allows the consumers or users of jurisdictional services (i.e. corporations, individuals, workers etc.) to freely switch their resources to alternative jurisdictions. Under conditions of imperfect information, the matching between consumers and jurisdictions cannot generate a spontaneous equilibrium, but rather an incessant variety of regulatory and policy solutions and cross-system movements, promoting efficiency and diversity.

With increasing globalization and the deepening of European integration, the JC debate has acquired a new momentum.<sup>4</sup> The EU in particular can be seen as a historically unprecedented laboratory to gauge the alleged virtues of this type of competition (at the level of States, not just sub-national governments), to identify the meta-rules which can sustain or hamper such virtues and, last but not least, to derive prescriptions for improvement.<sup>5</sup>

Not everybody shares, however, the favor with which law and economics approaches look at JC. The most widespread critique is that the latter may well generate efficiency gains and economic advantages through policy selection, but is also likely to cause an overall race to the bottom among systems,<sup>6</sup> especially as regards social standards, with detrimental effects for the most vulnerable.<sup>7</sup> While certainly plausible and empirically grounded, such critique still accepts the premises of JC theory: what is contested are the

<sup>1</sup> W. OATES, *Fiscal and Regulatory Competition: Theory and Evidence*, in *Perspektiven der Wirtschaftspolitik*, 2003, p. 377 *et seq.*

<sup>2</sup> F. VON HAYEK, *The Economic Conditions of Interstate Federalism*, in F. VON HAYEK (ed.), *Individualism and Economic Order*, Chicago: University of Chicago Press, 1948, p. 131 *et seq.*

<sup>3</sup> C.M. TIEBOUT, *A Pure Theory of Local Expenditures*, in *The Journal of Political Economy*, 1956, p. 416 *et seq.*

<sup>4</sup> P. BERNHOLZ, R. VAUBEL (eds), *Political Competition and Economic Regulation*, London: Routledge, 2007.

<sup>5</sup> D. ESTY, D. GERADIN (eds), *Regulatory Competition and Economic Integration: Comparative Perspectives*, Oxford: Oxford University Press, 2001; V. VANBERG, *Globalization, Democracy and Citizen Sovereignty. Can Competition Among Governments Enhance Democracy?*, in *Constitutional Political Economy*, 2000, p. 87 *et seq.*; V. VANBERG, *Competition Among Governments: The State's Two Roles in a Globalized World*, Freiburg: Walter Eucken Institut e.V., 2010, [www.econstor.eu](http://www.econstor.eu); for a critical view see M. HÖPNER, A. SCHÄFER, *Embeddedness and Regional Integration: Waiting for Polanyi in a Hayekian Setting*, in *International Organization*, 2012, p. 429 *et seq.*

<sup>6</sup> H.W. SINN, *The Selection Principle and Market Failure in System Competition*, in *Journal of Public Economics*, 1997, p. 85 *et seq.*

<sup>7</sup> P. GENSCHEL, *Globalization, Tax Competition, and the Welfare State*, in *Politics & Society*, 2002, p. 245 *et seq.*

consequences of JC, not its analytical assumptions about political competition – and democratic politics more generally.

Competition does play a significant role in contemporary political science. Rather than focusing on citizens and their need to shop around governmental jurisdictions in order to satisfy their preferences, empirical democratic theories tend however to focus on governmental authorities (or would be such) and their propensity to compete for citizen votes. Even though the rational calculus plays a role in vote choices, an equally significant role is played by ideological orientations, partisan identifications, habitual and emotional factors, and other non-rational elements. Elections are in their turn always embedded in a larger framework of “diffuse support” for the democratic polity as such, i.e. as community of citizens and groups sharing a political identity and thus a deep – and often implicit – attachment to the community and its authority structures (“right or wrong, my country”). Logically and empirically, the baseline of any reasoning about JC should thus be a set of relatively closed democratic associations/communities which democratically decide to open up to each other through the dismantlement of boundaries, accept the principles of free movement and nondiscrimination and create the conditions for JC. Most emblematically, this has been the experience of the European Union. The logical and empirical priority of shared political identities and democratic competition over JC has significant implications, especially as regards the transition process leading from democratic closure with no institutional competition among systems to democratic opening with full institutional competition.

Fiscal federalism, constitutional economics and ordoliberal ideas have provided many ideational insights for shaping the EU institutional architecture, especially that of the European Monetary Union (EMU). But the expected virtuous effects of these theories are now hugely at odds with recent developments. During the last decade the issues of open boundaries, the free movement of persons, workers, capitals and services have become increasingly contentious. How can we account for such developments? They have resulted – I contend – from a mechanism linked with “opening” which is entirely neglected by law and economics approaches: boundary removal promotes exit, but is inherently exposed to the risk of provoking a political countermovement and/or eroding the diffuse support for jurisdictional authorities. In his masterful book, *The Great Transformation*, Karl Polanyi argued that during the 19<sup>th</sup> century the utopia of a self-regulating market caused a social counter-movement, whose ultimate offspring was the welfare State.<sup>8</sup> It can be suggested that the 20<sup>th</sup> century has closed with a powerful strike back of the same utopia, extended, this time round, from economic to institutional competition. Also this second great transformation has produced a countermovement, of an essentially political nature. The rise of *souverainisme* can be in fact interpreted as a defensive reaction of nation-states against the erosion/dispersion of their authority. Politics cannot be reduced to a rational selection of

<sup>8</sup> K. POLANYI, *The Great Transformation. The Political and Economic Origins of Our Time*, Boston: Beacon Press, 1957.

public policies in response to regime shopping. It is a much wider and delicate sphere whose fundamental task is that of keeping the polity together through democratic authoritative decisions. It is a difficult task which requires much more than just smart economic constitutions and whose failure may have tragic consequences.

Starting from these premises, in this *Article* I intend to highlight some features of democratic politics which are neglected by JC theory and weaken its explanatory and prescriptive effectiveness. I will try to argue my points by using the well-known categories of "exit", "voice" and "loyalty" first introduced and systematically linked with each other by Albert Hirschman.<sup>9</sup> JC theories explicitly build on the mechanism of "exit" as a reaction to quality deterioration on the side of consumers/citizens and thus as a prompt for quality recuperation on the side of producers/jurisdictional leaders. JC theories also make use of the notion of "loyalty" and occasionally mention voice as well. In their turn, democratic theories have heavily drawn on Hirschman's concepts and insights to investigate both the historical process of State-building and, more recently, the process of European integration and EU-building. Hirschman's model lends itself well, in other words, to open a hopefully constructive dialogue between democratic theorists and JC scholars, raising the latter's awareness of some neglected aspects of the democratic political process.

The *Article* is divided into four sections. The first summarizes some key tenets of JC theories and discusses in particular the role which the latter assigns to exit. The second section illustrates the logic of democratic competition within spatially bounded territorial communities and highlights the role of voice and loyalty, which JC theories tend to downplay or neglect. The third section focuses on the current EU political predicament and interprets it as the outcome of the destructuring side-effects of increased exit opportunities. The last section concludes.

## II. JURISDICTIONAL COMPETITION AND THE VIRTUES OF EXIT

JC theory is the offspring of different schools of thought. As mentioned, its origins date back to Tiebout's model, according to which the best match between citizens' preferences and government public policies can be achieved through a "market" of competing legal jurisdictions offering tax-benefit packages to a customer base of mobile taxpaying citizens. Rational individuals will survey the range of available choices and will act in accordance with their preferences for specific bundles of public goods (and levels of taxation) offered by location-specific jurisdictions. In line with such reasoning, Tiebout was a strong supporter of administrative and fiscal devolution. The Tiebout model has had a profound influence on public economics and public choice theory. According to the "Leviathan"

<sup>9</sup> A.O. HIRSCHMAN, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States*, Cambridge, MA: Harvard University Press, 1970.

theory of the tax-welfare State proposed by Buchanan,<sup>10</sup> governments use their monopolistic positions to pursue revenue maximization, while powerful interest groups capture the benefits of public spending programs. Since traditional political controls fail to contain government growth, decentralization – backed by a strong economic constitution – proves intrinsically beneficial because it reduces the scope of the central government monopoly and contains the negative effects of regulatory capture. JC has exerted a significant influence also on the interdisciplinary field of law and economics.<sup>11</sup> Legal scholars have extended the focus of JC theory from the production of goods and services to all outputs of legal regulation, from contract enforcement to social and labor law. In this perspective, governments are just another type of producers in the overall economy and law is their product. In recent decades, JC has become a tenet of legal and fiscal theories of federalism and has attracted the attention of some ordo-liberal scholars of the Freiburg school.<sup>12</sup> These scholars (and in particular Viktor Vanberg) have offered novel elaborations of JC theory, discussing in more depths its political underpinnings and applying it to the process of European integration.

In line with Tiebout, contemporary JC looks at States as enterprises providing packages of jurisdiction services and regulations for inhabitants and users of their territories.<sup>13</sup> States have, however, a second function: like cooperatives or member-owned organizations, they “should serve the common interests of their members, the citizens”.<sup>14</sup> Citizen sovereignty must be safeguarded by rules that encourage the “producers of politics” to respond to citizens wants. In line with Hayekian theory and the principles of fiscal federalism, the most appropriate institutional architecture is a system of split-level governance, involving the sharing of legal powers between a central or federal authority and lower-level States, regions or localities. The main function of the central authority is to ensure free movement across jurisdictions, which requires legislative and judicial action to remove barriers to circulation and eliminate distortions of competition. The worst evil to be guarded off is “rent-seeking”, i.e. the acquisition of selective privileges or regulatory capture by special interest groups. This worry was central in the doctrine of first generation Ordo-liberals.<sup>15</sup> Public choice theorists have traditionally argued that rent seeking must be contrasted

<sup>10</sup> J.M. BUCHANAN, *The Limits of Liberty. Between Anarchy and Leviathan*, Chicago: University of Chicago Press, 1975.

<sup>11</sup> T.F. COTTER, *Legal Pragmatism and the Law and Economics Movement*, in *Georgetown Law Journal*, 1996, p. 2071 *et seq.*; V. VANBERG, *Freiburg School of Law and Economics*, in P. NEWMAN (ed.), *The New Palgrave Dictionary of Economics*, Vol. 2, London: Palgrave Macmillan, 1998, p. 172 *et seq.*

<sup>12</sup> A. PEACOCK, H. WILLGERODT (eds), *German Neo-Liberals and the Social Market Economy*, Vol. 1, London: Macmillan for the Trade Policy Research Centre, 1989.

<sup>13</sup> V. VANBERG, *Globalization, Democracy and Citizen Sovereignty*, cit.; V. VANBERG, *Competition Among Governments*, cit.; V. VANBERG, *Competitive Federalism, Government's' Dual Role and the Power to Tax*, in *Journal of Institutional Economics*, 2016, p. 825 *et seq.*

<sup>14</sup> V. VANBERG, *Globalization, Democracy and Citizen Sovereignty*, cit., p. 89.

<sup>15</sup> J. HIEN, C. JOERGES, *Ordoliberalism, Law and the Rule of Economics*, London: Hart, 2017.

by an economic constitution<sup>16</sup> that equips governments with adequate tools to implement schemes which benefit all citizens (the enabling part of the constitution) but also prevents them from acting in the interest of some special groups or against the interests of all (the limiting part of the constitution). In the recent Freiburg re-formulation, the economic constitution is not enough: the best remedy is a combination of the latter with JC.<sup>17</sup> JC also enhances the capacity for learning based on diversity and for solving that “knowledge problem” which had been highlighted by Hayek. Since knowledge is dispersed, it is inherently difficult to establish where the common interest lies and how best to achieve it. JC operates not only as a motivational force, but also as a vehicle of discovery, a way to improve knowledge and understanding about efficient performance.

JC brings into light the “protectionist dilemma” of democratic polities and at the same time provides a solution. Intra-jurisdictional special interests will tend to lobby in order to capture protectionist advantages. Since no actor can be sure that other actors will refrain from such behaviors, everybody has an incentive to adopt them, generating a typical prisoner dilemma. The economic constitution can pose constraints on government authorities in order to contain this dilemma. But in the Freiburg reformulation, constitutional provisions have only limited disciplinary powers.<sup>18</sup> The most effective counterforce against rent-seeking protectionism is, precisely, JC. It is true that inter-jurisdictional competitive relations can themselves degenerate into collectively harmful “beggar-thy-neighbor” confrontations (e.g. exploiting the possibilities provided by a context of unbridled tax competition). But such potential degenerations can be contained through appropriate meta-constitutional provisions valid for the entire association of those associations engaged in JC (e.g. the EU). Such rules must see to it that all participants derive more benefits than costs from intra and inter-state competition and thus consider the system as legitimate, based on its efficient performance.

The proponents of JC are aware that a given democratic polity may choose to insulate certain cherished characteristics of their system from competition; that particular polities may also want to ensure some degree of redistribution among its citizens, opposing potential “races to the bottoms”, e.g. as regards social standards.<sup>19</sup> These proponents of JC argue, however, that these preferences remain fully compatible with their model, as they can be secured through appropriate institutional designs. This case is made especially in respect of the European Union – an association of associations (the Member States) whose economic constitution (the Treaties) is based, precisely, on free movement and undistorted competition. As long as the participant units want to preserve their welfare

<sup>16</sup> J.M. BUCHANAN, *The Domain of Constitutional Economics*, in *Constitutional Political Economy*, 1990, p. 1 *et seq.*; D.J. GERBER, *Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the “New” Europe*, in *The American Journal of Comparative Law*, 1994, p. 25 *et seq.*

<sup>17</sup> V. VANBERG, *Globalization, Democracy and Citizen Sovereignty*, cit.

<sup>18</sup> *Ibidem* and V. VANBERG, *Competition Among Governments*, cit.

<sup>19</sup> H.W. SINN, *The Selection Principle and Market Failure in System Competition*, cit.

State distinctiveness, then harmful tax competition must be prevented, lest some governments avail of the latter to generate jurisdictional rents.<sup>20</sup>

JC theory is based on a close analogy between citizenship and consumership. It looks at laws and institutions as responses to the preferences of citizens, who can “vote with their feet” by moving to more convenient jurisdictions in the wake of cost-benefit calculations. Competition pressures legislators into being sensitive to exits as signals of dissatisfaction and to potential entries as signal of attractiveness. It is this rational sensitivity that prompts them to act. In JC theory, no autonomous, distinctive and functionally useful role is attributed to politics. Politics is either collapsed into policy production or treated as an arena of parasitic dynamics and exchanges. In the first case, the task of politicians is that of selecting efficient policy solutions through market-driven discovery. In the second case, democratic politics is a fluid field in which the formation of common interests is always exposed to the risks of rent seeking. The only way through which democratic pluralism can avoid the “protectionist dilemma” is by promoting JC embedded in a smart framework of meta-constitutional provisions capable of safeguarding JC and more generally market-conformity.

### III. DEMOCRATIC COMPETITION AND THE VIRTUES OF VOICE AND LOYALTY

As mentioned above, modern empirical democratic theories have indeed borrowed a lot from models of economic competition. Rather than focusing on citizens/consumers, political scientists have however focused on the elites. Joseph Schumpeter was the first to oppose the citizen-centered with an elite centered doctrine of democratic politics. According the first doctrine (which Schumpeter called the classical doctrine), “the democratic method is that institutional arrangement for arriving at political decisions which realizes the common good by making the people itself decide issues through the election of individuals who are to assemble in order to carry out its will”.<sup>21</sup> According to Schumpeter’s own “other doctrine”, “the democratic method is that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people’s vote”.<sup>22</sup> Individuals who compete to acquire the power to decide are, precisely, the elite (or would-be such). The “producers of politics” – the expression used by JC theorists to designate incumbent democratic rulers – cannot be reduced to policy seekers who try to satisfy in the most efficient way citizen preferences; they are also vote-seekers, for the simple reason that electoral support is a precondition for accessing policy-making offices. And although some citizens may indeed be rational policy demanders ready to vote with their feet, other voters cast their ballots based on a variety of non-instrumental motives: emotions, identifications, traditions and so on. Voters are not mere passive prey to the competitive struggle of the elites. They

<sup>20</sup> V. VANBERG, *Globalization, Democracy and Citizen Sovereignty*, cit.; V. VANBERG, *Competition Among Governments*, cit.

<sup>21</sup> J. SCHUMPETER, *Capitalism, Socialism and Democracy*, London: Routledge, 2003, pp. 250 and 269.

<sup>22</sup> *Ibidem*, p. 269.

organize and mobilize to advance their claims and make themselves heard. In democratic politics, voice is more important than exit. And here we come to Hirschman's model.

As is known, this model focuses on dynamics of quality deterioration and consumer reactions. The model's basic thrust is that consumers or members of an organization have essentially two possible responses when they perceive that the organization's quality deteriorates: they can either exit (i.e. withdraw from consumption or the organization relationship) or voice (i.e. complain in order to repair or improve the relationship and/or making proposal for change). The model includes a third variable: loyalty. If disgruntled consumers/members have a high degree of loyalty *vis-à-vis* the organization, then the cost of exit will increase and that of voice will correspondingly decrease. It was Hirschman himself to recognize from the beginning that the exit-voice-loyalty triplet could be applied not only to the economic but also to the political sphere.<sup>23</sup> The first scholar who systematically applied Hirschman's model to macro-politics was the Norwegian political scientist Stein Rokkan.<sup>24</sup> Even though he did so in a historical perspective with a view to reconstructing the process of State-formation in Europe since the fall of the Roman empire, Rokkan's theory can be reformulated in more general and abstract terms, thus making it more easily comparable with JC theory.

The starting point of what can be called the Hirschman-Rokkan model (herefrom, HRM) is the very constitution of a territorial political community. How does a State become a "territorial enterprise" (*Betrieb*, in Weber's language), capable of taking collectively binding sovereign decisions? The first step is the construction of a center of authority within a given territorial area, commanding adequate resources to rule that area and its inhabitants. The key resource consists in coercive resources (remember Weber's definition of the State as the legitimate monopolist of coercive resources). Center-building always implies boundary setting. The controlled territory must be demarcated and defended from external intrusions. In their turn, subjects (especially those located in the peripheries) must be kept inside. Boundaries and closure are the foundational prerequisites for the very constitution of a political association claiming sovereignty over a territory.

The foreclosure of exits and entries prompts a dynamic which Rokkan called internal differentiation or "structuring". If subjects are locked inside, they will direct their attention towards the territorial center of authority for protecting/advancing their interests. In line with Hirschman's model, actors who cannot exit will tend to voice in case of dissatisfaction. They can do so individually, but soon discover that collective voice is more effective. "Internal structuring" is the process whereby bounded societies gradually put in place channels for interest aggregation and mechanisms that allow political exchanges: support to the authorities (a "who") in exchange of decisions (the "whats") which can be binding for all the

<sup>23</sup> A.O. HIRSCHMAN, *Exit, Voice and the State*, in *World Politics*, 1978, p. 90 *et seq.*

<sup>24</sup> S. ROKKAN, *Entries, Voices, Exits: Towards a Possible Generalization of the Hirschman Model*, in *Social Sciences Information*, 1974, p. 39 *et seq.*; P. FLORA, S. KUHNLE, D. URWIN (eds), *State Formation, Nation Building and Mass Politics in Europe. The Theory of Stein Rokkan*, New York: Oxford University Press, 1999.

members of the political association, precisely because all are bounded within it. No one can escape its jurisdiction. The democratic method *à la* Schumpeter is the most effective way to reconcile societal pluralism and its incessant, but “structured” voice manifestations with a responsive government operating in a context of liberal freedoms.

Albeit relevant, contingent material interests are not the only driver of a bounded society in its relationship with political authorities. The relationship between the external bounding and the internal binding of citizens through sovereign decisions is mediated by a third element: bonding.<sup>25</sup> This is a set of we-feelings that spread throughout the population in the wake of continuous mutual interaction, which generates material interdependence and cultural/emotional ligatures. In addition to the organization and stabilization of voice channels, bounding generates horizontal and vertical “loyalty”, the third notion of Hirschman’s triplet. Loyalty can be considered as a diffuse support, a disposition towards generalized and interest-independent compliance which plays a key role for the legitimation of political authority and the transformation of an association into a fully-fledged political community.

Figure 1 visualizes the application of the HRM model of “bounded structuring” to the long-term process of State formation in Europe. State-building, nation-building, mass democracy and the welfare State are the four ingredients and at the same time the four time phases of that process.

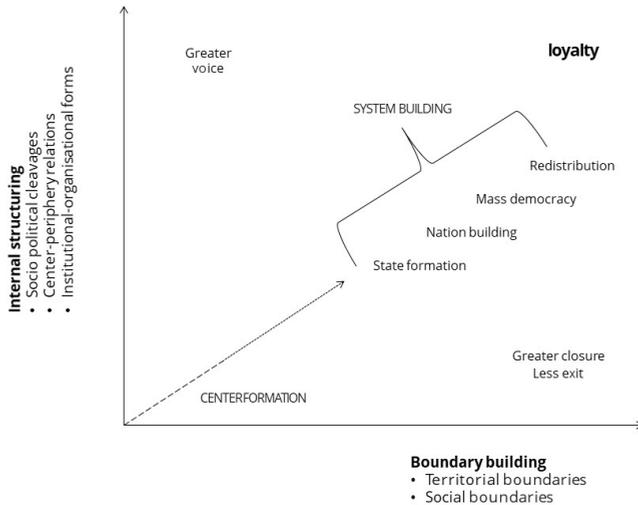


Figure 1

<sup>25</sup> M. FERRERA, *The Boundaries of Welfare. European Integration and the new Spatial Politics of Social Protection*, Oxford: Oxford University Press, 2005.

The consolidation of culturally embedded systems of national citizenship, resting on universal civil, political and social rights can be regarded as one of the most significant products of Western-style bounded structuring: the anchoring of people's interaction to an institutionalized system of mutual rights and obligations has allowed a quantum leap in the stabilization and generalization of social cooperation – the most fundamental task to be performed by “politics” as a distinct sphere of action.<sup>26</sup> The fusion between territorial control and identity, mass democracy and the welfare State produced very solid and highly integrated political communities, functioning according to distinct internal logics. Of course, these systems maintained several channels of mutual communication, especially in the economic sphere (markets typically rest on the availability of exit/entry opportunities, especially for goods). But during the golden age of the welfare-democratic nation-state, national economies essentially functioned as “black boxes” connected to each other by flexible exchange rates.<sup>27</sup> Within the black box, the “voice” dynamics of social and political pluralism shaped allocative and distributive outcomes.

Some of the pathologies of democratic politics (summarized in the notion of “rent-seeking”) denounced by JC theory have not gone unnoticed also on the side of political scientists. Social closure has been found to often serve “usurpative” rather than emancipatory objectives. The struggle for competition between incumbent and opposition parties has sometimes availed itself of top down clientelistic dispensations or bottom-up captures of special benefits. Contemporary rational choice theories have unveiled the dynamics which lead to such undesirable outcomes.<sup>28</sup> But both the awareness and the preoccupation about such dynamics were clearly present already in the early and classical debates about democracy and the welfare State. Commenting on the up rise of unofficial strikes at the time while he was writing his famous essay on class and citizenship, T.H. Marshall lamented that an attempt had been made “to claim the rights of both status and contract while repudiating the duties under both these heads”.<sup>29</sup> In his turn, R.M. Bendix warned that a fundamental civil right and pre-condition of voice, the freedom of association or “right to combine”, can be used “to enforce claims to a share of income and benefits at the expenses of the unorganized and the consumers”.<sup>30</sup>

Well-functioning markets can indeed serve as antidotes *vis-à-vis* such pathologies. And, more generally, the presence of exit options can be a potent generator of positive (i.e. virtuous) institutional innovation – as acknowledged by Rokkan himself in an early

<sup>26</sup> M. WEBER, *Economy and Society: An Outline of Interpretive Sociology*, Berkley: University of California Press, 1978.

<sup>27</sup> R. GILPIN, *The Political Economy of International Relations*, Princeton: Princeton University Press, 1987.

<sup>28</sup> S.C. STOKES, T. DUNNING, M. NAZARENO, V. BRUSCO, *Brokers, Voters, and Clientelism: The Puzzle of Distributive Politics*, Cambridge: Cambridge University Press, 2013.

<sup>29</sup> T.H. MARSHALL, *Citizenship and Social Class*, in T.H. MARSHALL, T. BOTTOMORE (eds), *Citizenship and Social Class*, London: Pluto Press, 1992, p. 42.

<sup>30</sup> R. BENDIX, *Nation-building and Citizenship*, New York: Wiley, 1964, p.105.

commentary to Hirschman.<sup>31</sup> In praising the virtue of exit, one should not forget, however, the interdependence between external closure and internal structuring. Opening increases options and contains “usurpative” exchanges. In this respect, JC theorists are definitely right. But opening can also produce de-structuring, i.e. a de-stabilization of political order and even an erosion of its foundations. This is the aspect neglected by JC theories. The introduction of exit and entry options in a previously closed community alters the distribution and the value of those internal resources around which social and political compromises typically rest. After a threshold, such disruption tends to prompt voice reactions: voice against exit (e.g. against company relocations or capital flights); voice against entries (e.g. voice against “Polish plumbers” or immigrants). Thus the very presence, dynamics and logic of JC gets *politicalized* (it become an issue of contention among opposing interests); it may then become *politicized* (conflicts become increasingly acute, “voice against” gets organized and active); and it may subsequently give rise to *polityzation*: the opponents of JC and opening may arrive at challenging the legitimacy of the wider polity, i.e. that association of associations which has made JC possible in the first place – and even voicing for outright exit from this association (e.g. the Brexit case).

#### IV. TOO MUCH OPENING? THE EU’S POLITICAL PREDICAMENT

The EU trajectory offers an emblematic example of the dynamics just described. European integration has operated since the 1950s as an “opening” force. Cross-national boundaries have been extensively re-defined, differentiated, reduced or altogether cancelled. An internal market has been established, resting on the free circulation of goods, persons, capitals and services. A tightly monitored competition regime forbids national closure practices that are judged as market distortions by supranational authorities. A common currency has been introduced, underpinned by an “economic constitution” oriented towards stability. Firms, capitals and more generally “tax bases” are no longer captive of the nation State, they can freely shop around in search of the most attractive jurisdictional rules and services. The traditional link between rights and territory has become much looser: for most civic and social rights, the filtering role of nationality has been neutralized. Through a long sequence of “opening” provisions, the EU has indeed been able to create an imperfect, but recognizable level playing field for jurisdictional competition.

We know however that during the last decade the issues of open boundaries, the free movement of persons, workers, and services have given rise to increasing conflicts: the EU seems to have fallen prey of disaggregative political and electoral dynamics.<sup>32</sup> Nationalist movements have made their appearance all over the continent, voicing for a restoration of boundaries and domestic sovereignty. A majority of Britons has voted for

<sup>31</sup> S. ROKKAN, *Entries, Voices, Exits*, cit.

<sup>32</sup> M. FERRERA, *The Stein Rokkan Lecture 2016 Mission impossible? Reconciling Economic and Social Europe After the Euro Crisis and Brexit*, in *European Journal of Political Research*, 2017, p. 3 *et seq.*

the exit of the UK from the EU – an odd case in which JC has backfired creating a demand for jurisdictional re-insulation against “entries”. To a large extent, it can be said that also the strictures of EMU’s fiscal rules have backfired, generating in certain countries the belief of an excessive and unwarranted limitation to domestic democratic choices.<sup>33</sup>

It is possible that such backfire may have partly resulted from a bad design of the EU’s economic constitution, and not from JC dynamics as such. But it seems reasonable to search for a more articulated explanation, capable of linking the rise of a novel integration/demarcation divide to the logic of democratic politics under de-bounding conditions. The HRM provides a theory which is uniquely fit for this purpose.

Figure 2 visualizes how the model can be applied to European integration in general as well as to its more recent developments. Compared to the post-war system of European nation-states, EU building may, in principle, be conceptualized as a novel higher order attempt at boundary reconfiguration and internal re-structuring. In this case, however, supranational center building can only take place at the expenses of national centers. For the latter, EU building works, as it were, as State-building in reverse: the HRM predicts “destructuring”.

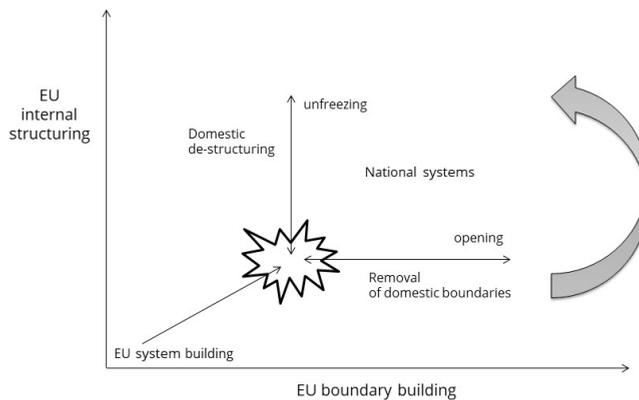


Figure 2

For argumentative purposes, let us break down the process of European integration in a three stage temporal sequence. At the beginning (say, the late 1940s) there was an ensemble of spatially bounded political units (the various European nation-states), separated by thick territorial and regulatory borders. Their political authorities controlled exits

<sup>33</sup> Fiscal rules have certainly contributed to domestic political turbulences during the post 2008 crisis and, in particular, they have triggered off neo-nationalist mobilizations against “Brussels” and its powers. These dynamics have interwoven with the horizontal tensions created by exit and entry movements, but are not per se related to JC.

and entries. The voice of citizens was channeled through established mechanism of interest articulation and aggregation, such as civic society and economic associations, the social partners and parties (internally structured voice). Public policies mainly resulted from domestic dynamics of political exchange between “whos” and “whats” (with different degrees of efficiency). Each national government could count on long-term legitimation, loyalty and durability.

During phase two (say, 1960s-1990s) boundaries started to be removed. A new, larger boundary configuration was established, guarded by supra-unit authorities (the EU). Cross-unit exits and entries became free, no longer under the control of national authorities. JC could thus take off, and (the possibility of) policy shopping/competition linked with free exits/entries created incentives for domestic authorities to adopt more efficient policy solutions. The removal of boundaries also impacted on voice, however. Exits and entries have altered the distribution and value of politically relevant resources. New lines of divisions and conflict potential have arisen (e.g. mobile actors vs. stayers).

And so we reach phase 3 (2000s onwards): established voice channels started to un-freeze (get deranged), political patterns got increasingly destructured and political loyalty/legitimation gradually unsettled. In the wake of boundary removal and JC, new types of voice make their appearance: e.g. voice against exit, voice against entry (right wing populism), voice against opening as such (euroscepticism) voice for re-closure (*souverainisme*) and so on.

In principle, we might imagine EU building to eventually lead to the formation of a much wider bounded association of associations, characterized by its own internal structuring at a higher level. But this scenario cannot be taken for granted. The opposite scenario is equally plausible: separatism (Brexit, Catalonia) or even disintegration.

The re-visitation (and broad generalization) of Rokkan’s theory in the face of EU-building has been masterfully provided by Bartolini. His message is clear: institutional democratization and the direct connection between the dynamics of supranational integration and those of national mass politics are deemed to generate an “explosive mixture of problems”.<sup>34</sup> As is well known, the euro-crisis and the ensuing great recession have heavily aggravated the problematic mixture. Building on a Rokkanian background, Hans Peter Kriesi and his collaborators have conceptualized and investigated the new conflict constellation emerged in the wake of EMU, the Eastern enlargements and the crisis.<sup>35</sup> The EU as such has become a major source of contention, originating a novel “integration-demarcation” cleavage.

<sup>34</sup> S. BARTOLINI, *Restructuring Europe*, Oxford: Oxford University Press, 2005, p. 409.

<sup>35</sup> H.P. KRIESI, *Restructuring of Partisan Politics and the Emergence of a New Cleavage Based on Values*, in *West European Politics*, 2010, p. 673 *et seq.*; H.P. KRIESI, E. GRANDE, M. DOLEZAL, D.M. HELBLING, P.D. HÖGLINGER, P.S. HUTTER, P.B. WÜEST, *Political Conflict in Western Europe*, Cambridge: Cambridge University Press, 2012; M. FERRERA, *The Stein Rokkan Lecture 2016 Mission impossible?*, cit.

Integration has implied a transfer of substantial authority from national governments to supranational institutions. Developments in this direction have been slow-moving, generating incremental cumulative effects. As predicted by JC theory, free movement has indeed generated policy shopping on the side of workers, capitals, service providers, firms and so on. The suppliers of jurisdictional goods have been induced to rationalize their regulatory frameworks. The suppression of exit controls have shifted policymakers' attention towards attracting precious resources from the outside – entry-oriented policies and measures. The completion of the internal market has indeed brought huge efficiency gains. EMU's rules have in its turn acted from above to contain fiscally unsustainable public finances and to promote market-conforming institutional reforms. However, these processes have also started to clash with nation-based welfare democratic practices and institutions, unleashing dangerous and destructive conflicts. Writing in the 1970s, Rokkan already warned about these risks. But he also added that nationalization of the citizenry inherent in the welfare State would not imply "an increase of feelings of xenophobia and distance from others".<sup>36</sup> In certain countries, right wing formations have unfortunately fomented xenophobic and even racist orientations and actual behaviors which have gone beyond Rokkan's wildest dreams. The last decade has unearthed the structural contradiction (to use Bartolini's words) between the dynamics of EU building and the preservation of the cultural, redistributive and political capacities of national governments on the other hand. In such a context, can the new supranational center really "hold"? Or are we faced with an unstoppable spiral of system disintegration, in the wake of an increasingly loud "voice for exit" (the UK case)?

## V. CONCLUSION

This *Article* has discussed the conception of democratic politics which underpins JC theory and has shed light on some dynamics which the latter neglects. My discussion has not challenged the internal logic of JC theory. It has however highlighted a major limitation: by focusing only on exit dynamics and their virtues, JC scholars downplay the key role of loyalty and of the "voice" side of politics. Governing a political community is always a balancing act whose ultimate and absolute mission is to safeguard to stability and durability of political order – which is something distinct and autonomous compared to the economic or legal orders. The existence of boundaries – and thus a certain degree of foreclosure of cross-boundary movements – is a necessary condition for political stability and durability.

European integration provides a telling example of how the virtues of exit find their limit in the potential erosion of loyalty and the disruption of voice structures – two processes which are deemed to backfire against exit itself and prompt dangerous de-legitimation spirals and anti-opening counter-movements. By removing a number of jurisdictional boundaries, integration has unquestionably increased the options of the various

<sup>36</sup> P. FLORA, S. KUHNLE, D. URWIN (eds), *State Formation*, cit., p. 265.

national actors. Individual citizens, service consumers, providers, financial institutions and, more generally, social and corporate actors can now choose among a much wider repertoire of “locality” options, i.e. choices about where to locate themselves within the EU space: staying inside the original or “natural” space of affiliation, exiting from it and entering into other spaces, staying out selectively from what they do not like. Moreover, actors can pursue such options through a wide range of “vocality” strategies, i.e. strategies that exploit all the possible confrontational opportunities offered by the EU multi-level institutional system, and especially the new EU legal order, increasingly serving as a “law-for-exit-and-voice”, i.e. a set of norms and venues (starting from the Court of Justice of the European Union) which actors can use in order to pursue their novel spatial interests. The wider menu of “locality” options and “vocality” strategies has prompted a new spatial politics in Europe, in which the territorial dimension (in its purely geographical, but also geo-hierarchical aspects) has become increasingly salient.<sup>37</sup>

While not denying that opening and jurisdictional competition have brought about some of their expected benefits, my discussion has shown that there are risks involved in the process. Too much emphasis on competition may jeopardize the delicate compromises between efficiency and equity, between the market and the solidarity logics which have been laboriously achieved through the long historical process of welfare State building. Especially after the 2004 enlargement, opening has raised increasing fears of social dumping and “social tourism”, triggering off undesirable dynamics of xenophobia and creating new strains between social groups instead of new ties. Such development has also raised delicate issues of legitimacy and democratic accountability – at least insofar as the EU’s low “polity-ness” is perceived as a problem by important societal actors, large segments of national public opinions and a number of national governments.

In an early commentary to Hirschman’s model, Samuel Finer aptly observed that exit and entries can sometimes turn into “demons” threatening the very basis of political association.<sup>38</sup> Smart and carefully calibrated boundary-building (and maintenance) is the key element for eliciting those “we-feelings” that make citizens loyal to their community and its political authorities. Conflict cannot be suppressed, but it can be channeled, civilized and turned into a spur for virtuous institutional change. Under certain conditions, voice can operate as the “angel” of politics. As I have underlined, in line with the prediction of JC theory, sometimes the angel of voice can be hijacked by petty interests, sectional lobbies, and exclusive groups defending their privileges. In such cases, opening and markets can be robust antidotes to particularistic predations. What matters is keeping an appropriate balance between exit and voice, capable of safeguarding adequate levels of systemic loyalty. Many commentators have criticized the way in which Hirschman treated

<sup>37</sup> M. FERRERA, *The Boundaries of Welfare*, cit.

<sup>38</sup> S. FINER, *State-building, State Boundaries and Border Control*, in *Social Science Information*, 1974, p. 79 *et seq.*

loyalty: as a residual category that “fills the equation” when, in the presence of quality deterioration, the dynamics of exit or voice do not unfold as expected.<sup>39</sup> But loyalty is not merely a “tax” on either exit or voice, that lowers their probability. It is the glue that keeps the polity together by sustaining its legitimation. As Weber aptly suggested more than a century ago, legitimacy is a necessary condition for any exercise of political authority. European politics is now confronted precisely with a legitimacy deficit, at the national and especially EU level. And our future as Europeans will depend on the capacity of political leaders (old and new) to overcome this formidable challenge.

<sup>39</sup> B. BARRY, *Exit, Voice and Loyalty*, review article, in *British Journal of Political Science*, 1974, p. 79 *et seq.*



## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## AT THE ROOTS OF REGULATORY COMPETITION IN THE EU: CROSS-BORDER MOVEMENT OF COMPANIES AS A WAY TO EXERCISE A GENUINE ECONOMIC ACTIVITY OR JUST LAW SHOPPING?

FRANCESCO COSTAMAGNA\*

TABLE OF CONTENTS: I. Free movement of companies and regulatory competition in the EU: Some introductory remarks. – II. Lack of genuine economic activity in the host State and the application of Treaty rules on freedom of establishment to the transfers of companies. – II.1. An economic activity-based definition of establishment: AG Kokott in *Polbud*. – II.2. Applying freedom of establishment rules when there is no genuine economic activity: the approach of the Court. – III. Law shopping as an abuse of the rules on freedom of establishment? – III.1. The restrictive reading of the doctrine of abuse in cases concerning cross-border transfer of companies. – III.2. Cross-border-transfers of companies and wholly artificial arrangements: the rise and fall of a partial exception to the restrictive reading of the doctrine of abuse. – IV. Cross-border transfer of companies and regulatory competition: the legislative response. Some conclusive remarks.

ABSTRACT: The *Article* critically engages with the case law of the Court of Justice on the application of Treaty provisions on freedom of establishment to cross-border transfers of companies. In particular, it demonstrates that the Court has come to consider the possibility for companies to use freedom of establishment as a tool to choose the law applicable to them as an objective of the relevant Treaty provisions, rather than as an abuse. The recently adopted *Polbud* judgment (Court of Justice, judgment of 25 October 2017, case C-106/16, *Polbud* [GC]) represents a fitting example in this regard. Here the Court held that Treaty provisions on freedom of establishment apply even in cases where the converting company has no intention to pursue any economic activity in the host State. Moreover, it posited that trying to relocate in another Member State with the sole purpose of paying lower taxes does not constitute an abuse and, thus, does not justify the adoption of restrictive measures by the departure Member State. The *Article* critically engages with this line of

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cases, showing its impact on recent attempts to harmonize the rules on cross-border transfers of companies. In particular, the analysis focuses on the 2018 Commission Proposal for a Directive regarding cross-border conversions, demonstrating that it tends to prioritize the promotion of freedom of establishment over competing interest and values, such as the respect for the integrity of national tax systems or the protection of workers' rights.

**KEYWORDS:** freedom of establishment – regulatory competition – abuse of law – cross-border transfers – taxation – workers' rights.

## **I. FREE MOVEMENT OF COMPANIES AND REGULATORY COMPETITION IN THE EU: SOME INTRODUCTORY REMARKS**

Art. 54 TFEU indicates that freedom of establishment also applies to companies and firms “formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union”. Consequently, companies have the right to freely move from one Member State to another, by transferring their central administration or head office, or, alternatively, by setting up a branch, an agency or a subsidiary.

The ability of companies to move freely across borders represents the main driver of regulatory competition. The relationship between regulatory competition and the European integration process is a controversial one. First, the multi-tiered structure of EU legal order creates the perfect conditions for regulatory competition. Economic actors can exploit the differences existing between national legal orders thanks to the creation of an integrated market space at supranational level. Adhering to the neoliberal vision of this process, some perceive regulatory competition as a force that contributes to the dismantling of the regulatory barriers to the free circulation of goods and services. From their point of view, regulatory competition is not an accident, and even less an abuse, but a constituent element of the internal market.

Conversely, there is now greater awareness of the fact that regulatory competition can be a threat for the legitimacy and the acceptability of the European integration process as a whole. Fostering unbridled intra-EU regulatory competition comes at the expenses of the pursuit of non-economic objectives and the safeguard of non-economic values, which tend to be perceived just as obstacles on the road toward greater efficiency. Furthermore, the process encroaches upon Member States' autonomy in the exercise of their legislative prerogatives in fields, such as taxation or social policy, that are still their exclusive competence. This occurs with regard to both the content of the norms, which must conform to the expectations of market actors even at the expenses of the pursuit of other competing objectives, and the legislative process. As for the latter, the unleashing of regulatory competition contributes to transforming law-making from a political process to a market-based one.

Against this background, the *Article* purports to shed more light on the status of regulatory competition in the EU legal order and, thus, on how far national authorities can go in confronting it: whether they have to accept this process as a corollary – or even an objective – of the internal market or whether they can consider it as an abuse and, thus, take action against it. To this end, the *Article* focuses at the rules governing the free movement of companies in the EU, focusing, in particular, on the scope of application of the freedom of establishment and the limits thereto. The first part critically engages with the Court's case-law concerning the applicability of Treaty rules on freedom of establishment when companies wish to transfer in another Member State just to change law applicable to their formation or activity and not to carry out any genuine economic activity there. The second part of the analysis deals with the restrictive approach adopted by the Court when it comes to the application of the doctrine of abuse to law shopping cases. In this context, the *Article* criticizes the Court's approach according to which promoting law shopping constitutes an objective of the EU provisions on freedom of establishment, prevailing on other competing objectives. The latest part of the *Article* shows the impact of the Court's case-law on recent attempts to harmonize the rules on cross-border transfers of companies. In particular, the analysis focuses on the 2018 Commission Proposal for a Directive regarding cross-border conversions, demonstrating that it tends to prioritize the promotion of freedom of establishment over competing interest and values, such as the respect for the integrity of national tax systems or the protection of workers' rights.

## II. LACK OF GENUINE ECONOMIC ACTIVITY IN THE HOST STATE AND THE APPLICATION OF TREATY RULES ON FREEDOM OF ESTABLISHMENT TO THE TRANSFERS OF COMPANIES

### II.1. AN ECONOMIC ACTIVITY-BASED DEFINITION OF ESTABLISHMENT: AG KOKOTT IN *POLBUD*

The question whether EU provisions on freedom of establishment also cover transfers of companies aiming uniquely at changing the legal clothes with no intention to pursue an actual business in the host State finds no answer in EU primary and secondary law. On the one hand, Arts 49 and 54 do not define the notion of establishment, while, on the other, legislative efforts directed at regulating cross-border transfers of companies have largely failed to tackle this issue.<sup>1</sup>

The gap has been filled by the Court, which has progressively broadened the scope of application of freedom of establishment. *Polbud*, a judgment adopted by the Court in

<sup>1</sup> See specifically E. SØRENSEN, M. NEVILLE, *Corporate Migration in the European Union*, in *Columbia Journal of European Law*, 2000, p. 181 *et seq.*

October 2017, represents a fitting example in this regard.<sup>2</sup> The case concerned the decision of a Polish company to convert into a private limited liability company governed by Luxembourg law, while continuing to carry out its activity in Poland. The Polish legislation stood in the way of this plan, making the cancellation from the national commercial register conditional upon the company being wound up after being liquidated. Polbud, wishing to retain its personality, refused to fulfil this requirement and, accordingly, saw its application to be removed by the Polish register rejected by the competent authorities. Consequently, it brought a judicial action against this decision, claiming that the requirement imposed by the Polish legislation was incompatible with Arts 49 and 54 TFEU. The Polish Government, backed by other intervening Member States, contested the applicability of these provisions in the case at hand, pointing to the fact that Polbud was just trying to change its legal clothes for tax purposes, without any intention to pursue a genuine economic activity in Luxembourg.

AG Kokott concurred with these States. In her Opinion in the case, she held that, assuming that the claim put forward by the Polish Government was correct, the situation did not fall under the scope of application of EU rules on freedom of establishment. Indeed, “although that freedom gives economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them”.<sup>3</sup> Her reasoning starts from the seemingly unassailable premise that freedom of establishment’s rules should apply only to operations involving an act of establishment.<sup>4</sup> According to AG Kokott, the notion inevitably presupposes the exercise by the undertaking of a genuine economic activity in the host Member State on a stable and continuous basis. This view on establishment corresponds to the one codified by Art. 4 of the Services Directive,<sup>5</sup> which defines establishment as “the actual pursuit of an economic activity, as referred to in Article 43 of the Treaty, by the provider for an indefinite period and through a stable infrastructure from where the business of providing services is actually carried out”. Moreover, the definition is perfectly in line with the one prevailing in the Court’s case-law. In *Gebhard*, a seminal judgment in this matter, it held that “[t]he concept of establishment within the meaning of the Treaty is therefore a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom”.<sup>6</sup> Likewise, in *Stauffer*, the Court excluded the applicability of Art. 49 TFEU to the case of an Italian charitable foundation holding commercial premises in Germany that were rented out by a German property

<sup>2</sup> Court of Justice, judgment of 25 October 2017, case C-106/16, *Polbud* [GC].

<sup>3</sup> Opinion of AG Kokott delivered on 4 May 2017, case C-106/16, *Polbud*, para. 38.

<sup>4</sup> *Ibid.*, para. 35.

<sup>5</sup> Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market.

<sup>6</sup> Court of Justice, judgment of 30 November 1995, case C-55/94, *Gebhard*, para. 25.

agent. Indeed, despite satisfying the requirement of a permanent presence in the host State, the foundation did not carry out any genuine economic activity there, since it did not actively managed the property.<sup>7</sup> Furthermore, AG Kokott highlighted that the Court has referred to an economic activity-based definition of establishment also in a number of judgments specifically concerning the free movement of companies. Both in *Cadbury Schweppes* and in *VALE*, for instance, it maintained that the notion of establishment “presupposes the actual establishment of the company concerned and the pursuit of genuine economic activity there”.<sup>8</sup>

AG Kokott did not elaborate much on what it takes to demonstrate that the company is pursuing a genuine economic activity. She made just some passing references, both in the body of the Opinion and in footnotes, to certain elements – such as the existence of “a level of infrastructure” enabling the pursuit of business – that can have a bearing. Overall, following the idea that the notion of establishment is to be interpreted broadly, AG Kokott seemed to set quite a low bar when it came to demonstrating that the company fulfils the requirement at hand. Not only may the “renting of premises for business purposes” be enough, but “even the intention to effect such establishment is sufficient”. Absent any of these elements, cross-border conversions having the sole objective of changing the *lex societatis* are excluded from the scope of application of Treaty rules on freedom of establishment. This conclusion has the merit to fully embed corporate mobility into the internal market,<sup>9</sup> to be intended as an area where all the obstacles to the free movement have been removed in order to stimulate the pursuit of actual business activities across border and not to increase regulatory competition opportunities. AG Kokott’s approach openly rejects the idea that regulatory competition can be considered as an objective of the internal market and even “an integral part of the constitutional structure of the European Union”.<sup>10</sup>

## II.2. APPLYING FREEDOM OF ESTABLISHMENT RULES WHEN THERE IS NO GENUINE ECONOMIC ACTIVITY: THE APPROACH OF THE COURT

For all its merits, the Court decided not to adhere to the solution proposed by AG Kokott, rejecting the proposition according to which freedom of movement rules apply only when the company pursues a genuine economic activity in the host State. Indeed, according to the Court it is immaterial whether the company wishes to convert into an en-

<sup>7</sup> Court of Justice, judgment of 14 September 2006, case C-386/04, *Stauffer*, paras 19-20.

<sup>8</sup> Court of Justice, judgment of 12 July 2012, case C-378/10, *VALE*, para. 34; judgment of 12 September 2006, case C-196/04, *Cadbury Schweppes* [GC], para. 54.

<sup>9</sup> J. MEEUSEN, *Freedom of Establishment, Conflict of Laws and the Transfer of a Company's Registered Office: Towards Full Cross-Border Corporate Mobility in the Internal Market?*, in *Journal of Private International Law*, 2017, p. 322.

<sup>10</sup> W. KERBER, *Interjurisdictional Competition within the European Union*, in *Fordham International Law Journal*, 1999-2000, p. 234.

tity governed by the law of another Member State without any intention to conduct its business there. This type of transformation falls in any case within the scope of application of Arts 49 and 54 TFEU, being it an economic operation in respect of which Member States have to comply with the freedom of establishment.<sup>11</sup> The only requirements to be fulfilled are, first, that the converting company has been formed in accordance with the legislation of a Member State and has its registered office, central administration or principal place of business within the EU and, second, that the conditions set forth by the legislation of the State of destination are satisfied.<sup>12</sup> Any consideration concerning the activity that the converting company is set to carry out in the host Member State is immaterial in this context.

The formalistic approach adopted by the Court led to a solution that seems to be logically flawed, coming to admit the applicability of freedom of establishment rules to situations where there is no establishment. Yet, the choice to disconnect the scope of application of freedom of establishment from the exercise of any genuine economic activity in the host State, allowing corporations to rely on these provisions to change their legal clothes, is in line with the Court's case-law on corporate cross-border transfers.

This approach had been first adopted in *Segers*,<sup>13</sup> a case concerning the exclusion from a national sickness scheme of the director of a company incorporated in England that did business entirely in the Netherlands. Replying to the doubts expressed by the national court as for the relevance of the latter element, the Court made clear that Art. 58 EEC (now Art. 54 TFEU) "requires only that the companies be formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Community. Provided that those requirements are satisfied, the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial".<sup>14</sup> The ruling represented the first moment in which the Court came to admit, even though only implicitly, that the freedom of establishment could be a vehicle for law shopping. In his Opinion in the case, AG Darmon made it more explicit, arguing that "the logical consequence of the rights guaranteed under the Treaty [is] the fact that a national of a Member State may take advantage of the flexibility of United Kingdom company law".<sup>15</sup>

At first, despite its potentially far-reaching implications for company law, *Segers* received relatively little consideration in the literature. One of the main reasons is that two years later the Court adopted *Daily Mail*, a judgment that "came as a godsend for those cherishing the role of the real seat theory as a protective mechanism against reg-

<sup>11</sup> *Polbud* [GC], cit., paras 31-33.

<sup>12</sup> *Ibid.*, para. 33.

<sup>13</sup> Court of Justice, judgment of 10 July 1986, case 79/85, *Segers*.

<sup>14</sup> *Ibid.*, para. 16.

<sup>15</sup> Opinion of AG Darmon delivered on 10 June 1986, case 79/85, *Segers*, para. 6.

ulatory arbitrage".<sup>16</sup> The case concerned the attempt by a UK company to transfer its central management in the Netherlands, while retaining its British legal personality in order to save taxes. British authorities refused to give their consent to the transfer until an exit tax had been fully paid. Daily Mail challenged the refusal in front of a national court, claiming that it constituted a violation of the right to move the central management and control in another member States, as provided for by Treaty rules on the freedom of establishment. The Court rejected the claim, making clear that such rules, "properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State".<sup>17</sup>

However, around the year 2000 the Court adopted a series of judgments that "shook the foundations of European corporate law"<sup>18</sup> and, as far as the notion of establishment is concerned, reverted to the approach that was already latent in *Segers*. The first, and possibly the best-known, episode of the series is *Centros*, a case concerning the exercise of the freedom of establishment by a British company that had been set up by a Danish couple with the sole purpose of circumventing the Danish legislation on the paying up of the minimum share capital.<sup>19</sup> This was the reason why the competent Danish authorities had refused to register Centros' branch office. The Court rejected the claim put forward by the Danish Government according to which the situation had a purely internal character, falling outside freedom of establishment's scope of application. Pointedly, the Court posited that it is "immaterial" whether the company has been established in a country where it does not conduct any business and with sole purpose of benefiting from a laxer corporate law.<sup>20</sup> The only relevant element is that Centros has been formed in accordance with the UK legislation and has its registered office there.<sup>21</sup>

The Court stuck to the same interpretative approach in other subsequent judgments concerning the free movement of companies. The *Überseering* case concerned the acquisition by two Germans of all the shares of a Dutch company, which was then led to con-

<sup>16</sup> M. GELTER, *Centros, the Freedom of Establishment for Companies and the Court's Accidental Vision for Corporate Law*, in F. NICOLA, B. DAVIES (eds), *EU Law Stories. Contextual and Critical Histories of European Jurisprudence*, Cambridge: Cambridge University Press, 2017, p. 321.

<sup>17</sup> Court of Justice, judgment of 27 September 1988, case 81/87, *Daily Mail*, para. 25.

<sup>18</sup> M. GELTER, *Centros*, cit., p. 309.

<sup>19</sup> Court of Justice, judgment of 9 March 1999, case C-212/97, *Centros*, para. 18. The judgment attracted much attention by both legal scholars and Governments. As for the former, see, *ex multis*, K.E. SØRENSEN, *Prospects for European Company Law After the Judgment of the European Court of Justice in Centros Ltd*, in *Cambridge Yearbook of European Legal Studies*, 1999, p. 203 *et seq.*; S. DEAKIN, *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonization. A Law and Economics Perspective on Centros*, in *Cambridge Yearbook of European Legal Studies*, 1999, p. 231 *et seq.*; F. MUNARI, P. TERRILE, *The Centros Case and the Rise of an EC Market for Corporate Law*, in *Il Diritto dell'Unione Europea*, 2001, p. 1 *et seq.*

<sup>20</sup> *Centros*, cit., para. 17.

<sup>21</sup> *Ibid.*, paras 20-21.

duct all its business in Germany. German courts, adopting a strict interpretation of the real seat theory, denied the recognition of *Überseering* as a legal entity. The company challenged this reading, contending that it was incompatible with EU rules on freedom of establishment. In the preliminary proceeding before the Court, one of the intervening Member States contested the applicability of these rules to the case at hand, due to the lack of a real and continuous link with the economy of the home State.<sup>22</sup> The Court rejected the claim, contending that such requirement applies only when the company “has nothing but its registered office within the Community”.<sup>23</sup> The very same approach was adopted in *Inspire Art*, a judgment concerning the compatibility with the rules on freedom of establishment of a Dutch legal act establishing that the directors of formally foreign companies were jointly and severally liable if the company had not the minimum capital imposed by the Dutch legislation. Some Governments asserted that, in the case of companies not carrying out any substantial activity in the State where they are formally established, the setting up of a branch in another Member State ought to be regarded as a form of primary establishment, rather than a secondary one. The reasoning rested on the assumption that the purpose of the rules on freedom of establishment “is to enable undertakings carrying on activities in one Member States to achieve growth in another Member State, which is not so in the case of ‘brass-plate companies’”.<sup>24</sup> Once again, the Court resolutely dismissed this argument, reiterating that the fact that a company is formed in one Member State and then carries out its main, or even entire, business in another Member State is “irrelevant with regard to application of the rules on freedom of establishment”.<sup>25</sup> The Court made clear that this holds true even in those cases where the decision to establish in one Member State has the sole purpose of benefiting of more favourable legislation.<sup>26</sup> Therefore, the Court openly admitted that freedom of establishment can be legitimately used as a vehicle for regulatory competition, barring the sole cases where this is done fraudulently or abusively.

This case-law is not contradicted by those judgments concerning cross-border corporate mobility cited by AG Kokott to back her choice to link the notion of establishment to the exercise of a genuine economic activity in the host State. Admittedly, both in *Cadbury Schweppes* and *VALE*, the Court adopted an activity-based notion of establishment only when reviewing the justification of a restriction and not when defining the scope of application of the rules on freedom of establishment. This notwithstanding, writing before *Polbud*, some authors argued that this bore little relevance, since “[n]othing in the wording of both judgments suggest that the Court wishes to limit the

<sup>22</sup> Court of Justice, judgment of 5 November 2002, case C-208/00, *Überseering*, para. 74.

<sup>23</sup> *Ibid.*, para. 75.

<sup>24</sup> Court of Justice, judgment of 30 September 2003, case C-167/01, *Inspire Art*, paras 84-85.

<sup>25</sup> *Ibid.*, para. 95.

<sup>26</sup> *Ibid.*, para. 98.

impact of its interpretation".<sup>27</sup> In their view, these judgments had to be understood as reviving the criterion of the "actual pursuit of an economic activity", as elaborated in *Daily Mail*,<sup>28</sup> and, consequently, excluding from the scope of application of Treaty rules on freedom of establishment artificial incorporations aiming uniquely at benefiting from a more favourable legislation. This understanding is now untenable in the light of *Polbud*. Indeed, as seen above, the judgment made clear that freedom of establishment also protects cross-border conversions having the sole scope of modifying the law applicable to the corporation, although the transforming company has not even the intention to pursue an economic activity in the host Member State.<sup>29</sup>

Unlike in other cases, here the concept of establishment is not interpreted "so as to limit the risk of abuse".<sup>30</sup> This does not mean that EU law on freedom of establishment condones any corporate cross-border transformation having just an artificial character, but it certainly constrains Member States' capacity of reaction by making law shopping the rule and any measure seeking to limit it just an exception.

### III. LAW SHOPPING AS AN ABUSE OF THE RULES ON FREEDOM OF ESTABLISHMENT?

#### III.1. THE RESTRICTIVE READING OF THE DOCTRINE OF ABUSE IN CASES CONCERNING CROSS-BORDER TRANSFER OF COMPANIES

Member States intervening before the Court in the cases on free movement of companies constantly claimed that corporate transformations not involving the pursuit of an economic activity in the host State and aiming at circumventing the applicable national legislation amounted to an abuse. The claim has been advanced either (or both) to plead for the exclusion of these operations from the scope of application of the freedom of establishment or (and) to justify the adoption of restrictive measures thereon.

<sup>27</sup> J. MEEUSEN, *Freedom of Establishment*, cit., 318.

<sup>28</sup> See, more specifically, Opinion of AG Darmon delivered on 7 June 1988, case 81/87, *Daily Mail*, para. 3.

<sup>29</sup> See M. SZYDŁO, *Cross-Border Conversion of Companies under Freedom of Establishment: Polbud and Beyond*, in *Common Market Law Review*, 2018, p. 1557 *et seq.* The Author strongly supports the approach adopted by the Court, which, in his view, "does not mean abandoning the principle that freedom of establishment requires the actual pursuit of a genuine economic activity through a fixed establishment in the host Member State for an indefinite period". However, the attempt to reconcile *Polbud* with the case law that adopted an activity-based notion of establishment is unconvincing. Indeed, according to the Author, in *Polbud* the company was seeking to pursue an economic activity in the host State, which, after the conversion, has become its previous home Member State, i.e. Poland. However, this reasoning completely misses the fact that in this case the exercise of the freedom of establishment was not functional to the pursuit of the economic activity, which continued unaffected by the conversion.

<sup>30</sup> K.E. SØRENSEN, *Abuse of Rights in Community Law: A Principle of Substance or Merely Rhetoric?*, in *Common Market Law Review*, 2006, p. 428.

The notion of abuse is a frequent presence in the Court case law.<sup>31</sup> This notwithstanding, the recourse to this concept in the EU legal order is still controversial from a terminological, conceptual and operative perspective.<sup>32</sup> The fact that, as seen above, the notion of abuse is considered both as a reason to exclude the applicability of the relevant Treaty rules and as a valid ground to derogate from these rules speaks volumes in this regard. However, an in-depth examination of the reasons that explain this state of confusion lies well beyond the scope of this *Article*.

The prohibition to rely upon EU law for abusive or fraudulent ends is considered as a general principle of EU law.<sup>33</sup> Contrary to several Advocates General,<sup>34</sup> for quite some time the Court refused to admit it openly. It was only in *Kofoed*, a judgment of 2007 concerning the charging of income tax in respect of an exchange of shares, that the Court explicitly held that the prohibition of abuse of rights is “a general Community law principle”.<sup>35</sup>

Despite its initial reticence, the Court has played a major role in the consolidation of this principle, delineating, *inter alia*, the operational criteria for assessing the existence of an abuse. The landmark judgment in this regard is *Emsland-Stärke*, a case concerning a German company exporting potato-based products to Switzerland just to obtain an export refund, before immediately shipping them back to Germany to be put on the market. There the Court came to define the notion of abuse on the basis of two main elements.<sup>36</sup> The first one is the so-called *objective test*, according to which the “finding of an abuse requires [...] a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved”.<sup>37</sup> This element measures the distance between the formal respect of the rules and the substantive achievements of their aims, which lays at the core of the notion of abuse. The second element, the so-called *subjective test*, looks at “the intention to obtain an advantage from the Community rules by creating

<sup>31</sup> A. SAYDÉ, *Abuse of EU Law and Regulation of the Internal Market*, Oxford and Portland: Hart Publishing, 2016, p. 11 *et seq.* The Author observed that references to this notion, or related ones, can be found in one out of ten judgments and in one out of five opinions delivered by Advocate Generals.

<sup>32</sup> A. SAYDÉ, *Abuse of EU Law*, cit., p. 9; M. GESTRI, *Abuso del diritto e frode alla legge nell'ordinamento comunitario*, Milano: Giuffrè, 2003, p. 13 *et seq.*

<sup>33</sup> R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law: A New General Principle of EU Law?*, Oxford and Portland: Hart Publishing, 2011; D. TRIANTAFYLLOU, *L'interdiction des abus de droit en tant que principe général du droit communautaire*, in *Cahiers de Droit Européen*, 2002, p. 612 *et seq.*

<sup>34</sup> See, for instance, Opinion of AG La Pergola delivered on 16 July 1998, case C-212/97, *Centros*, para. 20. Admittedly, AG La Pergola also pointed out that “[i]t is however by no means easy to define the precise scope of that principle”.

<sup>35</sup> Court of Justice, judgment of 5 July 2007, case C-321/05, *Kofoed*, para. 38.

<sup>36</sup> Court of Justice, judgment of 14 December 2000, case C-110/99, *Emsland-Stärke*. On the test see specifically P. KOUTRAKOS, *The Emsland-Stärke Abuse of Law Test in the Law of Agriculture and Free Movement of Goods*, in R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law*, cit., p. 203 *et seq.*

<sup>37</sup> *Emsland-Stärke*, cit., para. 52.

artificially the conditions laid down for obtaining it".<sup>38</sup> Recourse to this second element has been criticized by some scholars, as well as by Advocates General. More specifically, AG Poiares Maduro in *Halifax* posited that the subjective intention of the economic operators is not decisive to assess an abuse and that 'the intentions of the parties to [...] obtain an advantage from [EU] law are merely inferable from the artificial character of the situation to be assessed in the light of a set of objective circumstances".<sup>39</sup> The judgment of the Court followed the suggestion of the AG and, without abandoning the two-step test, held that the objective to obtain a tax advantage is proven when it is "apparent from a number of objective factors".<sup>40</sup>

In the cases concerning the free movement of companies, the Court has generally adopted a very restrictive reading of the doctrine of abuse. While formally admitting the possibility for the Member States to invoke it in order to prevent economic operators to circumvent their legislation or obtain undue advantages through the application of EU law, *de facto* the Court closed off the doctrine of abuse almost entirely, even in cases concerning letter-box companies. Once again, it was *Centros* that set the tone. In that case, the Danish authorities claimed that forming a company in a less regulatory Member State with the sole purpose of circumventing the Danish legislation constituted an abuse and that, consequently, they had the right to refuse the registration of the branch. The Court rejected this claim, finding against the possibility to consider the behaviour of Mr and Mrs Bryde as having an abusive character under EU law. It did so by taking into account two main aspects.

First, it explicitly excluded that law shopping constitutes an abuse, making clear that "the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment".<sup>41</sup> Indeed, circumventing domestic rules governing the formation of companies fails to pass the objective test, as elaborated in *Emsland-Stärke*. According to the Court, this conduct is in line with the purpose of freedom of establishment, i.e. allowing economic operators to pick and choose the rules of company law that are more favourable to them and their business. The reasoning of the Court certifies the inclusion of the encouragement of law shopping, at least with regard to company law, within the objectives of the freedom of establishment.

Second, the Court rejected the claim according to which the absence of any meaningful economic activity could be considered as a proxy for the artificiality of the incorpora-

<sup>38</sup> *Ibid.*, para. 53.

<sup>39</sup> Opinion of AG Poiares Maduro delivered on 7 April 2005, case C-255/02, *Halifax*, paras 70-71.

<sup>40</sup> Court of Justice, judgment of 21 February 2006, case C-255/02, *Halifax* [GC], para. 75. See more specifically A. LENAERTS, *The General Principle of the Prohibition of Abuse of Rights: A Critical Position on Its Role in a Codified European Contract Law*, in *European Review of Private Law*, 2010, p. 1135 *et seq.*

<sup>41</sup> *Centros*, *cit.*, para. 27.

tion in the UK and, thus, warrant a finding of abuse. As well explained by Saydé, the artificiality requirement serves to “identify practices that are devoid of economic rationality, but for the regulatory benefit claimed”.<sup>42</sup> In this case, the fact that Centros never conducted any business in the UK and that all its activities were located in Denmark could be well taken as proofs of the artificial character of the situation and, thus, of its abusive nature. The Court decided otherwise, arguing that the absence of any meaningful economic activity in the State of incorporation “is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment”.<sup>43</sup>

The Court followed the same interpretative approach in other decisions concerning free movement of companies and evasion of national company law. In *Inspire Art*, for instance, it reiterated that setting up a company in a Member State with the sole purpose of benefiting from less restrictive company law rules is “inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty”.<sup>44</sup> Moreover, also in this case the Court explicitly excluded that lack of genuine economic activity in the State of incorporation could justify the adoption of restrictive measures by the State in which the company wished to open a branch to carry out all of its activities.<sup>45</sup>

### III.2. CROSS-BORDER-TRANSFERS OF COMPANIES AND WHOLLY ARTIFICIAL ARRANGEMENTS: THE RISE AND FALL OF A PARTIAL EXCEPTION TO THE RESTRICTIVE READING OF THE DOCTRINE OF ABUSE

The Court seemed to have steered a new course in *Cadbury Schweppes*, at least with regard to the possibility to consider law shopping as an abuse justifying the adoption of restrictive measures by the competent national authorities. The case concerned the UK Controlled Foreign Company (CFC) legislation then in force, which taxed resident companies on profits of subsidiaries established in a jurisdiction with a lower level of taxation, while exempting those with subsidiaries in the UK – even if more favourably taxed – or in jurisdiction with a higher level of taxation. Cadbury Schweppes Treasury International was a subsidiary of Cadbury Schweppes that has been established in Ireland. In the view of the referring court, the creation of the subsidiary was aimed at avoiding the application of certain UK tax provisions on exchange transactions and, more in general, to benefit from the Irish tax regime. Therefore, it asked the Court to clarify whether such a conduct could be considered as an abuse of the right of establishment and, thus, it justified the adoption of restrictive measures by the concerned Member State.

<sup>42</sup> A. SAYDÉ, *Abuse of EU Law*, cit., p. 84.

<sup>43</sup> *Centros*, cit., para. 29.

<sup>44</sup> *Inspire Art*, cit., para. 138.

<sup>45</sup> *Ibid.*, para. 139.

At first, the Court followed *Centros*, reiterating that the choice to form a company in a country with the sole purpose of benefiting from its legislation does not constitute abuse in itself.<sup>46</sup> Yet, the Court admitted that there may be cases when Member States are entitled to restrict the enjoyment of the right of establishment. In particular, the British Government, backed by many other intervening Member States, maintained that the measure intended to counter an abusive form of tax avoidance deriving from the artificial transfer of a resident company to a low-tax Member State through the establishment of a subsidiary there. The Court found that a national measure restricting freedom of establishment can be justified if it “relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the member State concerned”.<sup>47</sup> Quite remarkably, this finding is based on an understanding of the objective of the freedom of establishment that is at odds with the one elaborated in *Centros*. According to *Cadbury Schweppes*, the ultimate aim of this freedom is to allow a national of a Member State to participate on a stable basis to the economic life of another Member State, by carrying out an actual business therein. For good measure, the Court added that “the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period”.<sup>48</sup> Against this background, the creation of arrangements that do not reflect the economic reality and have the sole purpose of escaping the application of tax provisions is not in line with this objective and, consequently, have an abusive character that can justify the adoption by the Member States of measures restricting the right of establishment.

This was not the first time in which the Court referred to the notion of *wholly artificial arrangements*.<sup>49</sup> However, *Cadbury Schweppes* is the first case where the Court laid down the criteria to identify it. In particular, one needs to look at its physical existence in terms of premises, staff and equipment in the territory of the host Member State, so to assess whether the subsidiary carries out a genuine economic activity therein.<sup>50</sup> According to this judgment, the absence of an economic activity in the host State is what makes the arrangement wholly artificial and, thus, abusive under EU law.<sup>51</sup>

*Cadbury Schweppes* was very well received by commentators and even Advocates General, considering it, if compared with *Centros*, a more careful attempt to strike a balance between the competing interests at stake. Quite significantly, in his Opinion on *Cartesio*, AG Poiares Maduro affirmed that the judgment showed that “it may not always be possible to rely successfully on the right of establishment in order to establish

<sup>46</sup> *Cadbury Schweppes* [GC], cit., para. 37.

<sup>47</sup> *Ibid.*, para. 51.

<sup>48</sup> *Ibid.*, paras 53-54 (emphasis added).

<sup>49</sup> Court of Justice, judgment of 16 July 1998, case C-264/96, *ICI*, para. 26.

<sup>50</sup> *Cadbury Schweppes* [GC], cit., para. 67.

<sup>51</sup> *Ibid.*, para. 68.

a company nominally in another Member State for the sole purpose of circumventing one's own national company law" and that, consequently, it "represents a significant qualification of the rulings in *Centros* and *Inspire Art*".<sup>52</sup> Yet, it is doubtful whether, first, *Cadbury Schweppes*' deviation from previous case-law was so significant and, second, whether it actually intended to deviate from previous case-law.

As for the first aspect, it is worth considering that the *Cadbury Schweppes* formula sets quite a high threshold to prove abuse, by referring to *wholly* artificial arrangements. This is evident if one compares this notion of abuse with the one applied by the Court in other contexts, such as, for instance, in VAT cases. In *Halifax*, for instance, it held that abuse is established when "the essential aim of the transactions concerned is to obtain a tax advantage".<sup>53</sup> In *Part Service*, another VAT case, the Court explicitly ruled out the possibility to interpret "essential aim of the transaction" as meaning *sole purpose*, making clear that "there can be a finding of an abusive practice when the accrual of a tax advantage constitutes the principal aim of the transaction or transactions at issue".<sup>54</sup> Therefore, unlike in the context of free movement of companies,<sup>55</sup> in VAT cases an arrangement can be considered as having an abusive character "notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organisation or guarantee considerations".<sup>56</sup>

Second, the approach adopted by the Court in *Cadbury Schweppes* with regard to the possibility to invoke the doctrine of abuse to limit the use of freedom of establishment as a vehicle for law shopping can be reconciled with *Centros*. Indeed, the latter judgment made clear that Member States cannot limit the capacity of economic operators to freely choose their own legislation only with regard to the rules governing the formation of companies and not also those concerning the carrying on of certain trades, professions or businesses. Against this background, one could infer that national authorities still had the possibility to restrict freedom of establishment when this is

<sup>52</sup> Opinion of AG Poiares Maduro delivered on 22 May 2008, case C-210/06, *Cartesio*, para. 29.

<sup>53</sup> *Halifax*, cit., para. 75.

<sup>54</sup> Court of Justice, judgment of 21 February 2008, case C-425/06, *Part Service*, paras 44-45.

<sup>55</sup> For a further example of the strict standard applied by the Court in this context see Court of Justice, judgment of 17 September 2009, case C-182/08, *Glaxo Wellcome*, para. 100.

<sup>56</sup> *Part Service*, cit., para. 62. See also Court of Justice, judgment of 26 February 2019, joined cases C-116/16 and C-117/16, *T Danmark* [GC], para. 79, where the Court held that the setting up of empty financial arrangements would be abusive "even if the transactions at issue do not exclusively pursue such an aim, as the Court has held that the principle that abusive practices are prohibited applies, in tax matters, where the accrual of a tax advantage constitutes the essential aim of the transactions at issue". On the different standards used by the Court in the two contexts see more specifically K. LENAERTS, *The Concept of 'Abuse of Law' in the Case Law of the European Court of Justice on Direct Taxation*, in *Maastricht Journal of European and Comparative Law*, 2015, p. 342; F. VANISTENDAEL, *Cadbury Schweppes and Abuse from an EU Tax Law Perspective*, in R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law*, cit., p. 422.

used – or abused – in order to circumvent national tax legislation. *Cadbury Schweppes* confirmed this inference.

However, the distinction between the two sets of rules and, consequently, the two associated legal regimes is not as tight as expected. There have been cases where the Court turned to the *Centros* approach to deal with situations where economic operators were invoking freedom of establishment to escape from rules governing their activity and not their formation. *Viking* represents a fitting and troubling example in this regard. As it is well-known, the judgment concerned the decision by a Finnish company to reflag one of its vessels, by registering it in Estonia. The move had the sole purpose of modifying the law governing the wages of the crew, so to reduce them, without any change of physical establishment or cross-border movement. In *Cadbury Schweppes* terms, the reflagging could well be considered as a wholly artificial arrangement, having no other rationale than the extraction of a regulatory benefit deriving from the circumvention of the Finnish labour legislation. This notwithstanding, the Court did not even take into consideration the possibility that such transfer, entailing the use of a *flag of convenience*, could have an abusive character and, thus, justify the adoption of restrictive measures on this basis. As pointedly observed by Adams and Deakin, “*Viking* is the labour law equivalent to *Centros*”, in so far as “it validates the right of exit in the specific sense of a right to seek out an alternative, low-cost jurisdiction”.<sup>57</sup> By so doing, the Court went a step further in asserting that the promotion of regulatory competition is an objective of freedom of establishment, by making clear that the creation of a market for the rules does not concern only company law, but also labour law.

*Polbud* went in the same direction, extending the overly-restrictive notion of abuse elaborated in *Centros* in a case concerning the circumvention of national rules governing the activity of the company and not its formation. As seen above, the conversion of *Polbud* in a Luxembourg company had no other justification than the regulatory benefit obtained by choosing a more favourable tax legislation. This notwithstanding, the Court rejected the claim of the Polish Government according to which this practice was abusive and, thus, it justified the restriction of *Polbud*’s freedom of movement. The main problem does not lie with the conclusion adopted by the Court, but with the argumentative path taken to reach it. Indeed, it is hard to deny that the mandatory liquidation requirement prescribed by the Polish legislation had too wide a scope of application to be considered as a proportionate response to an abusive practice. As pointedly observed by the Court, such measure seems to establish a “general presumption of abuse”,<sup>58</sup> since it applies to any case in which a company transfers its registered office

<sup>57</sup> Z. ADAMS, S. DEAKIN, *Freedom of Establishment and Regulatory Competition*, in A. ARNULL, D. CHALMERS (eds), *The Oxford Handbook of European Union Law*, Oxford: Oxford University Press, 2015, p. 556.

<sup>58</sup> *Polbud* [GC], cit., para. 64.

from Poland to another Member State, without any consideration for the specific conditions in which the transfer takes place.

However, the Court referred to this argument just *ad abundantiam*, having already established that the decision of a company to move its registered office in another Member State “for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse”.<sup>59</sup> Apparently, the statement seems to simply reiterate what said in *Centros*, but, in reality, it goes further than that. Indeed, *Polbud* did not refer to “company law”, but to “legislation” in general terms. This means that law shopping is to be considered as one of the constitutive elements of freedom of establishment – and, consequently, not an abuse – not just when it concern the rules governing the formation of the company, but any legislation affecting its activities, such as, in the case at hand, tax law. Quite remarkably, in *Polbud* the Court did not even take into account whether incorporating a company under Luxembourg law without it carrying out any economic activity there could be considered as a “wholly artificial arrangement” and, thus, justify the adoption of restrictive measures.

#### IV. CROSS-BORDER TRANSFER OF COMPANIES AND REGULATORY COMPETITION: THE LEGISLATIVE RESPONSE. SOME CONCLUSIVE REMARKS

The analysis demonstrated that the Court has come to consider regulatory competition, even in its extreme forms, an objective of EU provisions on freedom of establishment, at least with regard to cross-border movement of companies. More specifically, the transfer of a company aiming uniquely at changing its legal clothes, without any intention to pursue an economic activities in the host Member State, not only falls within the scope of application of Arts 49 and 54 TFUE, but also enjoys an increased level of protection when it comes to the capacity of the Member States to adopt restrictive measures. This is particularly evident in the overly restrictive reading of the doctrine of abuse adopted by the Court in this context. In *Centros*, the Court ruled out the applicability of the doctrine by finding that setting up a company in a Member State with the sole purpose of benefiting from a less restrictive corporate law fails to pass the so-called objective test, being perfectly in line with the objective of freedom of establishment. The judgment made clear that this interpretative approach only applied in those cases where law shopping concerns rules governing the formation of companies and not also those governing their activity. Building on this distinction and adopting a more activity-related reading of the notion of establishment, *Cadbury Schweppes* admitted the possibility to consider as an abuse the creation of “wholly artificial arrangements for circumventing the tax legislation of a Member State”. Yet, subsequent case-law set aside this distinction, relying on *Centros* in cases where the transfer aimed at extracting a

<sup>59</sup> *Ibid.*, para. 62.

regulatory benefit deriving from the circumvention of rules concerning the activity of the company, and not its formation. This was the case of *Viking* and, more recently, *Polbud*, where the Court did not even consider whether incorporating a letter-box company in Luxembourg just to pay less taxes could be considered as a “wholly artificial arrangement” and consequently, having an abusive character.

The Court found no constraints in EU secondary law to its capacity to adopt a broad notion of freedom of establishment, advancing the proposition according to which such freedom can be used as a vehicle for unrestricted regulatory competition. At first, the Court considered the lack of a legislative act regulating this issue as a reason for caution and self-restraint. In *Daily Mail*, for instance, it argued that “the question whether – and if so how – the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions”.<sup>60</sup> Conversely, in *Centros* the Court completely changed its attitude, noting that “the fact that company law is not completely harmonised in the Community is of little consequence”.<sup>61</sup>

Since the late '60s, the EU has embarked in an extensive programme of corporate law harmonization, adopting several directives that touch upon different issues.<sup>62</sup> The aim of such programme was twofold seeking, on the one hand, to create the conditions for the full enjoyment of the freedom of establishment by companies and, on the other, to avoid – or, at least, to limit – regulatory competition. In this regard, some commentators argued that harmonization was considered as a *quid pro quo* for granting the right of establishment also to companies.<sup>63</sup> The harmonization of the rules on the transfer of companies was one of the key components of the harmonization programme, but, this notwithstanding, it has never seen the light of the day. The adoption of a directive on cross-border transfer of the registered office (the 14<sup>th</sup> Company Law Directive) was one of the short-term priorities of the 2003 Commission Action Plan on Modernising Company Law.<sup>64</sup> At that time, three consecutive rounds of consultations showed broad support for the adoption of the directive.<sup>65</sup> Yet, in 2007 the Commission decided not to table a proposal, citing

<sup>60</sup> *Daily Mail*, cit., paras 22-23.

<sup>61</sup> *Centros*, cit., para. 28.

<sup>62</sup> M. GELTER, *Centros*, cit., p. 311 *et seq.* See also L. ENRIQUES, *A Harmonized European Company Law: Are We There Already?*, in *International and Comparative Law Quarterly*, 2017, p. 763 *et seq.*

<sup>63</sup> C.W.A. TIMMERMANS, *Methods and Tools for Integration. Report*, in R.M. BUXBAUM, A. HIRSCH, K.J. HOPT (eds), *European Business Law: Legal and Economic Analyses on Integration and Harmonization*, Berlin, New York: De Gruyter, 1996, p. 132.

<sup>64</sup> Communication from the Commission to the Council and the European Parliament of 21 May 2003, *Modernising Company Law and Enhancing Corporate Governance – A Plan to Move Forward*, COM(2003) 284 final.

<sup>65</sup> See G.-J. VOSSENSTEIN, *Modernization of European Company Law and Corporate Governance. Some Considerations on its Legal Limits*, Alphen aan den Rijn: Kluwer Law International, 2010, p. 34 *et seq.*

as main reasons the lack of political consensus among the Member States, the absence of a strong economic case and the existence of other legal tools, such as the European Company Statute or the Cross-Border Merger Directive, that can be used to transfer the seat.<sup>66</sup> The decision to drop the proposal was not well received by the European Parliament, which kept pressing the Commission toward the adoption of a proposal on cross-border transfer of seat, detailing a list of recommendations to be followed.<sup>67</sup>

In 2018, the Commission bowed to the pressure, presenting a proposal for a Directive amending Directive (EU) 2017/1132 regarding cross-border conversions, mergers and divisions.<sup>68</sup> Building on European Parliament's recommendations, the Proposal sets both procedural and substantive rules on cross-border conversions with the aim of fostering companies' cross-border mobility and, at the same time, protecting those affected by the conversion. The explanatory memorandum admitted that the *Polbud* judgment represented a turning point in the process toward the harmonization of the rules governing cross-border transformations. According to the Commission, the judgment confirmed the right of companies to convert cross-border, even in cases where there is no intention to carry out any business in the host State, but, at the same time, made more urgent a legislative intervention on the matter. Indeed, the "ECJ, being a judiciary organ, may not create any procedure for making such conversions possible or set out the related substantive conditions".<sup>69</sup>

Once adopted, the Directive would grant to limited liability companies<sup>70</sup> the right to carry out a cross-border conversion without losing their legal personality. To this end, the converting company has to go through quite a complex screening procedure that sees the participation of authorities from both the departure and the destination Member State, as well as external experts. The first step of the procedure is the preparation by the management of the company of the draft terms of cross-border conversion, as well as of two reports detailing, first, "the legal and economic aspects of the cross-border conversion" and, second, the implications of the conversion on the safeguarding

<sup>66</sup> See G.-J. VOSSESTEIN, *Transfer of the Registered Office. The European Commission's Decision not to Submit a Proposal for a Directive*, in *Utrecht Law Review*, 2008, p. 53 *et seq.*

<sup>67</sup> See European Parliament Resolution 2011/2046(INI) of 2 February 2012 with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats.

<sup>68</sup> Proposal for a Directive of the European Parliament and the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM(2018)241 final.

<sup>69</sup> Proposal for a Directive COM(2018)241 final, explanatory memorandum, p. 3.

<sup>70</sup> Art. 86c of the Proposal establishes that companies cannot carry out a transborder conversion when: (a) proceedings have been instituted for the winding-up, liquidation, or insolvency of that company; (b) the company is subject to preventive restructuring proceedings initiated because of the likelihood of insolvency; (c) the suspension of payments is on-going; (d) the company is subject to resolution tools, powers and mechanisms provided for in Title IV of Directive 2014/59/EU of the European Parliament and of the Council; (e) preventive measures have been taken by the national authorities to avoid the initiation of proceedings referred to in points (a), (b) or (d)".

of employment relationship and the conditions of employment. The draft terms and the reports are evaluated by an independent expert appointed by the competent authorities of the departure Member State.<sup>71</sup> The expert has to draw up a report containing a detailed assessment of the conversion and, to this end, he has to be entitled to obtain all relevant information and documents and to carry out all necessary investigations to verify all elements of the draft terms or management reports.<sup>72</sup> Subsequently, the draft terms of conversion have to be approved by the general meeting of the company, by also taking into consideration the reports adopted by the management and one of the independent expert.<sup>73</sup> At that point, the competent authorities of the departure Member State can issue a pre-conversion certificate, so to attest compliance with all the relevant conditions and the proper completion of all procedures and formalities. The decision to issue or, more probably, to refuse the certificate has to be amenable to judicial review. The last part of the procedure is far less burdensome, concerning the destination State. Here, the designated authorities have to assess the completion of its procedures and formalities, confirm receipt of the pre-conversion certification and, ultimately, formally approve the conversion.<sup>74</sup>

One of the main objectives of the screening procedure or, at least, of the part under the jurisdiction of the departure Member State is to avoid that cross-border conversions are used as a tool for law shopping. According to Art. 86c, para. 3, of the Proposal, the competent authority of the departure Member State “shall not authorise the cross-border conversion where it determines that it constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members”. The independent expert is called upon to provide the competent authorities all the relevant factual information to make this assessment and, “at a minimum”: the characteristics of the establishment in the destination Member State, including the intent, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due and the commercial risks assumed by the converted company in the destination Member State and the departure Member State. All these elements need to be taken into account by the competent authorities of the departure Member State in the in-depth assessment carried out to determine whether the conversion constitute an artificial arrangement and, thus, in deciding whether to issue a pre-conversion certificate.<sup>75</sup>

<sup>71</sup> Art. 86g, para. 6, of the Proposal exempts from this duty “micro” and “small enterprises” as defined in Commission Recommendation 2003/361/EC.

<sup>72</sup> *Ibid.*, Art. 86g, para. 4.

<sup>73</sup> *Ibid.*, Art. 86i.

<sup>74</sup> *Ibid.*, Art. 86p.

<sup>75</sup> *Ibid.*, Art. 86n.

The main problem is that, despite the complexity of the procedure and the apparent detail of the substantive conditions, these provisions look quite timid and confused in addressing the problem of the use – or abuse – of free movement of companies as a way to foster regulatory competition. First, Recital 3 of the Preamble fully endorses the proposition according to which the rules on freedom of establishment apply even when the conversion is not functional to the exercise of an economic activity in the destination Member State or, in other words, when the cross-border transfer aims to create a letter-box company. To this end, the Proposal explicitly upholds the over-broad reading of the notion of establishment adopted by the Court in *Polbud* and, implicitly, it advances the idea that the removal of barriers within the internal market is not intended just to facilitate cross-border economic activities, but also to encourage unhindered regulatory competition.

At the same time, the Proposal acknowledges that freedom of establishment – and companies' right to convert therein – can “be used for abusive purposes such as for the circumvention of labour standards, social security payments, tax obligations, creditors', minority shareholders' rights or rules on employees' participation”.<sup>76</sup> To avoid such risk, the Proposal imposes to the departure Member State to refuse the authorization to the conversion where it determines that the operation “constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members”.<sup>77</sup>

The provision only apparently reproduces the formula used in *Cadbury Schweppes*, introducing some elements of novelty that add to the confusion and, ultimately, could enable the Court to further constrain the capacity of Member States to take action against artificial arrangements. As seen above, the key point in *Cadbury Schweppes* was whether the arrangement made any sense from an economic point of view or whether its only rationale was to obtain a regulatory gain. In that case, the Court opted for a more restrictive approach than in other contexts, holding that only *wholly* artificial arrangements could be considered as having an abusive nature. The Proposal drops the reference to the fact that the conversion has to pursue no other objectives than obtaining regulatory benefits, pointing instead to other elements. Indeed, before refusing to authorize a cross-border conversion, departure Member States have to prove something more, i.e. that the arrangement is set to generate *undue* benefits or that it has *unduly* negative effects on the rights of the affected workers, creditors or minority members. The Proposal does not offer any clarification on how to identify the moment in which a tax advantage or an injury become undue. It is unclear, for instance, whether it is just a quantitative matter: Member States are due to tolerate up to a certain – unspecified – point and, once this threshold is passed, they can intervene. This state of uncertainty potentially leaves the Court with a wide margin of action, allowing it to stretch the notion of *undue* as an accordion and, quite

<sup>76</sup> *Ibid.*, Recital 7.

<sup>77</sup> *Ibid.*, Art. 86c, para. 3.

likely, to reduce the capacity of departure Member States to block a cross-border conversion. Indeed, one can argue that the provision can be interpreted in the sense that Member States cannot refuse to authorize a cross-border conversion even if it is a wholly artificial arrangement, in so far as it does not generate undue tax advantages for the company or it unduly prejudices the rights of the workers.

Overall, the Commission's Proposal is very much in line with the case-law of the Court when it comes to the relationship between the promotion of freedom of establishment and the safeguard of competing interests with specific regard to cross-border movement of companies. Both institutions tend to prioritize the former over the latter, by making the possibility of choosing the most favourable legislation one of the objectives of the rules on freedom of establishment. Moreover, they both purport to limit the capacity of the Member States to adopt restrictive measures, even in cases where the cross-border transfer is devoid of economic rationality and the competition does not just involve the rules on the incorporation of companies, but also those regulating their activity. In this context, the respect for the integrity of national tax systems or the safeguard of the rights of the workers affected by the cross-border conversion are just second-tier objectives when compared with the right of companies to freely choose their legal clothes.





## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## DO ENVIRONMENTAL RULES AND STANDARDS AFFECT FIRMS' COMPETITIVE ABILITY?

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ABSTRACT: The *Article* considers whether EU environmental standards are relevant for the competitiveness of our firms and analyses this phenomenon under the lenses of EU law and case-law as developed through the decades. Starting from the first environmental rules adopted by the EEC prior to the conferral of competences in this field by the Member States to the Community in order to remove "non-tariff barriers" to trade within the (old) common market, the analysis moves to the implications for EU firms of EU environmental standards as they have been established within the EU environmental policy and consistently with the goal of a high level of environmental protection within the EU. The analysis seems to show that within the EU a race to the bottom never occurred; on the contrary, the EU comprehensive legislation on environmental purposes based on the duty to comply with high environmental standards has improved EU firms' competitiveness in the global markets. Given these results, the author welcomes recent EU initiatives aimed at adopting unilateral "extraterritorial" environmental standards applicable to non-EU firms engaged in trade with the EU, or to negotiate high environmental standards within trade agreements executed between the EU and third countries.

KEYWORDS: competitive regulation – environmental protection – European Union – international trade free trade agreements – WTO.

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## I. THE ECONOMIC BACKGROUND

The enactment of any rule, because of its intrinsic nature, modifies or constraints behaviours compared to the previously existent legal environment. In order to comply with this rule, its addressees must therefore change the patterns of their activities to adapt them to the regime it sets out: in other words, any rule normally sets standards of behaviours to their addressees that become mandatory (or recommended) upon the entry into force of this rule.

Rules are often introduced to improve previously existing standards: for instance, the increase of data protection treatment for better safeguarding individual rights in the “big data” era, or the reduction of greenhouse gases emissions by vehicles. When such phenomena take place, addressees of these rules must undergo an adaptation process of their past behaviours, and this often entails the need to carry out investments or sustain expenses. If only some persons are the addressees of this rule, which leaves other persons unaffected, only the former are subject to the need to change their conducts or past practices. If these persons are firms operating in the same market, this rule will therefore introduce a relative variation in the competitive environment affecting them.

Economists have extensively debated the impact of regulation on firms’ ability to compete, and have analysed this phenomenon under different viewpoints: the inter-individual level, the industry-level, as well as, within a transnational context, the domestic level *vis-à-vis* other States’ economies.<sup>1</sup>

Many areas of law have been investigated and, among the most celebrated ones, the environmental one is surely at the forefront, in particular with regard to environmental regulation. While it is certain that any human activity has an impact on the envi-

<sup>1</sup> For a general overview, and for further bibliographic references, see J. BHAGWATI, R.P. HUDEC (eds), *Fair Trade and Harmonization: Prerequisites for Free Trade*, Vol. 1, Cambridge and London: MIT Press, 1996; J.D. WILSON, *Theories of Tax Competition*, in *National Tax Journal*, 1999, p. 269 *et seq.*; E. WUBBEN, *What's in it for Us? Or: The Impact of Environmental Legislation on Competitiveness*, in *Business Strategy and the Environment*, 1999, p. 95 *et seq.*; W.E. OATES, *A Reconsideration of Environmental Federalism*, in *Resources for the Future Discussion Paper*, no. 54, 2001, available at [pdfs.semanticscholar.org](https://pdfs.semanticscholar.org); J. URPELAINEN, *Regulation Under Economic Globalization*, in *International Studies Quarterly*, 2010, p. 1099 *et seq.*; E. WILLIAMS, K. MACDONALD, V. KIND, *Unravelling the Competitiveness Debate*, in *European Environment*, 2002, p. 284 *et seq.* More focussed on environmental competitive regulation are the works by D.C. ESTY, M.E. PORTER, *Industrial Ecology and Competitiveness*, in *Journal of Industrial Ecology*, 1998, p. 35 *et seq.*; A. LEVINSON, *Environmental Regulatory Competition: A Status Report and Some New Evidence*, in *National Tax Journal*, 2003, p. 91 *et seq.*; D.M. KONISKY, *Regulatory Competition and Environmental Enforcement: Is There a Race to the Bottom?*, in *American Journal of Political Science*, 2007, p. 853 *et seq.*; F. IRALDO, F. TESTA, M. MELIS, M. FREY, *A Literature Review on the Links Between Environmental Regulation and Competitiveness*, in *Environmental Policy and Governance*, 2011, p. 210 *et seq.*; T. KOZLUK, V. ZIPPERER, *Environmental Policies and Productivity Growth A Critical Review of Empirical Findings*, in *OECD Journal Economic Studies*, 2015, p. 155 *et seq.*; V. HEYVAERT, *Regulatory Competition Accounting For the Transnational Dimension of Environmental Regulation*, in *Journal of Environmental Law*, 2013, p. 1 *et seq.*

ronment (i.e. bears an environmental footprint),<sup>2</sup> it goes without saying that also environmental rules and standards have an impact on firms' behaviours. Therefore, especially in an open or globalised market perspective, the evaluation of such an impact is essential for policymakers.

The scope and limits of this *Article* do not allow a thorough economic analysis on regulatory competition in the environmental sector; rather, this short essay is focussed exclusively on the inter-State (or inter-regional) viewpoint. From this viewpoint, three options are essentially debated among economists.

The first one, also known as the neo-classical approach, assumes that in an open market situation, firms will be negatively affected by the adoption of environmental regulations, i.e. rules that enhance environmental standards for firms operating in a given legal system which competes with other firms subject to other and more relaxed standards; this will eventually determine a race to the bottom situation: unless harmonised environmental rules creating universal standards have been agreed among all legal systems whose firms compete in the same markets, those systems enjoying lower environmental standards will cause their firms to be more competitive compared to the peers located in States having more stringent environmental legislations.<sup>3</sup>

A second view (also known as the "revisionist" one) implies on the contrary that the enactment of rules introducing tighter environmental standards will produce a race to the top effect: more precisely, firms that are addressees of these rules will eventually be given a competitive advantage *vis-à-vis* their competitors who are not subject to these rules, mainly due to the need of the former to enhance technology to meet the new standards and produce superior qualitative output which, in the end, is preferred by buyers/consumers worldwide. Also known as the "Porter Hypothesis", named after the economist who has developed it,<sup>4</sup> this theory has obvious implications for enhancing environmental standards while at the same time fostering the overall competitiveness of a national or regional economy.

A third approach is the "resource-based view", taking a more cautious stance: in particular, it advocates that the outcome of an environmental regulation on the firms' competitive ability will eventually depend on the measures that lawmakers use; there-

<sup>2</sup> In addition to the authors quoted above, footnote 1, see F. MUNARI, L. SCHIANO DI PEPE, *Tutela transnazionale dell'ambiente*, Bologna: Il Mulino, 2012, p. 12 and *passim*; P. FICCO, *Il Rapporto tra ambiente e competitività. L'impatto sulle attività delle imprese*, in *Amministrazione in cammino*, 2005, p. 1 *et seq.*

<sup>3</sup> Cf. e.g. W. GRAY, R. SHADBEGIAN, *Plant Vintage, Technology, and Environmental Regulation*, in *Journal of Environmental Economics and Management*, 2003, p. 384 *et seq.*

<sup>4</sup> M.E. PORTER, *America's Green Strategy*, in *Scientific American*, 1991, p. 168 *et seq.*; M.E. PORTER, C. VAN DER LINDE, *Green and Competitive: Ending the Stalemate*, in *Harvard Business Review*, 1995, p. 120 *et seq.*; M.E. PORTER, C. VAN DER LINDE, *Toward a New Conception of the Environment Competitiveness Relationship*, in *Journal of Economic Perspectives*, 1995, p. 97 *et seq.*

fore, before advancing general conclusions, one should carry out a more sophisticated analysis concerning the implications of any such measure.<sup>5</sup>

Neither of the three alternatives above seems clearly prevailing in the economic literature, and in fact no decisive evidence seems to exist showing that environmental costs are an important factor for firms when taking a decision concerning the legal system in which they can locate their production.<sup>6</sup> Indeed, and with the probable exception of few economic sectors, there is little evidence that firms decide to move their production in countries where lower environmental standards prevail, and hence lower costs must be taken into account to be compliant with stricter environmental standards; for instance, taxation and labour costs have a much more substantial impact for multinational firms in their decision to select one country or another one for the purposes of establishing their centre of main interests, headquarters or production facilities.

## II. *ECONOMICS V. LAW: A DIFFERENT APPROACH*

The above paragraph considered economists' viewpoint: in the legal discourse the analysis is not limited to a mere cost-benefit analysis, but it also considers "values" that – albeit possibly becoming relevant also within an economic discourse – are not limited to firms' competitiveness. These values may be inspired by non (immediate) economic goals and consider also the normative situation as it globally stands.

Hence, a correct legal approach to environmental regulation in open markets would assume, in the first place, that if environmental protection is a mandatory obligation for the survival of the planet, of humans and of (as many as possible) other living species, then this obligation must be complied with by means of environmental legislation, no matter – at least in principle – what its implications for the firms can be. For instance, if a global agreement is reached to ban whale hunting for whatever reason, then the sort of whale hunters as business persons becomes substantially irrelevant.

In the second place, generally environmental legislation at domestic, regional and – not infrequently – universal level exists already; this provides a conclusive evidence that firms do not operate in a legal "vacuum". Therefore, environmental regulation already poses specific costs and constraints that firms take into account (and pay) when doing business. If this is true, the legal analysis can, at best, investigate on the degree and effectiveness of relevant pieces of legislation. However, since all firms are subject to (varying) costs imposed by the need to comply with (locally or internationally set) environmental standards, it can be safely assumed that environmental regulation is rarely able

<sup>5</sup> See e.g. and for further references, F. IRALDO, F. TESTA, M. MELIS, M. FREY, *A Literature Review on the Links Between Environmental Regulation and Competitiveness*, cit.; D.M. KONISKY, *Regulatory Competition and Environmental Enforcement: Is There a Race to the Bottom?*, cit.

<sup>6</sup> See K. HOLZINGER, T. SOMMERER, *'Race to the Bottom' or 'Race to Brussels'? Environmental Competition in Europe*, in *Journal of Common Market Studies*, 2011, p. 315 *et seq.*, also for further references.

to make production shift from one State to another one because of its potential impact on the overall competitiveness of a firm. There may be emblematic exceptions, such as the ship dismantling industry,<sup>7</sup> but normally the differences between environmental standards are not perceived as a clear obstacle to competition in open markets.

This said, one must be aware that the above conclusion works as a rule of thumb; therefore, some further insights seem opportune in order to assess whether a fine-tuning can lead to more conclusive reflections; in so doing, the EU legal perspective appears to be particularly interesting.

### III. THE *EVOLUTION* OF EU ENVIRONMENTAL LAW: FROM A NEO-CLASSICAL VISION TO THE PRECAUTIONARY PRINCIPLE

Originally, the then EEC had no competences in the environmental sphere;<sup>8</sup> they have been conferred to the European Communities with the Single European Act and have been gradually strengthened with subsequent European treaties. However, even before these powers had been formally entrusted to the EEC, some measures were adopted at European level. Their rationale (and legal basis) was that different environmental costs of firms arising out of non-harmonised national environmental standards would affect firms' ability to compete in the common market, with specific regard to the free movement of goods and services.<sup>9</sup> In other words, a neo-classical approach was clearly underlying these measures, which permitted the adoption of both *a*) political documents and *b*) pieces of legislation.

In the first category, it is worth noting the first Environment Action Programme of 1972, which was adopted in the same year in which the United Nations Conference on Human Environment (UNCHE) took place: such Programme was based on the ideas that prevention is better than cure and that the "polluter pays" principle should be applied. This Programme also recommended Member States to establish a Ministry for the pro-

<sup>7</sup> H.H. HILLYER, *The Hard Reality of Breaking Up: The Global Transboundary Movement of Ocean Vessel Demolition and Waste*, in *Vermont Journal of Environmental Law*, 2012, p. 755 *et seq.*; J.K. CHOI, D. KELLEY, S. MURPHY, D. THANGAMANI, *Economic and Environmental Perspectives of End-of-life Ship*, in *Resources, Conservation and Recycling*, 2016, p. 82 *et seq.*

<sup>8</sup> On this issue see N. DE SADELEER, *Environmental Governance and the Legal Bases Conundrum*, in *Yearbook of European Law*, 2012, p. 1 *et seq.*; P. PUGH, *The Battle on Environmental Policy Competences. Challenging the Stricter Approach: Stricter Might Lead to Weaker Protection*, in R. MACRORY (ed.), *Reflections on 30 Years of EU Environmental Law*, Groningen: Europa Law Publishing, 2006, p. 10 *et seq.*; O. PORCHIA, *Tutela dell'ambiente e competenze dell'Unione europea*, in *Rivista Italiana di Diritto Pubblico Comunitario*, 2006, p. 17 *et seq.*

<sup>9</sup> On this topic see C. PONCELET, *Free Movement of Goods and Environmental Protection in EU Law: A Troubled Relationship?*, in *International Community Law Review*, 2013, p. 171 *et seq.*; H. TEMMINK, *From Danish Bottles to Danish Bees: The Dynamics of Free Movement of Goods and Environmental Protection – A Case Law Analysis*, in *Yearbook of European Environmental Law*, 2000, p. 61 *et seq.*

tection of the environment as an institutional tool to start coordinating and governing the respective environmental policies at national level.

Secondly, and as far as pieces of legislations are concerned, reference must be made to the harmonisation instruments adopted pursuant to Art. 100 EEC (now 114 TFEU), concerning national laws having direct influence on the creation or functioning of the common market.<sup>10</sup> When more ambitious goals had to be achieved, such as the adoption of a frame regime on wild birds, or on seals hunting, Art. 235 EEC (now 352 TFEU) was used.<sup>11</sup>

Aside of that, however, even prior to any entrusting to the then EEC of environmental competences, the Court of Justice did not miss the occasion to establish that “environmental protection [...] is one of the Communities’ essential objectives”,<sup>12</sup> thus limiting the freedom to trade waste oils products which could be dangerous for the environment.

When the Single European Act conferred the EEC powers to enact environmental rules, times were however not ripe to have a clear understanding of the footprint that environmental rules would have determined on the Communities’ legal system.<sup>13</sup> Thus, Art. 130r.4 EEC conferred powers to the EC as long as “the objectives [concerning environmental protection] can be attained better at Community level than at the level of the individual Member States. Without prejudice to certain measures of a Community nature, the Member States shall finance and implement the other measures”. On a side note, this was the first occasion in which the EU treaties explicitly set out (a criterion

<sup>10</sup> See e.g. the Council Directive 79/923/EEC of 30 October 1979 on the quality required of shellfish waters, no longer in force and now replaced by Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy; the Council Directive 84/360/EEC of 28 June 1984 on the combating of air pollution from industrial plants, whose regime is now provided for by Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control); and especially the first waste framework directive (Council Directive 75/442/EEC of 15 July 1975), now replaced by Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008 on waste and repealing certain Directives. See N. DE SADELEER, *Environnement et marché intérieur*, Bruxelles: Editions de l'Université de Bruxelles, 2010; A.R. ZIEGLER, *Trade and Environmental Law in the European Community*, Oxford: Clarendon Press, 1996.

<sup>11</sup> See the Council Directive 79/409 on the conservation of wild birds, now repealed by the Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009, and the Council Directive 83/129/EEC of 28 March 1983 concerning the importation into Member States of skins of certain seal pups and products derived therefrom.

<sup>12</sup> See Court of Justice, judgment of 7 February 1985, case 240/83, *Procureur de la République v. Association de défense des brûleurs d'huiles usagées (ADBHU)*, para. 13.

<sup>13</sup> On the relation between the Single European Act and the environment see *inter alia* C.D. EHLERMANN, *The Internal Market Following the SEA*, in *Common Market Law Review*, 1987, p. 398 *et seq.*; D. VANDERMEERSCH, *The Single European Act and the Environmental Policy of the European Economic Community*, in *European Law Review*, 1987, p. 407 *et seq.*; L. KRAMER, *The Single European Act and Environmental Protection: Reflections on Several New Provisions in Community Law*, in *Common Market Law Review*, 1987, p. 659 *et seq.*

that later on would become) subsidiarity as a tool to allocate powers between the EC/EU and the Member States.<sup>14</sup>

As said, the idea of leaving room to Member States in order to allow them to legislate on environmental purposes was probably due to the limited experience gained by legal scholars and policymakers on the then fairly new subject-matter concerning environmental protection. And yet, one cannot deny that, in those years, it was still debated whether the enactment of EU "selected" legislation to protect the environment would have implied distortions of trade or even breach of competition rules. In this sense, as we shall better see below, the *Bettati* judgment is a very clear example of the fears existing in the early EEC years, i.e. that different environmental standards at European level would affect trade among States.<sup>15</sup>

This said, Art. 130r EEC already envisaged, *inter alia*, the full catalogue of the backbone principles provided for by transnational environmental law, such as the precautionary principle, the principle of preventive action, the principle mandating that environmental damage should as a priority be rectified at source, and finally the polluter pays principle.

This after having anyway clarified that the EC environmental "should take into account the diversity of situations in the various regions of the Community". The meaning of this sentence can be manifold, but for sure it allows (or more precisely, it allowed) room for regulatory competition at Member States' level, as we shall see in a while.

#### IV. THE INTENSITY OF EU ENVIRONMENTAL PROTECTION AND ITS CAPABILITY TO AFFECT EU FIRMS' ABILITY TO COMPETE

The above criteria are still in place. They are completed by another principle which is relevant for our purposes, i.e. the one establishing that EU law and policy must "aim at a high level of protection" of the environment.<sup>16</sup>

As a matter of fact, this principle has always remained literally unchanged since the Single European Act; however, it has progressively shifted towards a more rigorous interpretation: in the first years of implementation of the EU environmental policy, the Court of Justice endorsed the view that the EU legislator complied with the above legislative criterion when the EU measure was at least as protective as the existing international standards.

Quite probably, the rationale behind this approach was still linked to the room that apparently Member States had in shaping more ambitious environmental goals than those enacted at European level, this permitting regulatory competition. Again, such a

<sup>14</sup> On the relation between the principle of subsidiarity and the environment see *inter alia* J. VAN ZEBEN, *Subsidiarity in European Environmental Law: A Competence Allocation Approach*, in *Harvard Environmental Law Review*, 2014, p. 415 *et seq.*; L. BRINKHORST, *Subsidiarity and European Community Environmental Policy. A Pandora's Box*, in *European Law Review*, 1991, p. 20 *et seq.*

<sup>15</sup> Court of Justice, judgment of 14 July 1998, case C-341/95 *Bettati v. Safety High-Tech*.

<sup>16</sup> This principle is still in force, and is now codified by Arts 3, para. 3, TEU and 191, para. 2, TFEU.

conclusion seems confirmed by the *Bettati* judgment, where the Court excluded that the high level of protection mentioned in Art. 130r EEC would not necessarily require to be the highest that is technically possible, this being a choice left to the Member States, which were entitled – if they so wished – to maintain or introduce more stringent protective measures than those adopted at EC level.<sup>17</sup>

After many years of EU environmental legislation,<sup>18</sup> we may however wonder whether this has ever been the case.

Indeed, the *Bettati* judgment leaves room to believe that, in those years, the provision now embodied in Art. 191, para. 2, TFEU (i.e. the “*Union policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Union*”)<sup>19</sup> was never intended to permit regulatory competition among Member States on domestic environmental policies; rather, more probably this provision would have allowed a race to the top, thus allowing States to implement more courageous environmental policies than those politically available at Community level.

However, as a matter of fact, the original concern – if ever existed – that EU environmental law would leave room for Member States to enhance their domestic environmental standards, or maintain lower standards for whatever purposes, did not materialise. As effectively pointed out, the transfer of environmental competences from States to the Union determined a vast implementation of an EU environmental policy, aiming at harmonising standards among Member States. Hence, neither a race to the top nor a race to the bottom occurred; rather the outcome was a ... race to Brussels, where all stakeholders urged the EU to adopt uniform environmental rules valid throughout all Member States.<sup>20</sup>

It is hard to understand whether this consequence derived also from the existence of specific remedies available under EU law, such as the infringement procedure now established by Art. 258 TFEU: this provision offers, in fact, the most powerful tool to grant a “vertical governance” concerning transnational environmental law at EU level,

<sup>17</sup> See *Bettati*, cit., para. 47. See J.H. JANS, *Gold Plating of European Environmental Measures?*, in *Journal for European Environmental and Planning Law*, 2009, p. 417 *et seq.*

<sup>18</sup> On EU environmental policy see generally N. HAIGH, *EU Environmental Policy. Its Journey to Centre Stage*, London, New York: Routledge, 2016; G. VAN CALSTER, L. REINS, *EU Environmental Law*, Cheltenham: Edward Elgar, 2017; H. SELIN, S.D. VANDEVEER, *European Union and Environmental Governance*, London and New York: Routledge, 2015; M. LEE, *EU Environmental Law, Governance and Decision-Making*, Oxford: Oxford University Press, 2014; O. PORCHIA, *Le politiche dell'Unione europea in materia ambientale*, in R. FERRARA, M.A. SANDULLI (eds), *Trattato di diritto dell'ambiente*, Milano: Giuffrè, 2014, p. 153 *et seq.*; A. JORDAN, C. ADELLE, *Environmental Policy in the EU: Actors, Institutions and Processes*, Abingdon: Routledge, 2013; L. KRÄMER, *EC Environmental Law*, London: Sweet & Maxwell, 2007; R. MACRORY (ed.), *Reflections on 30 Years of EU Environmental Law: A High Level of Protection?*, cit.

<sup>19</sup> Emphasis added.

<sup>20</sup> This expression is the same used by K. HOLZINGER, T. SOMMERER, *'Race to the Bottom' or 'Race to Brussels? Environmental Competition in Europe*, cit., for which I am indebted.

which – coupled with the principle of integration of EU environmental policy with all other policies carried out by the Union<sup>21</sup> – substantially marks the difference between the much higher effectiveness of the transnational environmental policy in Europe than in other region of the world.<sup>22</sup> Yet, it cannot be excluded that, because of the risk that differentiated domestic environmental rules (and hence standards) would be challenged and eventually frustrated under EU fundamental freedoms,<sup>23</sup> a true regulatory competition did never occur at EU level.

## V. MAIN FEATURES OF EUROPEAN ENVIRONMENTAL POLICY AND THEIR EXTRATERRITORIAL REACH: AN ATTEMPT TO COMBAT REGULATORY COMPETITION AT INTERNATIONAL LEVEL?

Since long, the scope of EU environmental policy virtually encompasses all subject-matters falling within a broad definition of “environment”, i.e., as it was clearly pointed out by the Court of Justice in one of first seminal cases in our subject matter, (i) the environment *stricto sensu*, (ii) human health, as well as (iii) the exploitation of natural resources.<sup>24</sup> Moreover, and in the first place, the standard established at primary law level is one of a “high level of protection” under Art. 191 TFEU; secondly, and as said, a fundamental principle is also established both by Art. 37 of in the Charter of Fundamental Rights of the European Union (Charter) and by Art. 11 TFEU, obliging the EU environmental policy to be “integrated into the policies of the Union and ensured in accordance with the principle of sustainable development”. And finally, the EU environmental policy is seen as a proactive one: it is not limited to achieve environmental *conservation* but also to “promot[e] measures at international level to deal with regional or worldwide environmental problems [...] in particular with a view to promoting sustainable development”.<sup>25</sup>

<sup>21</sup> See Art. 11 TFEU. See for example J. NOWAG, *Environmental Integration in Competition and Free-Movement Laws*, Oxford: Oxford University Press, 2017.

<sup>22</sup> See F. MUNARI, L. SCHIANO DI PEPE, *Tutela transnazionale dell'ambiente*, cit., p. 69 *et seq.*

<sup>23</sup> See e.g. Court of Justice, judgment of 20 September 1988, case C-302/86 *Commission of the European Communities v. Kingdom of Denmark (the “Danish bottles”)*.

<sup>24</sup> These conclusions seem undisputed since Court of Justice, judgment of 5 May 1998, case C-157/96, *The Queen v. Ministry of Agriculture, Fisheries and Food, Commissioners of Customs & Excise, ex parte National Farmers' Union, David Burnett and Sons Ltd, R. S. and E. Wright Ltd, Anglo Beef Processors Ltd, United Kingdom Genetics, Wyjac Calves Ltd, International Traders Ferry Ltd, MFP International Ltd, Interstate Truck Rental Ltd and Vian Exports Ltd (Mad Cow)*, para. 64 and judgment of 8 July 2010, case C-343/09, *Afton Chemical Ltd v. Secretary of State for Transport*, para. 32. See also General Court, judgment of 11 July 2007, case T-229/04, *Kingdom of Sweden v. Commission of the European Communities (Paraquat)*.

<sup>25</sup> Reference is made, once again, to Arts 191 and 11 TFEU respectively. On this topic see E. MORGERA (ed.), *The External Environmental Policy of the European Union – EU and International Law Perspectives*, Cambridge: Cambridge University Press, 2012; G.M. DURAN, E. MORGERA, *Environmental Integration in the EU's External Relations: Beyond Multilateral Dimensions*, Oxford and Portland: Bloomsbury, 2012; T. FAJARDO DEL CASTILLO, *Revisiting the External Dimension of the Environmental Policy of the EU: Some Challenges Ahead*, 2010, in *Journal for European Environmental and Planning Law*, 2010, p. 365 *et seq.*

Against these legal benchmarks, it comes as no surprise that no room is left for Member States to deviate from them. This excludes also any regulatory competition between Member States based on the environment. Rather, the development of EU environmental policy has put the Union in the front line as the most advanced legal system worldwide.

This evolution had, however, other consequences. In particular, since international standards have been surpassed by stricter EU ones, the Court of Justice has repeatedly stated that the latter apply even in presence of more relaxed “universal” standards. Reference is made, in particular, to the *Intertanko* judgment,<sup>26</sup> where it was held that Directive 2005/35 on ship-source pollution and on the introduction of penalties<sup>27</sup> should by all means be enforced by ships flying the flag of a Member State party to the Marpol 73/78 and of the United Nations Convention on the Law of the Sea (UNCLOS) even if these ships actually complied with relevant rules established at international level already. The same approach was used in the *Commune de Mesquer* case,<sup>28</sup> which applied the EU waste legislation to oil spills at sea,<sup>29</sup> with a view to enhancing the number of persons responsible to remedy and reimburse pollution damages occurring to EU coasts: by considering hydrocarbons and heavy-fuel oil mixed with sea water as waste under relevant EU legislation, also the producer of this waste (i.e. the charterer of the *Erika* vessel) was held responsible for the pollution, thus adding such entity to the ship-owner and the International Oil Pollution Compensation Fund (IOPCF), i.e. the responsible parties of oil spills at sea under the applicable International Convention on Civil Liability for Oil Pollution Damage.

Even more daring has been the outcome of the *ATAA* judgement,<sup>30</sup> where the Court established that Directive 2008/101 to combat aircraft emissions and commit for a sustainable air transport industry<sup>31</sup> must be applied also to non-EU air carriers willing to call European airports. Moreover, the Court of Justice established that this conclusion would prevail even against the arguments that this claim by the EU to have its standards applied extraterritorially to all aircraft carriers would be illegitimate under interna-

<sup>26</sup> Court of Justice, judgment of 3 June 2008, case C-308/06, *The Queen, ex parte International Association of Independent Tanker Owners (Intertanko) and Others v. Secretary of State for Transport*.

<sup>27</sup> Directive 2005/35/EC of the European Parliament and of the Council of 7 September 2005 on ship-source pollution and on the introduction of penalties for infringements.

<sup>28</sup> Court of Justice, judgment of 24 June 2008, case C-188/07, *Commune de Mesquer v. Total France SA and Total International Ltd* [GC].

<sup>29</sup> In particular, Council Directive 75/442/EEC, now replaced by Directive 2008/98/EC.

<sup>30</sup> Court of Justice, judgment of 21 December 2011, case C-366/10, *Air Transport Association of America and Others v. Secretary of State for Energy and Climate Change* [GC].

<sup>31</sup> Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community.

tional customary rules of international law on freedom of the skies as well as under the International Civil Aviation Organization (ICAO) Convention.<sup>32</sup>

As said, this approach seems to be strongly rooted into EU law, not only in the Court's case-law,<sup>33</sup> but also at secondary law level. More precisely, as regards EU environmental legislation on transboundary matters that are – or should be – covered by international standards, the rationale which seems now generally established within the Union legal system is to wait until international documents have been adopted setting or trying to set “universal” environmental standards, and then to rapidly enact EU legislation anticipating the entry into force of the former. In so doing, the EU (i) “imports” into its own legislation international standards that are not in force yet (and might never enter into force at in-

<sup>32</sup> In the Court's words “As for the fact that the operator of an aircraft in such a situation is required to surrender allowances calculated in the light of the whole of the international flight that its aircraft has performed or is going to perform from or to such an aerodrome, it must be pointed out that, as European Union policy on the environment seeks to ensure a high level of protection in accordance with Article 191(2) TFEU, the European Union legislature may in principle choose to permit a commercial activity, in this instance air transport, to be carried out in the territory of the European Union only on condition that operators comply with the criteria that have been established by the European Union and are designed to fulfil the environmental protection objectives which it has set for itself, in particular where those objectives follow on from an international agreement to which the European Union is a signatory, such as the Framework Convention and the Kyoto Protocol. Furthermore, the fact that, in the context of applying European Union environmental legislation, certain matters contributing to the pollution of the air, sea or land territory of the Member States originate in an event which occurs partly outside that territory is not such as to call into question, in the light of the principles of customary international law capable of being relied upon in the main proceedings, the full applicability of European Union law in that territory (see to this effect, with regard to the application of competition law, *Ahlström Osakeyhtiö and Others v Commission*, paragraphs 15 to 18, and, with regard to hydrocarbons accidentally spilled beyond a Member State's territorial sea, *Case C-188/07 Commune de Mesquer* [2008] ECR I-4501, paragraphs 60 to 62). It follows that the European Union had competence, in the light of the principles of customary international law capable of being relied upon in the context of the main proceedings, to adopt Directive 2008/101, in so far as the latter extends the allowance trading scheme laid down by Directive 2003/87 to all flights which arrive at or depart from an aerodrome situated in the territory of a Member State” (paras 128 *et seq.*). For a critical appraisal of this judgment see A. GATTINI, *Between Splendid Isolation and Tentative Imperialism: The EU's Extension of Its Emission Trading Scheme to International Aviation and The ECJ's Judgment in the Ata Case*, in *International and Comparative Law Quarterly*, 2012, p. 977 *et seq.* Even if this judgment has had no practical effects, since the application of taxes for greenhouse gas emissions to non-EU aircrafts were postponed, the political “signalling” made by the EU not to allow entry into the EU air transport markets of aircraft not paying the same bill as that requested to EU carriers was very clear and contributed to an overall reflection on this topic at ICAO level. See L. SCHIANO DI PEPE, *European Union Climate Law and Practice at the End of the Kyoto Era: Unilateralism, Extra-territoriality and the Future of Global Climate Change Governance*, in R.V. PERCIVAL, J. LIN, W. PIERMATTEI (eds), *Global Environmental Law at a Crossroads*, Cheltenham and Northampton: Edward Elgar, 2014, p. 279 *et seq.*, in particular at pp. 292-294.

<sup>33</sup> For other cases in this sense, see judgment of the Court of Justice, judgment of 14 July 1994, case C-379/92, *Matteo Peralta*; judgment of 23 January 2014, case C-437/11, *Mattia Manzi and Compagnia Naviera Orchestra v. Capitaneria di Porto di Genova*.

ternational level) through the adoption of EU environmental rules, and then (ii) applies its own rules extraterritorially to all “actors” willing to trade within the EU.<sup>34</sup>

Sometimes this policy is implemented irrespective of the existence of any international consensus – or even treaty – to introduce rules setting new environmental standards in any given area. Probably, the most important example in this area is given by the ambitious REACH regime,<sup>35</sup> introducing at EU level an ambitious environmental discipline applicable to all chemicals produced or imported in the Union, i.e. a regime having extraterritorial effects aimed to be applied in an important market area to all firms that are therefore requested to abide by these new rules (and undergo relevant costs to comply with the EU standards) if they want to produce or sell chemicals in the EU.

As said, I am persuaded that, albeit having an extraterritorial reach, these regulations are fully legitimate under international law and consistent with the so-called “effects doctrine”, as recently endorsed by the Court in the *Intel* judgment.<sup>36</sup>

No doubt that the aim of this proactive track-record by the EU in the implementation of transnational environmental policy through the adoption of EU rules is to promote the enhancement of high environmental standards at large, in the light of the fact that modern environmental protection cannot be limited to the territories and the jurisdictions of single legal systems.

However, clearly but indirectly, this approach introduces also a sort of regulatory competition (aimed at achieving a “race to the top”) by the EU which applies to EU and multi-national firms operating in the EU. And the outcome of this approach is that of pushing at least EU firms towards global leadership in fostering “green” technology and production processes, on whose pay-off I shall return below.<sup>37</sup>

<sup>34</sup> Significant examples are provided within the maritime field, for instance Regulation (EU) 1257/2013 of the European Parliament and of the Council of 20 November 2013 on ship recycling and amending Regulation (EC) 1013/2006 and Directive 2009/16/EC, which anticipated the 2009 Hong-Kong Convention on ship recycling prepared at International Maritime Organization (IMO) level, or Regulation (EC) 782/2003 of the European Parliament and of the Council of 14 April 2003 on the prohibition of organotin compounds on ships, anticipating the 2001 International Convention on the Control of Harmful Anti-fouling Systems on Ships (which however entered into force in 2008, see [www.imo.org](http://www.imo.org)).

<sup>35</sup> See Regulation (EC) 1907/2006 of the European Parliament and of the Council of 18 December 2006 concerning the Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), establishing a European Chemicals Agency, amending Directive 1999/45/EC and repealing Council Regulation (EEC) 793/93 and Commission Regulation (EC) 1488/94 as well as Council Directive 76/769/EEC and Commission Directives 91/155/EEC, 93/67/EEC, 93/105/EC and 2000/21/EC.

<sup>36</sup> Court of Justice, judgment of 22 September 2017, case C-413/14 P, *Intel v. Commission*, para. 40 *et seq.*

<sup>37</sup> See *infra*, section VII.

## VI. REGULATORY COMPETITION IN ENVIRONMENTAL STANDARDS AND TRADE AGREEMENTS BETWEEN THE EU AND THIRD COUNTRIES

Based on the goal to preserve and improve the quality of the environment at global level, as well as in the field of international relations,<sup>38</sup> it is not surprising that the EU has been working to implement worldwide its environmental objectives, thus attempting to induce as many firms as possible to comply with EU environmental rules, even if these firms are not based in the EU, when they are nevertheless willing to trade within the Union.

Indeed, when this approach was challenged against WTO rules, the EU had much fewer chances to implement it, because of legal provisions already existing since long – such as those contained in the General Agreement on Tariffs and Trade (GATT) – that had been adopted not only prior to the foundation of the EU, but even prior to the emergence of environmental law as a field of law capable of protecting the environment.<sup>39</sup> However, the WTO is no longer the only relevant *forum* for global business decisions: in the past years, the growing importance of finance and thus of investments (especially foreign direct ones) have induced States and regional organizations to re-assess relevant existing bilateral agreements and update them to new schemes. In addition, the Treaty of Lisbon has transferred to the EU the exclusive competence to stipulate treaties on (foreign direct) investments, thus enhancing also EU capabilities to implement the goals established by Art. 21, para. 2, let. f), TEU when using its newly conferred powers to negotiate modern bilateral agreements covering trade and investments. Moreover, and at least looking at the more recent case-law of the Court of Justice concerning its role and willingness to interpret and monitor compliance of these bilateral agreements with EU law,<sup>40</sup> it is reasonable to believe that the safeguard at bilateral level of the EU principles on the environment will be carefully scrutinized also by the EU judiciary.

The EU paramount interest to avoid any regulatory competition on environmental standards with its trading partners seems witnessed by the guidelines issued by the Commission in 2015. Already in its title, i.e. “Trade to All: Towards a more responsible trade and investment policy”,<sup>41</sup> it makes clear the EU thrust to improve socially respon-

<sup>38</sup> See, expressly, Art. 21, para. 2, let. f), TEU.

<sup>39</sup> See e.g. WTO DSB, panel report of 18 August 1997, case no. ds48, *Canada v. European Communities - EC Measures Concerning Meat and Meat Products (Hormones)*, [www.wto.org](http://www.wto.org). See generally M. PALLEMAERTS (ed.), *EU and WTO Law: How Tight is the Legal Straitjacket for Environmental Product Regulation?*, Brussels: VUB Press, 2006; A. NOTARO, *Judicial Approaches to Trade and Environment. The EC and the WTO*, London: Cambridge University Press, 2003; J. WIERS, *Trade and Environment in the EC and the WTO. A Legal Analysis*, Groningen: Springer, 2002; J. SCOTT, *On Kith and Kine: Trade and Environment in the EU and WTO*, in J.H.H. WEILER (ed.), *The EU the WTO and the NAFTA*, Oxford: Oxford University Press, 2000, p. 125 *et seq.*; G. VAN CALSTER, *International & EU Trade Law. The Environmental Challenge*, London: Cameron May, 2000; D. GERADIN, *Trade and the Environment. A Comparative Study of EC and US Law*, Cambridge: Cambridge University Press, 1997.

<sup>40</sup> Court of Justice, judgment of 6 March 2018, case C-284/16, *Slovak Republic v. Achmea BV*[GC].

<sup>41</sup> The document is available at [trade.ec.europa.eu](http://trade.ec.europa.eu).

sible patterns in international trade and investments treaties. In this vein, the Commission is adamant in stating that “open markets do not require us to compromise on core principles, like [...] sustainable development around the world or high quality safety and environmental regulation and public services at home”.<sup>42</sup> And it clearly advocates that the EU strategy will ensure that the Union trade policy will not merely consider the EU interests but also our values, among which sustainable development,<sup>43</sup> shall be promoted through the EU trade agreements and trade preference programmes.

In other words, while different environmental standards may be irrelevant within the WTO, and therefore regulatory competition on environmental matters can still occur at that level, such an option would seem substantially reduced within trades between the EU and those third countries with whom a series of “new generation” trade agreements have been concluded: reference is made, *inter alia* to the Comprehensive Economic and Trade Agreement with Canada (CETA),<sup>44</sup> the Free Trade Agreements (FTAs) with Singapore, Vietnam, or South Korea, the Deep and Comprehensive Free Trade Area (DCFTA) with Georgia, Moldova and Ukraine); and negotiations are ongoing with other important trading partners, such as Japan and Indonesia.<sup>45</sup> In all these treaties clear provisions exist entrusting the contracting parties with the power to modify and upgrade their environmental legislation and excluding that the introduction of new environmental standards be considered as an unilateral alteration of the investment conditions for the respective firms which is inconsistent with the treaty.

<sup>42</sup> Quoted from the foreword by Ms Malmström, EU Trade Commissioner. See W.T. DOUMA, *The Promotion of Sustainable Development Through EU Trade Instruments*, in *European Business Law Review*, 2017, p. 197 *et seq.*; B.O. GIUPPONI, *Squaring the Circle Balancing Sustainable Development and Investment Protection in the EU Investment Policy*, in *European Energy and Environmental Law Review*, 2016, p. 44 *et seq.* See also C. MARTINI, *Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting*, in *International Lawyer*, 2017, p. 529 *et seq.*; G. MAYEDA, *Integrating Environmental Impact Assessments into International Investment Agreements: Global Administrative Law and Transnational Cooperation*, in *Journal of World Investment & Trade*, 2017, p. 131 *et seq.*; T.L. SLATER, *Investor-State Arbitration and Domestic Environmental Protection*, in *Washington University Global Studies Law Review*, 2015, p. 131 *et seq.*; K. NOWROT, *How to Include Environmental Protection, Human Rights and Sustainability in International Investment Law*, in *Journal of World Investment & Trade*, 2014, p. 612 *et seq.*; S. DI BENEDETTO, *International Investment Law and the Environmental*, Cheltenham: Edward Elgar, 2013; J.E. VINALES, *Foreign Investment and the Environment in International Law*, Cambridge: Cambridge University Press, 2012.

<sup>43</sup> It is beyond the scope of this short essay to deal with the legal ineffable nature of the principle of sustainable development within transnational environmental law; I therefore refer to F. MUNARI, L. SCHIANO DI PEPE, *Tutela transnazionale dell'ambiente*, cit., p. 37 *et seq.*, for a (constructive) criticism of this principle.

<sup>44</sup> See N. MEYER-OHLENDORF, C. GERSTETTER, I. BACH, *Regulatory Cooperation Under CETA: Implications for Environmental Policies*, in *Ecologic Institute Working Paper*, 2016, p. 1 *et seq.*; A. DE MESTRAL, *When Does the Exception Become the Rule – Conserving Regulatory Space under CETA*, in *Journal of International Economic Law*, 2015, p. 641 *et seq.*

<sup>45</sup> For an overview of these bilateral treaties see G. ADINOLFI, *Alla ricerca di un equilibrio tra interessi economici e tutela dell'ambiente nella politica commerciale europea*, in *Eurojus.it*, 14 May 2017, rivista.eurojus.it.

Such a result is also achieved by means of a different drafting technique compared to previous bilateral investment treaties: in particular, these agreements not only jointly – and quite correctly – discipline trade and investments; they also introduce prominent environmental principles and values, and corresponding rights and obligations, between the contracting parties.

More precisely, and in the first place, it is worth remembering the reciprocal obligation to promote sustainable development, which is constantly inserted as a specific chapter of the above mentioned agreements or in their preamble.

Secondly, quite interesting for our purposes is also the provision under which each party has the right to implement its environmental policies and to introduce non-discriminatory environmental measures without this being considered in any way an indirect expropriation of foreign investors. Indeed, such treaties contain a tentative prohibition onto the contracting parties to modify (i.e. to lower) existing environmental standards in order to favour investments. To this end, worth recalling is in particular the provision contained in the DCFTAs with Georgia, expressly establishing the need to upgrade to EU environmental standards Georgia's legislation on environmental protection.

In the third place, mutual support is established between trade and environmental policy, thus enabling the EU to foster its paramount principle of integration<sup>46</sup> not only internally, but also within trade agreements with third countries.

And finally, multilateral environmental agreements are expressly referred to in some of the (preferential trade) agreements between the EU and third countries, and it is clarified that their implementation cannot be considered as a prevention of trade liberalization.

Once again, looking at the abovementioned provisions with the lens of the corresponding case-law developed within the WTO dispute settlement system, we can certainly conclude that substantial steps ahead have been done compared to the narrow interpretation of Art. XX, let. b) and g), GATT. Too often this proviso has been applied without any reference to the existing international environmental standards that instead should have been guided a much more sympathetic approach for trade-related environmental measures adopted by WTO contracting parties.<sup>47</sup>

Hopefully the approach of the bilateral free trade agreements will enhance the EU role in dictating environmental standards capable to diminish any potential for regulatory competition based on more relaxed environmental standards also in trade with third countries.

<sup>46</sup> See footnote 21 and referring text.

<sup>47</sup> See WTO DSB, panel report of 3 September 1991, case no. ds21, *United States - Restrictions on imports of Tuna*; panel report of 16 June 1994, case no. ds29, *United States - Restrictions On Imports Of Tuna*; WTO Appellate Body report of 29 April 1996, case no. ds2, *US Standards for Reformulated and Conventional Gasoline*; all available at [www.wto.org](http://www.wto.org).

## VII. POTENTIAL PERSPECTIVES OF THE EU ACTION: AN IMPLIED ATTEMPT TO ENGAGE IN A “RACE TO THE TOP”

As already said, even if the EU enjoys a shared competence in environmental law, its activity over the decades to implement a fully-fledged environmental policy at EU level has made pointless the possibility for Member States to engage in any regulatory competition as far as environmental standards are concerned.

Indeed, in the previous paragraphs we have noted that the EU – as probably the world area enjoying the highest environmental standards or at least aiming to pursue the most ambitious environmental goals – is in fact trying to have its standards applied or respected even outside its jurisdiction. This is done (i) both unilaterally, by means of an extraterritorial application of EU rules, especially when coincident with international standards not yet in force,<sup>48</sup> and (ii) at treaty level, since the new trade agreements concluded by the EU expressly advocate the need to foster sustainable trade.

It is not always clear whether these choices are taken by considering also the need to avoid environmental regulatory competition among firms operating in the liberalised marketplace that may be caused by different rules and standards applied outside the EU. However, this means that firms have to constantly adapt to continuously growing standards: consider, for instance, the automotive industry and the substantial investments in research and development that vehicle manufacturers need to undergo to comply with stricter and stricter emission levels in the atmosphere.

On the other hand, it seems undeniable that there is a clear policy driver in the stance adopted by the EU. In the 2017 “State of the Union Address”, President Juncker pointed out that “trade is about exporting our standards, be they social or environmental standards, data protection or food safety requirements”; furthermore, he also added that “I want Europe to be the leader when it comes to the fight against climate change. [...] Set against the collapse of ambition in the United States, Europe must ensure we make our planet great again. It is the shared heritage of all of humanity”.<sup>49</sup>

Of course, political wishes neither necessarily nor immediately become hard law. However, little doubt exists that the EU is taking seriously the opportunity to bring its firms to the forefront of technological innovation in order to prospectively enjoy a competitive advantage *vis-à-vis* their peers located in other countries, in preparation of the green economy revolution which hopefully will mark the world trade future, consistently with the goals set out during the Rio+20 summit in 2012.<sup>50</sup>

There is, in other words, a potential for regulatory competition as far as environmental standards are concerned, which the EU apparently is trying to implement, and

<sup>48</sup> See footnote 34 and referring text.

<sup>49</sup> See [europa.eu](http://europa.eu).

<sup>50</sup> See UN Commission on Sustainable Development, *The Future We Want: Zero Draft of the Outcome Document*, New York, 2012, in [www.uncsd2012.org](http://www.uncsd2012.org).

this seems particularly true concerning EU climate strategies and targets under the 2015 Paris Agreement. Reference is made, for instance, (i) to the 2020 Climate and Energy Package, which sets a reduction in the emission of 23 per cent compared to 2016 targets;<sup>51</sup> (ii) to the 2030 Energy Strategy, targeting a 40 per cent cut in greenhouse gas emissions compared to 1990 levels, at least a 27 per cent share of renewable energy consumption, and at least 27 per cent energy savings compared with the business-as-usual scenario;<sup>52</sup> (iii) to the 2050 Low-Carbon Roadmap, suggesting that the EU should cut greenhouse gas emissions to 80 per cent below 1990 levels.<sup>53</sup>

No doubt that this series of packages and goals show that EU institutions and decision-makers do not care at all about the risk that enhancing EU environmental standards may jeopardise the competitiveness of EU firms in the world trade. In fact, as said already, the opposite seems true: the implicit rationale of all these measures might even be that EU firms will eventually benefit of the very ambitious standards (and corresponding rules) adopted at EU level, because this will induce or force them to become world leaders in producing goods and services comparatively bearing the smallest environmental footprint.

## VIII. CONCLUDING REMARKS

After some decades, principles are now rooted in the legal discourse – be it domestic, regional, or global – mandating environmental protection (and possibly its improvement) as a backbone principle for regulating whatever human activity. The implementation of this principle may not be overreaching yet, may not be immediate, and may not be easy, especially as regards global challenges such as climate change.

And yet, no doubt exists that rules must be introduced to modify the existing behavioural patterns by firms and individuals/consumers, in order to protect and promote the environment. And even if among economists the Keynesian quotation “in the long run, we are all dead” has still appeal, this is not a good reason to kill our planet with regulatory competition playing with environmental standards.<sup>54</sup> Luckily enough, legal scholars and policymakers in the EU have clearly taken an opposite direction, pushing for a global en-

<sup>51</sup> See [ec.europa.eu](http://ec.europa.eu).

<sup>52</sup> See [ec.europa.eu](http://ec.europa.eu).

<sup>53</sup> See [ec.europa.eu](http://ec.europa.eu).

<sup>54</sup> In this vein, it has been for example decided that the responsibility of sponsoring States *ex Art. 139*, para. 1, of the UNCLOS Convention to ensure that sponsored entities carry out their activities in deep seabed areas beyond national jurisdiction in conformity with Part XI of the UNCLOS Convention applies “equally to all sponsoring states, whether developing or developed” in order to avoid the spread of “sponsoring states of convenience”, which “would jeopardize uniform application of the highest standards of protection of the marine environment, the safe development of activities in the Area and protection of the common heritage of mankind” i.e. in order to prevent regulatory competition (see the Seabed Disputes Chamber of the International Tribunal for the Law of the Sea, advisory opinion of 1 February 2011 on Responsibilities and Obligations of States Sponsoring Persons and Entities with Respect to Activities in the Area, paras 158-159).

hancement of environmental standards also as a tool to promote “greener” and more efficient firms. In other words, and to come back to the opening statements of this *Article*, environmental standards do affect firms’ competitive ability, but in my view if a sound, coherent and “globally directed” policy is construed to implement these standards, eventually the influence for the interested firms will be beneficial, and not detrimental.



## ARTICLES

### SPECIAL SECTION – REGULATORY COMPETITION IN THE EU: FOUNDATIONS, TOOLS AND IMPLICATIONS

*edited by* Francesco Costamagna

## REGULATING TAX COMPETITION IN THE INTERNAL MARKET: IS THE EUROPEAN COMMISSION FINALLY CHANGING COURSE?

PIETER VAN CLEYNENBREUGEL\*

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ABSTRACT: The establishment of an internal market has not only increased cross-border mobility, but also triggered more direct tax competition between EU Member States. Relying on national tax laws in an attempt to attract businesses and investment benefitting from free movement rights under EU law, Member States have been willing to lower their tax rates and to offer specific advantages to incoming businesses. In an attempt to avoid Member States’ competitive dynamics from resulting in a race to the fiscal bottom, the European Union responded to those tendencies by proposing different steps to curb harmful tax competition. This *Article* offers an overview of the different regulatory responses put in place at EU level to address and regulate tax competition, prior to calling for a more integrated Commission approach governing tax competition in the internal market.

KEYWORDS: European Union – internal market – regulatory competition – state aid – tax harmonisation – budgetary policy coordination.

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## I. INTRODUCTION

The establishment of an internal market has facilitated the free movement of goods, services, capital and persons between the different EU Member States. The kind of enhanced cross-border mobility promoted by the internal market is conditioned upon Member States abolishing rules that restrict individuals' and businesses' movement to other Member States. Although the abolition of such rules is in no way absolute, it cannot be denied that European Union law limits Member States' abilities to impede the exit of businesses and individuals from their territories.<sup>1</sup> The possibility for businesses or individuals to exit a Member State also implies that they can decide to relocate to a Member State with a more advantageous regulatory or fiscal framework.<sup>2</sup> As a result, Member States have been challenged to find legal ways either to keep or to attract businesses and individuals in their territories. The field of taxation has offered significant opportunities in that regard, giving rise to a competition between EU Member States using their tax system as a means to attract or keep individuals and businesses within their territories.

From the EU's point of view, the issue of tax competition, albeit controversial, has long been considered an unfortunate collateral side-effect of the EU's internal market ambitions.<sup>3</sup> The financial and sovereign debt crises, an increasing global competition between the European Union as a whole and other nations, trade or political blocs as well as specific tax practices tailored to the likes of big businesses have nevertheless put the issue of tax competition more prominently on the political agenda. As a result, the Commission,

<sup>1</sup> See for authors recognising that tendency, T. HEREMANS, *Professional Services in the EU Internal Market*, Oxford: Hart, 2012, p. 177. More specifically, see also N. REICH, *Competition Between Legal Orders: a New Paradigm of EC Law?*, in *Common Market Law Review*, 1992, p. 861 *et seq.*; J. SUN, J. PELKMANS, *Regulatory Competition in the Single Market*, in *Journal of Common Market Studies*, 1995, p. 67 *et seq.*, S. DEAKIN, *Legal Diversity and Regulatory Competition: Which Model for Europe?*, in *European Law Journal*, 2006, p. 440 *et seq.*, C. RADAELLI, *The Puzzle of Regulatory Competition*, in *Journal of Public Policy*, 2004, p. 1 *et seq.*

<sup>2</sup> This relates to so-called theories of economic federalism, as developed most notably by C. TIEBOUT, *A Pure Theory of Local Expenditures*, in *The Journal of Political Economy*, 1956, p. 416 *et seq.*; W. OATES, *The Theory of Public Finance in a Federal System*, in *The Canadian Journal of Economics*, 1968, p. 37 *et seq.*; W. OATES, *On Local Finance and the Tiebout Model*, in *The American Economic Review*, 1981, p. 93 *et seq.*; W. OATES, *Toward a Second-Generation Theory of Fiscal Federalism*, in *International Tax and Public Finance*, 2005, p. 349 *et seq.* See for more EU law attuned perspectives, T. HEREMANS, *Professional Services*, *cit.*, p. 91; G. HERTIG, *Regulatory Competition in EU Financial Services*, in *Journal of International Economic Law*, 2000, p. 349 *et seq.*; K. RIESENHUBER, *A Competitive Approach to EU Contract Law*, in *European Review of Contract Law*, 2011, p. 115 *et seq.*; R. SEFTON-GREEN, *Choice, Certainty and Diversity: Why More is Less*, in *European Review of Contract Law*, 2011, p. 134 *et seq.*

<sup>3</sup> For critiques and calls to address the issue more explicitly, see among many others, C. PINTO, *Tax Competition and EU Law*, Amsterdam: Springer Netherlands, 2003, p. 453 *et seq.*, for a complete overview and for literature references. See also G. DAVIES, *The Process and Side-effects of Harmonisation of European Welfare States*, in *Jean Monnet Working Paper*, no. 2, 2006, for a critical perspective. For a more nuanced perspective, see in particular J. HINES JR., *Harmful Tax Competition and Its Harmful Remedies*, in *British Tax Review*, 2006, pp. 309-312.

supported by the political rhetoric of Member States' political leaders,<sup>4</sup> has taken or proposed to take action against certain types of harmful tax competition practices.

This *Article* analyses the measures put in place at Commission level to address and counter harmful tax competition within the EU internal market. To that extent, it offers a summary of the reasons for and extent of tax competition rendered possible under the EU legal framework in place (II), followed by an overview of recent policy measures taken to tackle the excesses of such tax competition (III). Although the Commission's proposals show that tax competition is taken ever more seriously, the proposals should only be considered a starting point for a much wider and more transparent debate on tax competition within the EU internal market (IV).

At the outset, it is important to understand that this *Article* does not wish to take a position on the desirability, as such, of tax competition within the EU internal market. Although sound reasons can be offered from a normative point of view, whether or not grounded in empirical evidence, both to justify its existence and to advocate its complete abolition,<sup>5</sup> the ambitions of this paper are much more modest. Its only aim is to document the European Commission's increased awareness of the excesses of tax competition within the EU internal market, prior to analysing the Commission's regulatory and policy responses taken in light of such awareness. In doing so, the *Article* will critique for the Commission for not taking this awareness more seriously by developing a more integrated approach to tax competition. Acknowledging and trying to address tax competition are only starting points for more fine-tuned policy developments in which the abolition or diminution of tax competition is to take centre stage.<sup>6</sup>

## II. TAX COMPETITION AND THE EU INTERNAL MARKET: FROM BENEFICIAL TO EVER MORE DANGEROUS

Although concerns of tax competition and the lack of EU action in that field are being voiced rather frequently,<sup>7</sup> the scope and extent of such tax competition is often unclear. To clear the ground in that regard, this part of the *Article* therefore briefly revisits the role of tax law in the EU internal market set-up (II.1), prior to defining in a more precise way the contours of the current tax competition reality (II.2) and the Commission's rela-

<sup>4</sup> The French President Emmanuel Macron has been most vocal in this regard, in his famous speech on Europe delivered at the Sorbonne on 26 September 2017, available at [www.elysee.fr](http://www.elysee.fr).

<sup>5</sup> See N. REICH, *Competition Between Legal Orders*, cit.; S. DEAKIN, *Legal Diversity and Regulatory Competition*, cit.; W. OATES, R. SCHWAB, *Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?*, in *Journal of Public Economics*, 1988, p. 333 *et seq.*

<sup>6</sup> For a similar example, see recently J. SNELL, J. JAAKKOLA, *Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context*, in *European Law Journal*, 2016, p. 772 *et seq.*

<sup>7</sup> To take a recent example that goes beyond scholarly discussions, L. BERSHIDSKY, *EU Tax Competition is Unfair and Inefficient*, in *Bloomberg Opinion*, 31 May 2017, [www.bloomberg.com](http://www.bloomberg.com).

tively recent acknowledgement of instances of “aggressive” tax competition (II.3). That analysis allows to conclude that current policy debates on tax competition above all identify or address a competition to lower corporate tax rates in an attempt to attract or retain multinational businesses’ establishments. Other fields of taxation, like customs duties or consumer-imposed taxes, such as excise duties or value-added taxes, and even personal income taxes do not generally feature in discussions on tax competition within the EU internal market.

## II.1. THE PLACE OF TAX PROVISIONS IN THE EU INTERNAL MARKET’S LEGAL SETUP

Upon first glance, the EU internal market envisages to a large extent the harmonisation or streamlining of Member States’ tax law provisions. Throughout the Treaty on the Functioning of the European Union, different provisions can be said to removing the competitive playing field for Member States to use tax law as an instrument to attract or keep businesses and, to a lesser extent, workers or other professional individuals.

First, Art. 30 TFEU establishes a customs union characterised by the complete abolition of all kinds of customs duties on imports and exports of goods as well as charges having an equivalent effect to such duties. The Court of Justice has interpreted that notion to the largest extent possible, effectively eliminating all kinds of customs, excise or other duties that apply on the occasion of crossing a border between two Member States or between parts of a single Member State.<sup>8</sup> As a result, Member States have lost all powers to lower or modify customs tariffs in order to stimulate the export or import of goods in (parts of) their territories, effectively removing all kinds of regulatory competition that could take place between Member States. Although the complete removal of tax competition only applies to the narrow field of customs duties, Art. 110 TFEU extends the same philosophy to more general fiscal measures such as excise duties or other taxes imposed particularly on goods. Per that provision, no Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. In the same way, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products. The Court of Justice interpreted those provisions widely, leaving Member States little room for tax competition by means of taxing goods from different

<sup>8</sup> See among others, Court of Justice, judgment of 1 July 1969, joined cases 2/69 and 3/69, *Diamantarbeiders*, paras 28-32; judgment of 9 September 2004, case C-72/03, *Carbonati apuani*. See, to that extent, also M. GRAVE, *L’interdiction des taxes d’effet équivalant à un droit de douane: un élément fondamental de l’union douanière au service du marché intérieur et de la politique commerciale commune*, in *Revue des Affaires européennes*, 2005, p. 621 *et seq.*

Member States differently.<sup>9</sup> The removal of such competition is further enhanced by the adoption of a common customs tariff at EU level, applicable to goods entering and leaving the territory of the internal market as a whole. Art. 31 TFEU states that a common custom tariff duties are to be fixed by the Council. At this time, indeed, a common tariff system has been put in place Regulation 2658/87.<sup>10</sup> On top of that, the European Union has adopted a Union Customs Code by virtue of Regulation 952/2013.<sup>11</sup> As far as the flow of goods is concerned, tax competition is therefore significantly reduced and almost completely removed by virtue of European Union law.

Second, in relation to the free movement of capital, Art. 63 TFEU recognises explicitly that restrictions on capital movements between Member States and between Member States and third countries are to be removed. That provision particularly allows for the transfer of money and investments in other Member States. Art. 65 TFEU nevertheless acknowledges that Member States have the right to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested and, additionally, to take measures to prevent the infringement of their legislation or to tax capital movements to third countries.<sup>12</sup> In so stating, the fact that capital movements are to be permitted under EU law, does not require Member States directly or automatically to modify their tax regimes or to enter into a competitive race with other Member States in order to prevent the exit of capital from their territories. Quite on the contrary, in terms of capital, investments and profits derived from such investments can still be taxed by the Member State concerned, either upon exit from the territory of that Member State or – in cases where the person or business concerned remains established in that Member State – as part of overall tax payment obligations. As such, the liberalisation of capital movements is not meant to trigger a competitive dynamic between Member States seeking to lower taxes to prevent the exit of capital from their territories.<sup>13</sup>

<sup>9</sup> For an overview, see S. VAN DEN BOGAERT, P. VAN CLEYNENBREUGEL, *Free Movement of Goods*, in F. AMTENBRINK, D. CURTIN, B. DE WITTE, P.J. KUIJPER, A. McDONNELL, S. VAN DEN BOGAERT (eds), *The Law of the European Union*, Den Haag: Wolters Kluwer, 2018, pp. 529-538.

<sup>10</sup> Council Regulation (EEC) 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff.

<sup>11</sup> Regulation (EU) 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code.

<sup>12</sup> See for an example Court of Justice, judgment of 14 February 1995, case C-279/93, *Schumacker*, paras 30-31.

<sup>13</sup> As will be made clear *infra* in this section, it can nevertheless be argued that the fact that Member States can apply their tax laws stimulates businesses to move their capital to another Member State. In that case, the first Member State can tax capital upon its departure, but cannot impede the movement to another Member State. From that point of view, free movement of capital does not as such limit tax competition as a potential side-effect of free movement.

Third, the founding EU Treaties offer legal bases to harmonise Member States' tax legislation. Allowing for harmonising legislation, the Treaty thus offers significant opportunities to replace diverging Member States' tax systems by an EU-wide and coordinated fiscal system. From the early stages of European economic integration onwards, calls have been made for a more streamlined approach in that regard. The 1962 Neumark Report presented a first opportunity, in which the European Commission not only called for the harmonisation of indirect (value-added) taxes, but also in the realm of personal and corporate taxes, giving rise to 1967 legislative proposals to that extent.<sup>14</sup> Art. 113 TFEU requires the Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, to adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition. On the basis of that provision, the European Union has set up a harmonised value-added tax (VAT) system, which operates in a streamlined and mandatory way across the different Member States.<sup>15</sup> In the same way, the European Union has relied on that legal basis to harmonise the structure and operations of excise duties on alcoholic and tobacco products as well as on energy and electricity.<sup>16</sup> On top of that, Arts 192 and 194 TFEU allow the EU to adopt fiscal measures taking the shape of similar indirect taxes or excise duties to support the EU's environmental and energy policies; measures in those fields have nevertheless been based predominantly on Art. 113. The adoption of those measures also requires unanimity within the Council. Arts 115 or 352 TFEU equally requiring unanimity, also could serve as legal bases to harmonise tax legislation in this context. In theory, harmonisation measures in the realm of personal income or corporate taxation could therefore also see the light of day. Just like the other tax instruments based upon secondary legislation, however, their adoption requires the Council to reach unanimous agreement on the scope, contents and functioning of the tax measure at hand.

The different provisions thus identified could create an impression that the founding fathers of the EU directly or indirectly wanted to avoid tax competition taking place in the internal market. However, the EU legal framework also potentially limits further

<sup>14</sup> European Commission, *Rapport du Comité fiscal et financier*, 1962, p. 32, available at [publications.europa.eu](http://publications.europa.eu). Proposals adopted focused on value-added tax only, see Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes and Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.

<sup>15</sup> As the most recent elaboration of that mechanism, see Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>16</sup> See for an overview of legal instruments in this field, [ec.europa.eu](http://ec.europa.eu).

prospects at tax harmonisation in three ways. As a result, a more nuanced picture of the role of tax within the EU internal market legal set-up appears.

First, the TFEU explicitly limits in certain ways harmonisation in the field of taxation. Art. 114 TFEU, which allows the Council – through qualified majority voting – and Parliament to adopt measures to make the internal market function (better) explicitly excludes fiscal provisions from its scope of application. As a result, only Arts 113 and 115 TFEU can be relied on, requiring the unanimous agreement of all EU Member States. As the Neumark report forecasted, initiatives had to be taken in the realm of personal and corporate taxes to avoid competitive dynamics from taking shape.<sup>17</sup> Those proposals – as well as similar proposals in the 1970s, 1980s and 1990s<sup>18</sup> – did not materialise, however, since no unanimous agreement could be found between the Member States, as required by Art. 113 TFEU. It thus shows that the unanimity requirement constitutes an impediment to further harmonisation, making tax competition easier to take shape. In the same way, prior to the entry into force of the Lisbon Treaty, Member States explicitly had to enter into negotiations to abolish double taxation between Member States.<sup>19</sup>

Second, the TFEU contains only specific provisions on the (indirect) taxation of products. No provisions on corporate tax or personal income tax have been inserted in the Treaties, giving the impression that those matters remain the province of the EU Member States. As such, the Treaty creates the impression that Member States remain free to adapt their fiscal systems in order to attract businesses from other Member States, triggering a potential competitive race grounded in fiscal competition. The same goes for initiatives aimed at stimulating industrial policy across the European Union.<sup>20</sup> Although the EU may take coordinating measures in that regard, it cannot – under the banner of industrial policy – decide to lower corporate tax rates across different Member States.<sup>21</sup> One or more Member States, however, would remain at liberty to take this kind of action, to the extent that they respect other EU rules on free movement and undistorted competition. From that point of view, the Treaty set-up of the internal market would indeed contribute to putting in motion a competitive dynamic between the different Member States, competing for businesses by means of tax policies.

Third, and more fundamentally, the internal market is predicated upon a philosophy of cross-border movement. Individuals and businesses – just like goods – have to be able to

<sup>17</sup> *Rapport du Comité fiscal et financier*, cit., p. 29.

<sup>18</sup> In addition to the 1962 Report, the 1970 van den Tempel Report (European Commission, *Corporation Tax and Income Tax in the European Communities*, 1970, available at [www.europarl.europa.eu](http://www.europarl.europa.eu)) and the 1992 Ruding Report (European Commission, *Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation*, 1992, available at [publications.europa.eu](http://publications.europa.eu)) have pointed towards similar problems, the latter particularly in the realm of corporate taxation.

<sup>19</sup> Art. 293 EC Treaty.

<sup>20</sup> See in general, P. JANSEN, *From Policy to Law? Industrial Policy Under European Union Law*, unpublished doctoral thesis, KU Leuven, 2018.

<sup>21</sup> Art. 173, para. 3, TFEU.

move freely to other Member States. That means that not only the exit from one territory has to be facilitated, but also that Member States may tailor their policies to attract businesses to their territories. Although the TFEU – for instance in Art. 65 TFEU – does allow for Member States to subject the exit from their territory to certain conditions such as the payment of taxes due, the entire philosophy of the EU internal market is constructed around guaranteeing free movement. One important feature of free movement consists in attracting businesses and lowering taxes compared to other Member States could be seen as a viable and valuable policy option in that regard. As a result, the lowering of tax rates in an attempt to attract businesses would perfectly fit the philosophy of the EU internal market. The Court of Justice of the European Union has made an important contribution to this type of movement in the context of corporate law. It has confirmed indeed that individuals can decide to create a corporation in a Member State that imposes less administrative or capital requirements on the establishment of a legal person. Using the legal personhood accorded to that corporation, Arts 49 and 54 TFEU subsequently allow for that corporation to establish a branch or agency in another Member State and to conduct the majority or even all of its activities there.<sup>22</sup> As EU internal market law allows Member States' corporate laws to be modified in order to attract businesses on their territory, nothing would seem to impede that those states also use tax laws as a subsidiary or alternative means to attract such businesses. The Court of Justice in this context stated that Member States can take measures to avoid the abuse of their (corporate or tax) laws, but did not specify how far Member States could go in that respect.<sup>23</sup> Quite on the contrary, it stated explicitly that "the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty."<sup>24</sup> As a result, the use of tax law as a way to attract businesses seems to have been validated as a viable policy option in the wake of this line of case law.

The picture that emerges from the foregoing overview is therefore rather ambiguous. On the one hand, the TFEU has eliminated or offered opportunities to eliminate tax competition in the realm of indirect taxation of goods. In the same way, it has allowed Member States to continue to tax capital leaving its territory upon exit. The adoption of EU secondary legislation in the realm of value-added tax and excise duties has also streamlined the approach to indirect taxation across the different EU Member States. On the other hand, however, the harmonisation of Member States' tax laws is subject to unanimity voting in the Council. Given that Member States consider personal income

<sup>22</sup> Court of Justice, judgment of 9 March 1999, case C-212/97, *Centros*, para. 27. See also Court of Justice, judgment of 5 November 2002, case C-208/00, *Überseering*, para. 94; judgment of 30 September 2003, case C-167/01, *Inspire Art*, para. 105.

<sup>23</sup> *Centros*, cit., para. 25.

<sup>24</sup> Court of Justice, judgment of 12 September 2006, case C-196/04, *Cadbury Schweppes* [GC], para. 50, and references included therein.

and corporate taxation to be closely linked to their sovereignty, harmonisation initiatives have been limited in presence and scope in those fields. Coupled with an internal market philosophy aimed at stimulating free movement and attracting businesses or individuals from other Member States, it would therefore not seem unlikely that tax competition between Member States takes place against the background of the current EU internal market legal framework.

## II.2. TAX COMPETITION WITHIN THE EU INTERNAL MARKET

It follows from the previous overview that tax competition between Member States is indeed a possibility under the current EU internal market legal framework. Although the EU has taken a uniform or harmonised approach to the indirect taxation of goods, personal income and corporate taxation vary significantly across different EU Member States. Against the background of the internal market's free movement philosophy, Member States have indeed not shied away from seeking to attract businesses by lowering corporate tax rates. When talking about tax competition within the internal market, the focus predominantly lies on a tendency consisting in the lowering of tax rates in an attempt to attract businesses to establish themselves on the territory of that Member State. The lowering of tax rates in that understanding is coined as a move to attract businesses and could result in a race to the bottom: in the attempt to attract or keep businesses, Member States would go so far as to almost lower tax rates to zero for corporate taxation in an attempt to enable businesses to establish themselves on their territory.<sup>25</sup> Although the occurrence of that extreme scenario remains contested among economists,<sup>26</sup> research in that field has shown that Member States have grown more than ever aware of the tax rates in force in their neighbouring countries.<sup>27</sup> A tendency can be noted that Member States are more consciously competing directly with those neighbouring Member States in an attempt to attract businesses to their territories.<sup>28</sup> Overall, it can therefore be deduced that the internal market and the possibilities for movement generated by it have effectively turned tax competition into a reality.

<sup>25</sup> See for that extreme scenario, W. OATES, *Fiscal Federalism*, New York: Harcourt, 1972.

<sup>26</sup> In contrast with C. TIEBOUT, *A Pure Theory of Local Expenditures*, cit., would argue the opposite. See to that extent also A. RAZIM, E. SADKA, *Tax Competition and Migration. The Race-to-the-bottom Hypothesis Revisited*, in *NBER Working Paper*, no. 16670, 2011. In the context of the EU in particular, S. KROSTRUP, *Are Corporate Tax Burdens Racing to the Bottom in the European Union?*, in *ERPU Working Paper*, no. 4, 2004.

<sup>27</sup> See G. NICODÈME, *Corporate Tax Competition and Coordination in the European Union. What Do We Know? Where Do We Stand?*, in C. READ, G.N. GREGORIOU (eds), *International Taxation Handbook. Policy, Practice, Standards and Regulations*, Oxford: CIMA, 2007, pp. 182-183.

<sup>28</sup> See J. HUNADI, M. ORVISKA, *The Empirical Evidence for Corporate Tax Competition Among the EU Member States*, in *Region Direct*, 2014, p. 105 *et seq.*, and references included therein.

Since the early 1990s, the EU institutions have acknowledged not only the possibility of such tax competition, but also its reality within the internal market. From 1996 onwards, the European Commission designed and developed plans of attack in order to tackle the issue of tax competition within the internal market.<sup>29</sup> In doing so, it recognised explicitly that regulatory competition was indeed taking place in this domain. Voicing the Commission's point of view, a study of the Directorate-General for Research of the European Parliament most readily acknowledged that

"the removal of legal and technical barriers to trade has made companies and their production bases more mobile: in theory (and subject to the constraints created by language and cultural differences), the whole Single Market can be supplied from one Member State. Tax has therefore become an important factor in location decisions, particularly for companies based outside the EU (e.g. the US computer companies recently established in Ireland). This, in turn, has encouraged national, regional and local authorities to compete in attracting firms to their areas through various 'tax breaks'- often in near-breach of Community competition rules".<sup>30</sup>

Aligning itself with contemporary Organization for Economic Co-operation and Development (OECD) reports on harmful tax competition on an even more global scale,<sup>31</sup> the Parliament effectively asked the Council and the Commission to take more concrete steps against such practices deemed harmful to the internal market.<sup>32</sup>

Seeking to combat harmful tax competition within the EU internal market, the Council in 1997 adopted a Code of Conduct, through which Member States pledged to roll back harmful tax competition practices.<sup>33</sup> A non-binding instrument, the Council Code proposed a stand-still and rollback of such practices, most particularly in the realm of special tax arrangements.<sup>34</sup> According to the Council, a fiscal measure can be considered as triggering harmful tax competition in the following circumstances:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- tax benefits reserved for non-residents;

<sup>29</sup> Communication COM(96) 546 final of 22 October 1996 from the Commission on taxation in the European Union, and Communication COM(97) 564 final of 11 May 1997 from the Commission on a package to tackle harmful tax competition within the European Union.

<sup>30</sup> See B. PATTERSON, A. MARTINA SERRANO, *Tax Competition in the European Union*, in *European Parliament Working Paper*, no. ECON 105, 1998, p. 4.

<sup>31</sup> Organization for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue*, Paris: OECD Publishing, 1998.

<sup>32</sup> European Parliament Resolution C4-0333/98 of 18 June 1998 on the Commission Communication "A package to tackle harmful tax competition in the European Union".

<sup>33</sup> Council Conclusions of 1 December 1997 concerning taxation policy.

<sup>34</sup> Resolution of the Council and of the Representatives of the Governments of the Member States, meeting within the Council on a code of conduct for business taxation, annexed to the Council Conclusions of 1 December 1997, cit., points C and D.

- tax incentives for activities isolated from the domestic economy and therefore have no impact on the national tax base;
- tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group deviating from internationally accepted rules or standards;
- lack of transparency regarding the application of the tax laws concerned.<sup>35</sup>

As a follow-up, the Council tasked a Code of Conduct group with the identification of different potentially harmful practices. That identification would be a starting point in effectively requiring Member States to stop extending them and to roll them back. The group effectively identified those practices in the then-15 Member States and tasked the Commission with monitoring their rollback.<sup>36</sup> In addition, the Commission committed to applying its State aid rules to special tax arrangements that were considered harmful to competition within the EU internal market.<sup>37</sup>

Despite acknowledging the potential of harmful tax competition, the Council and Parliament also maintained that tax competition taking place within the EU internal market is not in itself problematic. Both institutions indeed did not shy away from acknowledging both the positive and negative effects that tax competition can produce.<sup>38</sup> In terms of positive effects, they noted that Member States have become ever more aware of each other's tax systems, resulting in a larger amount of transparency regarding tax rates and tax structures in force. Increased transparency between Member States can, according to the EU institutions, contribute to better streamlining and converging of Member States' tax regimes.

The reality of tax competition within the EU internal market being acknowledged, the European Commission has above all highlighted the potentially beneficial effects of tax competition.<sup>39</sup> Limiting the need for intervention to instances of harmful tax competition, discussions on the abolition of such competition have in that regard have centred mainly on so-called special tax arrangements crafted by individual Member States.<sup>40</sup> The clearest example of such arrangements can be found in the context of so-called tax

<sup>35</sup> Resolution annexed to the Council Conclusions of 1 December 1997, cit., point B.

<sup>36</sup> See for the 1999 Report containing an overview of those measures, ec.europa.eu. For a critical assessment, see W.W. BRATTON, J.A. McCAHERY, *Tax Competition and Tax Coordination in the European Union. Evaluating the Code of Conduct on Business Taxation*, in *Common Market Law Review*, 2001, p. 677 *et seq.*

<sup>37</sup> See the 1998 Commission notice on the application of the State aid rules to measures relating to direct business taxation. For a comment in that regard, see W. SCHÖN, *Taxation and State Aid Law in the European Union*, in *Common Market Law Review*, 1999, p. 911 *et seq.*

<sup>38</sup> European Parliament Resolution C4-0333/98, cit., point D; Council Conclusions of 1 December 1997, cit., points C and D *a contrario*.

<sup>39</sup> Communication COM(96) 546, cit., p. 3.

<sup>40</sup> B. PATTERSON, A. MARTINA SERRANO, *Tax Competition in the European Union*, cit., p. 20.

rulings.<sup>41</sup> Beyond those specific examples, however, the overall abolition of all kinds of tax competition was not considered seriously in the late 1990s and early 2000s.

### II.3. CURRENT POSITION: “AGGRESSIVE” TAX COMPETITION CALLS FOR EU INTERVENTION

In light of the ever increasing coordination of budgetary policies in the wake of the 2010 sovereign debt crisis,<sup>42</sup> the Commission has emphasised more than ever the need to coordinate Member States’ competitive dynamics and to address ways to overcome so-called aggressive kinds of tax competition taking the shape of “aggressive tax planning” strategies maintained by Member States.<sup>43</sup> Aggressive tax planning refers to a strategy maintained by some Member States seeking to attract businesses by lowering corporate taxes to a significant extent.<sup>44</sup> Confronted with increasing tax avoidance tendencies and increasing mobility on a more global level, the Commission has called for ways to contain the excesses of tax competition and tax evasion within the European Union, as the next section will show.

On a more general level, one can infer from the discourse currently in place at the European Commission that its take on tax competition has become more nuanced over the last twenty years.<sup>45</sup> Whereas, in 1996, the Commission proudly highlighted the positive effects tax competition within the internal market brought about, its current practice is much more nuanced if not ambivalent. The Commission has not abandoned completely its position that tax competition is indeed beneficial to the internal market, but at the same time, it cannot be excessive. As a result, it is at present not entirely clear what kinds of tax competition would still be deemed to bring about positive effects. Hence, the EU’s strategies to overcome “aggressive” tax competition do not always appear as streamlined as they could be.

### III. OVERCOMING “AGGRESSIVE” TAX COMPETITION: A CHANGE OF COURSE

In the wake of the sovereign debt crisis, the European Commission has now taken the firm position that aggressive tax competition needs to be controlled in some way and

<sup>41</sup> According to the 2016 Commission notice on State aid, a tax ruling is meant to establish in advance the application of the ordinary tax system to a particular case in view of its specific facts and circumstances. For reasons of legal certainty, many national tax authorities provide prior administrative rulings on how specific transactions will be treated fiscally, see Commission notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, para. 169.

<sup>42</sup> In the same way argued by J. SNELL, J. JAAKKOLA, *Economic Mobility and Fiscal Federalism*, cit., p. 773.

<sup>43</sup> For a document clearly containing that kind of discourse, see ec.europa.eu.

<sup>44</sup> See also the OECD’s discourse focused on aggressive tax planning, at [www.oecd.org](http://www.oecd.org).

<sup>45</sup> At the same time, however, the Commission keeps relying on the narrative of harmful tax competition as a means to bring attention to an otherwise neglected policy domain, see for that point of view, C. RADAELLI, *Harmful Tax Competition in the EU: Policy Narratives and Advocacy Coalitions*, in *Journal of Common Market Studies*, 2002, p. 661 *et seq.*

that EU law can play a role in that regard. Until most recently confronted with a lack of willingness by Member States in harmonising certain features of their personal income and corporate tax regimes – although the tide recently seems to have been turning in this respect (III.1) –, the Commission has had to make use of alternative legal instruments to confront the excesses of tax competition within the internal market. Two policy instruments have been relied on in doing so. On the one hand, the use of State aid rules to curb the practice of granting advantageous corporate tax rulings to individual businesses. Although those provisions can indeed play a role in this respect, that role is limited at best (III.2). In the realm of both corporate and personal income tax competition, the Commission now increasingly relies on its newly enhanced budgetary policy coordination powers conferred in the wake of the sovereign debt crisis. Albeit imperfect, the Commission appears convinced that such coordination also serves as a tool to diminish aggressive tax competition within the internal market (III.3).

### III.1. HESITANT STEPS TOWARDS HARMONISATION

The harmonisation of diversified national (corporate or personal income) tax regimes has been considered ever since the 1960s. In the 1962, 1970 and 1992 Reports mentioned above,<sup>46</sup> Commission-designated experts have proposed some kinds of harmonisation of Member States' tax regimes. Political sensitivities, however, have resulted in those propositions never materialising.

In the wake of the 1997 Council Code of Conduct, the Commission decided to take more concrete actions in this regard. Its preferred way forward has been to propose tax law harmonisation, albeit in a most gradual way. Two related steps can be distinguished in this regard.

Firstly, the European Commission proposed additional measures calling for increased transparency and the abolition of further obstacles posited by tax laws across the European Union. In the shadows of its ambitious financial services action plan (FSAP),<sup>47</sup> harmonising the provision of financial services within the internal market, the Commission also presented a communication on preventing and combating corporate and financial malpractice.<sup>48</sup> In this Communication, the Commission called for increased transparency in the exchange of information regarding taxes due by businesses.<sup>49</sup> In creating transpar-

<sup>46</sup> See *supra*, references in footnote 18.

<sup>47</sup> Communication COM(1999) 232 final of 11 May 1999 from the Commission, *Implementing the Framework for Financial Markets: Action Plan*, p. 3. The Commission maintained that with the introduction of the euro, a unique window of opportunity existed to equip the EU with a modern financial apparatus in which the cost of capital and financial intermediation are kept to a minimum, see Communication COM(1999) 232, cit., p. 5.

<sup>48</sup> Communication COM(2004) 611 final of 27 September 2004 from the Commission on Preventing and Combating Corporate and Financial Malpractice.

<sup>49</sup> Communication COM(2004) 611, cit., p. 6.

ency, complex and multinational businesses would be taxed more fairly and correctly. A 2009 Good Governance Paper suggested Member States what steps they could take in that regard. Although not directly addressing tax competition as such, the Commission seemingly believes that more transparency might diminish Member States' appetite for competitive initiatives in the realm of taxes.<sup>50</sup> At the same time, however, no binding legal instruments had been adopted in the early 2000s in this context.

Secondly, the Commission has taken also more direct steps proposing to harmonise the corporate tax base for multinational businesses within the EU internal market. Starting with communications in 2001,<sup>51</sup> 2003,<sup>52</sup> 2005<sup>53</sup> and 2007,<sup>54</sup> the Commission in 2011 proposed a harmonised or common consolidated corporate tax base. According to that proposal, cross-border companies will only have to comply with one, single EU system for computing their taxable income.<sup>55</sup> More particularly, businesses would be able file one single tax return for all of their EU activities. They would also be able to offset losses in one Member State against profits in another. The consolidated taxable profits were then to be shared between the Member States in which the group is active, using an apportionment formula, allowing each Member State will then tax its share of the profits at its own national tax rate.<sup>56</sup> The proposal would result in the elimination of most corporate tax competition between Member States, as it provides a single EU system for companies to calculate their taxable income and a "one stop shop" to file a tax return for all their EU activity.<sup>57</sup> At the same time, however,

"the common approach proposed would ensure consistency in the national tax systems but would not harmonise tax rates. Fair competition on tax rates is to be encouraged. Differences in rates allows a certain degree of tax competition to be maintained in the internal market and fair tax competition based on rates offers more transparency and

<sup>50</sup> Communication COM(2009) 201 final of 28 April 2009 from the Commission on promoting good governance in tax matters.

<sup>51</sup> Communication COM(2001) 582 final of 23 October 2001 from the Commission, *Towards an Internal Market Without Tax Obstacles - A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities*.

<sup>52</sup> Communication COM(2003) 726 final of 24 November 2003 from the Commission, *An Internal Market Without Company Tax Obstacles: Achievements, Ongoing Initiatives and Remaining Challenges*.

<sup>53</sup> Communication COM(2005) 330 final of 20 July 2005 from the Commission, *Common Actions for Growth and Employment: The Community Lisbon Programme*.

<sup>54</sup> Communication COM(2007) 223 final of 16 September 2009 from the Commission, *Implementing the Community Programme for Improved Growth and Employment and the Enhanced Competitiveness of EU Business: Further Progress During 2006 and Next Steps Towards a Proposal on the Common Consolidated Corporate Tax Base (CCCTB)*.

<sup>55</sup> Commission Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 final, p. 5.

<sup>56</sup> See the explanations by the Commission in the accompanying memorandum, available at [europa.eu](http://europa.eu).

<sup>57</sup> Communication COM(2011) 121, cit., p. 6.

allows Member States to consider both their market competitiveness and budgetary needs in fixing their tax rates".<sup>58</sup>

Seeking to eliminate anticompetitive mismatches between national systems, preferential regimes and hidden tax rulings, which tax avoiders exploit, the proposal contained strong anti-abuse provisions.<sup>59</sup> At the time, however, Member States were not willing to move forward with this proposal. Given that unanimity was required in order for the measure to be adopted, failure to have all Member States on board practically implied the end of the proposal.<sup>60</sup>

More recently, however, the European Commission took up once more the two harmonisation proposals (increasing transparency and a common corporate tax base), seeking to move forward once more. This time, progress seems to have been made in the realm of increased transparency, thus also giving way to new steps in the harmonisation of the corporate tax base across the EU Member States. In particular, the Commission in 2015 proposed its anti-tax avoidance package,<sup>61</sup> containing, *inter alia*, a proposal for a Directive on tax avoidance. That Directive has been adopted by the Council in July 2016.<sup>62</sup> The Directive contains four sets of rules aimed at countering aggressive tax planning. Firstly, "[e]xceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation".<sup>63</sup> Secondly, a taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes when transferring the head office or permanent establishment in another Member State.<sup>64</sup> Thirdly, the Directive puts in place a foreign-controlled company rule. According to that rule, Member States shall tax – to a more or less significant extent – the activities of that controlled company on their territory.<sup>65</sup> Fourthly, the Directive also contains a more general anti-abuse clause. According to that clause, "a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part." Not genuine are measures,

<sup>58</sup> *Ibid.*, p. 4.

<sup>59</sup> *Ibid.*, p. 47.

<sup>60</sup> See for background, M.F. DE WILDE, *Tax Competition Within the European Union. Is the CCCTB Directive a Solution?*, in *Erasmus Law Review*, 2014, p. 24 *et seq.*

<sup>61</sup> See ec.europa.eu.

<sup>62</sup> Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

<sup>63</sup> *Ibid.*, Art. 4, para. 1.

<sup>64</sup> *Ibid.*, Art. 5, para. 1.

<sup>65</sup> *Ibid.*, Art. 7.

which are not put into place for valid commercial reasons, which reflect economic reality.<sup>66</sup> The Directive only harmonises the minimum requirements and does not preclude application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases.<sup>67</sup> In doing so, the Council nevertheless aims to limit the scope of harmful corporate tax competition. The Directive is currently being transposed: Member States have until 1 January 2019 to implement its provisions.<sup>68</sup> It remains to be seen if and how the Directive will be applied and enforced on a day-to-day basis. It can be presumed that its implementation and correct application will take some time before completely resulting in a diminution of corporate tax competition among EU Member States.

Concerning the harmonisation of the consolidated corporate tax base, the Commission in 2016 relaunched its 2011 proposal. Proposing a common corporate tax base Directive as well as a common consolidated corporate tax base Directive,<sup>69</sup> both proposals are currently being discussed by the Council. It remains to be seen whether the proposals will be adopted and, if so, when they will be implemented and applied at Member State level.<sup>70</sup> On 19 June 2018, however, France and Germany have proposed a common position paper on this subject, hoping to move forward and reach a deal on a harmonised consolidated corporate tax base by mid-2019.<sup>71</sup>

Although recent legislative initiatives and proposals at EU level have shown an acute awareness at EU level that aggressive tax competition requires regulatory steps, the harmonising measures taken so far have been relatively modest. In obliging Member States to take action against corporate tax avoidance strategies, the EU institutions nevertheless give a clear signal that tax avoidance – and especially aggressive tax competition – is no longer deemed acceptable within the EU internal market. It remains to be seen to what extent the proposals or Directive will succeed in bringing about real change. All of that will naturally depend on the vigorousness with which the new Directive will be enforced and the degree to which it will be supplemented by additional harmonising instruments.

<sup>66</sup> *Ibid.*, Art. 6.

<sup>67</sup> *Ibid.*, Art. 3.

<sup>68</sup> *Ibid.*, Art. 11.

<sup>69</sup> Commission Proposal for a Council Directive on a common corporate tax base, COM(2016) 685 and Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2016) 683 final.

<sup>70</sup> For a preliminary analysis, see M.F. DE WILDE, *The CCCTB Relaunch: A Critical Assessment and Some Suggestions for Modification*, available at [papers.ssrn.com](http://papers.ssrn.com).

<sup>71</sup> The paper is available at [www.economie.gouv.fr](http://www.economie.gouv.fr). In essence, it proposes to move forward as a way to increase tax transparency between Member States. See also, [www.euronews.com](http://www.euronews.com).

### III.2. STATE AID RULES

Awaiting the transposition of more specific rules on tax avoidance, the Commission has not refrained from using an alternative legal instrument in an attempt to counter aggressive tax competition. Ever since the 1990s, the Commission has indeed stated it may use its enforcement powers in the realm of State aid in order to condemn and prohibit special tax arrangements that distort or threaten to distort competition in the internal market.<sup>72</sup> The State aid provisions offer a useful – if only limited and supplementary – instrument in that regard.

According to Art. 107 TFEU, any advantages given by or imputable to a public authority of an EU Member State to preselected businesses or groups of businesses that appreciably affect trade between Member States are considered as aid incompatible with the EU internal market. Such aid cannot be granted to beneficiaries, unless the Commission has given an explicit authorisation to that extent or unless a legal instrument specifically allows for its granting.<sup>73</sup> Advantages granted by public authorities do not necessarily need to take the format of a direct subsidy. Any loss of income by the public authority can also qualify as an advantage. From that point of view, tax breaks or tax reductions have been considered to constitute advantages.<sup>74</sup> The State aid provisions – and accompanying prohibition to grant advantages qualifying as State aid – only apply to so-called “selective” measures. Measures in principle are selective if they apply to a single company, a specific economic sector or a specific part of the territory of a Member State.<sup>75</sup> Measures applying to all economic actors and to the territory of a Member State as a whole are not selective. From a tax law point of view, that means that general reductions in corporate tax rates, of which every corporation established or wanting to get established on the Member State’s territory can benefit, are not considered State aid measures targeted by Art. 107 TFEU.<sup>76</sup>

Against that background, the role of State aid provisions is both limited and specific. It only envisages a limited number of tax arrangements proposed at Member States’ levels and, in addition, only focuses on those that could be deemed to comprise selective advantages. In the Commission’s current enforcement practice, attention has predominantly focused on so-called tax ruling practices of Member States. As Commissioner for Competition Vestager said in a speech of October 2017, “EU State aid rules help to ensure that companies can compete on the merits within the Single Market. The rules prevent Member States from giving unfair advantages only to selected companies. For

<sup>72</sup> See the 1998 Commission notice on the application of the State aid rules to measures relating to direct business taxation, cit.

<sup>73</sup> See Art. 108, para. 1, TFEU.

<sup>74</sup> Commission notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, cit., para. 68.

<sup>75</sup> *Ibid.*, para. 117 *et seq.*

<sup>76</sup> *Ibid.*, para. 118.

example, a Member State cannot give tax benefits to multinational groups, which are not available to local businesses. That distorts competition. It is illegal under EU State aid rules".<sup>77</sup> Since 2013, the European Commission has therefore taken an increasing interest in Member States' practices of granting tax benefits to mainly multinational undertakings by means of individual tax rulings or specifically tailored tax agreements. In this respect, the Commission in October 2015 found that the Netherlands has given unlawful aid to Starbucks and Luxemburg to Fiat Chrysler.<sup>78</sup> In January 2016, it held that Belgium give advantages to at least 35 undertakings benefiting from an excess profit ruling regime.<sup>79</sup> In August 2016, Ireland was condemned for having granted over €13 billion tax advantages to Apple.<sup>80</sup> In October 2017, Luxemburg's treatment of Amazon was deemed also to constitute State aid.<sup>81</sup> At this moment, Luxemburg's tax treatments of McDonalds<sup>82</sup> and GDF Suez<sup>83</sup> are still under investigation, as is the United Kingdom's tax scheme for multinationals.<sup>84</sup> Member States having granted unlawful State aid by means of tax rulings have been required by the Commission to recover the advantages from the beneficiary undertakings concerned. At present, numerous appeals are pending against Commission recovery decisions before the EU General Court.<sup>85</sup>

<sup>77</sup> Statement by Commissioner Vestager of 4 October 2017 on illegal tax benefits to Amazon in Luxemburg and referring Ireland to Court for failing to recover illegal tax benefits from Apple, europa.eu.

<sup>78</sup> See europa.eu.

<sup>79</sup> See europa.eu.

<sup>80</sup> See europa.eu.

<sup>81</sup> See europa.eu.

<sup>82</sup> See europa.eu.

<sup>83</sup> See europa.eu.

<sup>84</sup> See europa.eu.

<sup>85</sup> Cases currently pending before the General Court in the specific context of tax rulings and also questioning the selectivity issue are: case T-755/15, *Luxemburg v. Commission*; case T-759/15, *Fiat Chrysler Finance Europe v. Commission*; case T-760/15, *Netherlands v. Commission (Starbucks)*; see also case T-636/16, *Starbucks and Starbucks Manufacturing Emea v. Commission*; case T-778/16, *Ireland v. Commission*; case T-783/16, *Government of Gibraltar v. Commission*; case T-892/16, *Apple Sales International and Apple Operations Europe v. Commission*; case T-131/16, *Belgium v. Commission*; as well as actions initiated by businesses having benefited from those rulings, see pending cases T-201/16, *Soudal v. Commission*; T-263/16, *Magnetrol International v. Commission*; T-265/16, *Puratos and others v. Commission*; T-278/16, *Atlas Copco Airpower e Atlas Copco v. Commission*; T-311/16, *Siemens Industry Software v. Commission*; T-319/16, *BASF Antwerpen v. Commission*; T-321/16, *Ansell Healthcare Europe v. Commission*; T-324/16, *VF Europe v. Commission*; T-335/16, *Esko-Graphics v. Commission*; T-343/16, *Trane v. Commission*; T-350/16, *Kinopolis Group v. Commission*; T-351/16, *Belgacom International Carrier Services v. Commission*; T-357/16, *Punch Powertrain v. Poland*; T-370/16, *Anheuser-Busch Inbev e Ampar v. Commission*; T-371/16, *BP Aromatics v. Commission*; T-373/16, *Victaulic Europe v. Commission*; T-388/16, *Eval Europe v. Commission*; T-420/16, *SJM Coordination Center v. Commission*; T-444/16, *Vasco Group and Astra Sweets v. Commission*; T-467/16, *Flir Systems Trading Belgium v. Commission*; T-637/16, *Wabco Europe v. Commission*; T-681/16, *Henkel Belgium v. Commission*; T-800/16, *Mayekawa Europe v. Commission*; T-832/16, *Celio International v. Commission*; T-858/16, *Dow Corning and Dow Corning Europe v. Commission*; T-867/16, *Nomacor v. Commission* in that respect. On 14 February 2019, the General Court

The State aid framework gives the European Commission a potentially powerful instrument to prohibit Member States' aggressive tax planning initiatives. At the same time, however, State aid provisions only provide a supplementary instrument to counter aggressive tax competition. Given that only selective measures can be prohibited, State aid provisions would not impede Member States to adopt an overall lenient or competitive corporate tax policy. From that point of view, the Commission has acknowledged explicitly that State aid constitutes a supplement to more harmonising measures. Although the threat of State aid repercussions may cause Member States to think twice when implementing a tax arrangement, the State aid provisions still leave a significant margin of discretion for Member States wanting to attract businesses to their territories.

### III.3. BUDGETARY POLICY COORDINATION

Another mean through which the European Commission has also sought to speed up the harmonisation or convergence process of Member States' corporate tax regimes by means of its new powers in the realm of budgetary policy coordination. In the wake of the 2009-2010 sovereign debt crisis, the European Union set out to strengthen its surveillance over economic and budgetary policies of Member States, predominantly within, but also outside the Eurozone.<sup>86</sup>

Imposing new budgetary obligations on the Member States, the EU particularly strengthened its budgetary supervision procedures through the so-called Six-Pack. The Six-Pack includes five regulations and one directive imposing stringent budgetary supervision requirements on the Member States.<sup>87</sup> Additionally, these measures were followed by the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.<sup>88</sup> The framework was later complemented by a Two-Pack of regulations further

held in cases T-131/16 and T-263/16 that the Belgian excess profit ruling scheme was not to be considered an aid scheme, for the practice was not sufficiently systematic. As a result, the General Court annulled the Commission decision referred to in footnote 79. The General Court did not establish whether the Belgian regime was to be considered selective, it was just not a systematic aid scheme.

<sup>86</sup> For an overview of measures, see V. BORGER, *The Transformation of the Euro: Law, Contract, Solidarity*, doctoral thesis, Leiden University, 2018.

<sup>87</sup> Adopted by the European Parliament and the Council on 16 November 2011, the six-pack comprises Regulation (EU) 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, Regulation (EU) 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, Regulation 1175/2011 amending Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Regulation (EU) 1176/2011 on the prevention and correction of macroeconomic imbalances, Regulation (EU) 1177/2011 of 8 November 2011 amending Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and Council Directive (EU) 2011/85 of 8 November 2011 on requirements for budgetary frameworks of the Member States.

<sup>88</sup> Treaty of 1 February 2012 on Stability, Coordination and Governance in the Economic and Monetary Union.

solidifying Member State obligations.<sup>89</sup> In the case of Member States facing defaults, as was the case in Greece, the obligations thus imposed limit their autonomy to decide on the amount they can spend on certain policy domains.<sup>90</sup> Although Member States retain some autonomy in deciding how and where to spend money, their actions are increasingly embedded in an EU-wide budgetary supervision framework.<sup>91</sup>

As part of the upgraded legislative framework, a so-called ‘European Semester’ has seen the light of day. That Semester allows the Commission to set priorities on how Member States’ budgets have to be shaped. In November, these priorities are made public in a so-called autumn package, following which the Commission assesses the economic and social policies in place in the different Member States. Those Member States subsequently have to address their reform programmes to the Commission, which will adopt country-specific recommendations in May. In addition, an obligation for Member States to submit their draft budgets to the European Commission, which is required to review them and to offer country-specific recommendations in order to make economic and fiscal policies sounder at Member State level.<sup>92</sup> The European Commission considers its country-specific recommendation and budgetary monitoring and oversight powers as supplementary tools of fiscal coordination within the EU internal market. On the one hand, the Semester analyses permit to highlight in a more specific way how Member States have to proceed in order to ensure the stability and shock-proof nature of their economies. On the other hand, the Commission can address specific recommendations to Member States in that respect, related to their budgetary policies and to ways in which transposition of EU law needs to be taken into consideration in those budgetary policy exercises. By way of example, the Commission’s Communication on the 2018 European Semester gave specific fiscal coordination nudges in that regard. According to the Commission,

“aggressive tax planning entails significant losses to European taxpayers; the transposition of EU legislation will help curtailing such practices. Revenue losses from profit shifting within the EU alone are estimated at EUR 50-70 billion. Aggressive tax planning distorts the playing field among companies, and unfairly diverts resources from governments’ spending objectives. Tax abuse can be reined in by strengthening national tax

<sup>89</sup> Adopted by the European Parliament and Council on 21 May 2013, it comprises Regulation (EU) 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, and Regulation (EU) 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area.

<sup>90</sup> F. FABBRINI, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges*. Oxford: Oxford University Press, 2016, p. 56. For more information, see [ec.europa.eu](http://ec.europa.eu).

<sup>91</sup> S. VAN DEN BOGAERT, A. CUYVERS, *Of Carrots and Sticks. What Direction to Take for the Economic and Monetary Union?*, in B. STEUNENBERG, W. VOERMANS, S. VAN DEN BOGAERT (eds), *Fit for the Future? Reflections from Leiden on the Functioning of the EU*, Den Haag: Eleven International Publishing, 2016, p. 122 *et seq.*

<sup>92</sup> See for a summary in that regard, [ec.europa.eu](http://ec.europa.eu).

legislation, increasing transparency, and cooperation among governments. Belgium, Cyprus, Malta and the Netherlands are amending aspects of their tax systems that have facilitated aggressive tax planning. In Ireland, the recommendations of an independent review of the corporation tax code have been submitted to public consultation. By the end of 2018, Member States have to transpose the provisions of the Anti-Tax Avoidance Directive (ATAD) into their national law<sup>93</sup>.

The Commission's ability to use the European Semester to highlight problems of tax competition and to nudge Member States to adapt their fiscal frameworks is promising in scope yet limited in scale. In terms of scope, country-specific recommendations are containing suggestions on how to make a budget sounder, generally in the context of a macro-economic imbalances procedure. As such, Member States budgetary and fiscal autonomy is placed ever more under the closer watch of the Commission. In terms of scale, however, the Commission's country-specific recommendations and compliance tools are not overly effective. In the context of the macro-economic imbalance procedure, the Commission's country-specific analyses may result in the conclusion that no imbalances, imbalances or excessive imbalances are present in a Member State's budget. In the excessive imbalances' situation a corrective procedure can be started, through which the Council adopts recommendations for corrective action. Persistent failure to comply with those recommendations may result in sanctions or fines being imposed in the case of Eurozone Member States.<sup>94</sup> The multiple layers of decision-making required before arriving at the imposition of sanctions as a means to force Member States into compliance demonstrate the limited potential of this procedure as a means to address tax competition within the internal market. That finding is even exacerbated in relation to Member States that are not having excessive imbalances or non-Eurozone Member States. In those instances, the possibility to impose fiscal corrections on Member States is even more limited. On a more general level, given their country-specific nature, recommendations cannot simply replace a full-blown harmonisation of corporate or other tax policies. From that point of view, budgetary control at best results in a supplementary and softer form of nudging Member States away from aggressive tax planning mechanisms. In doing so, the Commission may address aggressive tax competition, but only in an indirect and rather implicit way. As some Member States are not subjected to the budgetary compliance mechanisms to the same extent as others, their aggressive tax planning activities would risk to escape the Commission's scrutiny over their fiscal policies. This paradoxically could result in reducing aggressive tax planning strategies of Member States facing budgetary problems, but leaving similar strategies in other Mem-

<sup>93</sup> Communication COM(2018) 120 of 7 March 2018 from the Commission on 2018 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011, p. 10.

<sup>94</sup> See Regulation 1174/2011, to that extent.

ber States untouched. As a result, those Member States could even be more incentivised to engage in aggressive tax planning, seeking to attract businesses previously lured to those Member States now under closer watch of the Commission. From that point of view, the current legal framework governing economic governance hardly presents an effective instrument coherently to reduce tax competition across the internal market.

#### IV. CALLING FOR AN EVEN MORE EXPLICIT CHANGE OF COURSE

The previous section allows to conclude that the European Union in general and the European Commission in particular have not only recognised the vices of aggressive tax competition within the EU internal market, but have also developed three different strategies seeking to control or limit such competition. Seeking to correct the tax planning consequences the structure of the internal market has created, the Commission essentially proposes a soft convergence strategy (through budgetary policy coordination), a hard law enforcement strategy (State aid and recovery decisions imposed on Member States) and a classical harmonisation strategy, closing the gaps left in the absence of such harmonisation. Each of those strategies complements each other and has its merits. Despite their variety and complementarity, however, the approaches proposed or developed by the European Commission to deal with Member States' aggressive competition in the realm of corporate taxes are remarkable similar in ambition. It can be submitted that all three approaches essentially boil down to a so-called "corrective" approach to addressing excesses of the internal market setup. A corrective approach implies that the European Union wants to correct certain mishaps in the legal setup, without modifying, or even considering to modify the foundations of the legal framework in place. In proposing to use State aid, budgetary coordination and harmonisation, the EU only aims to ensure that the current setup does not result in disequilibria in the division of powers between the EU and Member States. Such disequilibrium would follow from the fact that tax competition could undermine the movement features on which the internal market has been built.

The EU internal market legal framework is indeed still conditioned upon the EU guaranteeing movement and Member States taking regulatory measures in the public or general interest protecting their territories. That setup remains fundamentally unchanged and unchallenged in the current EU aggressive tax competition debates. State aid enforcement only tackles selective measures that distort competition, budgetary policy recommendations only constitute recommendations and the current anti-tax avoidance Directive still leaves room for Member States to develop their own tax policy. From that point of view, the proposed strategies addressing aggressive tax competition instances all start from the same point: maintaining and enforcing the internal market legal setup as is presently in place.

It would be easy to blame the European Commission for having chosen only to correct excesses of tax competition through regulation, soft law and enforcement. Howev-

er, one can say that it is the only possibility within its mandate as guardian of the Treaties.<sup>95</sup> As the Member States have set up an internal market that allows for tax competition in the corporate and personal income fields, the Commission would only be able to correct certain excesses that do not alter the foundations of the internal market as we know it. From that point of view, the Commission would likely be overstepping its mandate under the Treaties if it decided to take action beyond the corrective measures – harmonisation proposals included – developed at present. From that point of view, it can be maintained that the EU constitutional framework only offers a limited toolbox allowing the Commission to deal with the negative effects of tax competition. It would therefore be perfectly understandable for the Commission to limit its corrective measures to what is possible under the current EU Treaty framework.

The constitutional limits identified as justifying further Commission action notwithstanding, the fact remains that the European Commission could do more to effectively counter the vices of aggressive tax competition and to limit tax competition more generally within the framework of the EU internal market. Two steps can be envisaged in that regard.

Firstly, the Commission should be more explicit on whether tax competition is something that should indeed be part of the EU internal market functioning or something to be abolished (gradually or completely). The current Commission proposals and reforms do not allow to answer that question in a clear fashion. On the contrary, those proposals and reforms can indeed be understood in two rather opposite ways.

On the one hand, as current proposals made by the European Commission only seem to correct excessive instances of tax competition, the Commission could be understood to consider regulatory competition as something bad in the particular context of corporate taxes, without however fully detracting from the long-maintained position that regulatory competition also produces beneficial effects within the internal market. Commission proclamations are generally limited to calling for fair taxation across the European Union and for making sure that the internal market freedoms are not abused or confirm that tendency. If that is still the case, the Commission would not consider all kinds of tax competition to be necessarily a bad thing requiring correction, but only the most aggressive or excessive ones. The question then naturally arises what kinds of tax competition the Commission still considers as beneficial – for instance a certain kind of competition in personal income taxes to stimulate workers' mobility – and what measures are to be taken to stimulate such competition. At present, the Commission proposals only focus on correcting aggressive tax competition instances and fail to make clear whether other kinds of tax competition can still be envisaged. For Member States wanting to fine-tune their tax systems, also in the light of EU initiatives harmonising certain features of corporate taxation, it would be useful to understand where and how tax competition can still be at play and what limits EU law will put or considers put-

<sup>95</sup> As guaranteed by Art. 17, para. 1, TEU.

ting on those activities. It would also have to be mentioned that a shift in position by the Commission as such does not change the state of EU law. Only when harmonising legislation in other tax competition domains would be adopted or when the Court of Justice would declare Member States' competitive dynamics as incompatible with EU internal market law would this be the case. In any case, however, the current Commission proposals do not allow to paint a clear picture on how much competition is still being allowed for in the realm of taxes.

On the other hand, however, the Commission's clear stance on wanting to remove all kinds of aggressive tax competition could also be understood as taking a position that tax competition as such is considered a relic from the past, currently no longer tolerated as a matter of EU law. The fact that the Commission scrutinises Member States' budgets more explicitly could be interpreted as an indication of that tendency. In that understanding, the Commission's proposals would constitute a first step in the complete eradication and abolition of all tax competition instances. If that position were indeed taken, all kinds of tax differences aimed at luring individuals or businesses to a Member State's territory would be deemed incompatible with the Commission's current tax competition position. From the point of view of EU law as a whole, that sort of "policy" incompatibility would not be necessarily problematic. At the same time, however, it would most likely give rise to legal uncertainty and more litigation. It is indeed not unlikely that Member States would contest each other's tax incentive practices for natural persons or for corporations as being incompatible with the EU internal market, asking the Court of Justice to take a more explicit position on that matter.<sup>96</sup> To the extent that the Court of Justice considers those practices to be legal, a position that could be said to underlie the Court's current case law,<sup>97</sup> the Commission will most likely have to nuance its position on tax competition. To the extent that the Court of Justice would consider tax competition equally problematic,<sup>98</sup> the Commission would most likely be called upon to swiftly proceed in taking new legislative initiatives to avoid opening the floodgates of litigation concerning each time individual Member States' specific tax provisions. In either case, the Commission would be called upon to make its position regarding the continued relevance or permissibility of tax competition more explicit.

<sup>96</sup> By virtue of the procedure provided for in Arts 259 and 260 TFEU.

<sup>97</sup> As the line of case law following *Centros*, cit. in the realm of corporate mobility has not been overruled formally, it could be argued indeed that the Court thinks regulatory competition – also extended to the field of taxation – remains legal as a matter of EU internal market law. For lack of certainty on that point, however, a more explicit question is to be raised to that extent.

<sup>98</sup> One of the questions currently accompanying the tax ruling State aid litigation concerns the extent to which the Commission effectively changed position in the debate, triggering the invocation of EU law general principles such as the principle of legal certainty, see, to that extent, P. VAN CLEYNENBREUGEL, *Recovering Unlawful Advantages in the Context of EU State Aid Tax Ruling Investigations*, in *Market and Competition Law Review*, 2017, p. 15 *et seq.*

Secondly, it follows at least from the foregoing that, whatever the position is the Commission now seemingly takes, its recent proposals addressing aggressive tax competition most fundamentally and directly call for it also taking a more explicit position on fields where tax competition still fits the EU internal market and those where this is no longer the case. As such, the proposals made by the Commission directly call for a more explicit and holistic reflection on tax competition in the internal market. As such, reflections have been made at that more general level in the 1990s and it would be a good time to re-launch them. It would therefore fall upon the Commission in the very first place to clarify its position on tax competition in a more general communication explaining the scope, nature and impact of its different recent tax competition-countering initiatives. As a follow-up to that communication, it would not be entirely unimaginable to revive the code of conduct group set up by the Council in 1997 and to transform it in a group of EU institutions' representatives, experts, policymakers and parliamentary representatives, re-opening debates on the future of tax competition in light of the Commission's recent stance on aggressive tax competition. Doing so would allow to build upon the momentum created by the Commission's initiatives and to continue debates on and action against tax competition situations that are incompatible with the internal market.

Given that Member States' aggressive tax planning strategies are increasingly frowned upon by the European Commission, it seems to be that tax competition may become ever more undesirable. To the extent that the European Union aims to integrate different Member States and to create a level playing field both for its businesses and citizens, Member States' tax planning strategies are to be condemned even more explicitly and directly. The current strategies engaged in by the Commission hardly suffice to achieve that goal. Now would be a good time to come up with a more holistic tax competition removal strategy and a more in-depth reflection on the regulatory instruments needed to achieve that aim. It can only be hoped that the European Commission – especially the new one taking office in 2019 – will take upon that call and finally take even larger steps to remove tax competition from the EU internal market.

## V. CONCLUSION

The internal market has turned movement between Member States into a reality. Such movement also incentivises Member States to take measures to attract or keep businesses within their territory. As a result, the setup of EU internal market law has given rise to so-called "aggressive" tax competition situations. Tax rulings tailored to multinational businesses constitute the most explicit expression of that tendency. Although the European Union has for a long time emphasised the positive effects tax competition could bring about, the sovereign debt and Eurozone crisis have definitely shifted the discourse in that respect. The current Commission has therefore made the combatting of aggressive tax planning instances one of its priorities. To that extent, three strategies have been pro-

posed, varying from soft convergence through budgetary recommendations over hard law enforcement by means of State aid to more nuanced harmonisation proposals.

Those three strategies neatly demonstrate that the Commission is aware of the aggressive tax competition problem and has taken steps to mitigate their prevalence. At the same time, however, this paper argued that those strategies reflect a rather limited toolbox for dealing with structural (fiscal) imbalances within the internal market and do not permit to clearly deduce the Commission's current take on the need for or continued relevance of tax competition within the internal market. It therefore invited the Commission to engage in a more general reflection, beyond the limited confines of corporate tax competition, on the virtues and vices of regulatory competition and the role of EU law in enabling or restraining such competition. Given that the Commission explicitly acknowledges the negative effects produced by tax competition, it was also suggested that a more fully developed plan aimed at reducing tax competition in the internal market and a reflection on regulatory instruments supporting it is overdue at this point in time.



## DIALOGUES SOLIDARITY AND CONFLICT

### INSTITUTIONALISING SOLIDARITY: A GENUINE CHALLENGE FOR EUROPE

ELISE MUIR\*

ABSTRACT: In *Solidarity and Conflict* (Cambridge: Cambridge University Press, 2018), Silvana Sciarra invites us to reflect along with her on how to design European governance so as to ensure participation and support. Is collective bargaining the way forward?

KEYWORDS: solidarity – conflict – collective bargaining – economic governance – *Viking* – collective interests.

#### I. INTRODUCTION

With her latest book, *Solidarity and Conflict*, Silvana Sciarra provides a most welcome addition to the literature on European social law and governance.<sup>1</sup> The author reflects on social conflicts in a transnational context. She submits that collective bargaining offers the best institutional setting to channel social tensions as well as to enhance support for the European project. While social conflicts are inevitable and most often painful, the interactions and infrastructures needed in response are seen as constituting the essence of a peaceful and united Europe.

In this fairly concise and very well written piece of scholarship, Silvana Sciarra succeeds in articulating a sharp critic of current European social governance through a positive lens. The book is enriching, thought provoking as well as refreshing in that it offers an opportunity to think constructively about social conflict in a transnational context. With a view to entering a *Dialogue* with the author and readership of *Solidarity and Conflict*, this note is structured in two parts. I will first identify the conceptual underpinnings of the book (section II) before inviting further reflections on the centrality of collective bargaining in the author's narrative (section III).

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<sup>1</sup> S. SCIARRA, *Solidarity and Conflict*, Cambridge: Cambridge University Press, 2018.

## II. A REMARKABLE PIECE OF SCHOLARSHIP FOR THE CONCEPTUAL APPROACH CHOSEN

The monograph stands out for the theoretical angle adopted. The conceptual approach results from a combination of focus, choice of tone as well as scope of the research.

In terms of focus, the book is centred on “solidarity” at a time when the theme has become crucial for the future of the European Union. Examples of highly topical debates on solidarity range from the difficulty to reform the Common European Asylum System, possibly related to the shape of the Schengen area,<sup>2</sup> to the negotiations on the Multi-Annual Financial Framework for 2021-2027, including a possible Eurozone specific prong.<sup>3</sup>

While acknowledging the importance of solidarity towards third-country nationals as well as the need to reflect on economic governance, Silvana Sciarra primarily devotes her attention to tensions “occurring in work organization and in the structure of the workforce”.<sup>4</sup> Solidarity is defined by reference to “ways in which collective interests emerge and are represented by organized groups at a national and transnational level”.<sup>5</sup> Instead of mapping out or categorizing social tensions, the author investigates the role of key players. Social partners, as well as instruments of funding, are seen as central to better articulate social tensions and reconnect domestic actors with the European project.

The *tone* of the monograph is purportedly positive and constructive. Silvana Sciarra rejects attempts, often simplistic, to categorically oppose the logics behind European market integration and the construction of a social Europe. She instead invites key stakeholders to embrace the transnational dimension of contemporary labour markets which she understands as a “resource for growth and competitiveness”.<sup>6</sup>

The intimate bond that the author creates between the concepts of “conflicts” and “solidarity”, allows her to acknowledge the deeply divisive effects of austerity measures from the past years while also arguing in favour of strengthening the design of collective bargaining. She argues that in a transnational context, collective bargaining is the best way to respond to the reoccurrence of economic shocks as well as to build stronger social cohesion.

This approach to social tensions is primarily institutional in nature, Silvana Sciarra emphasizes the importance of players and processes instead of engaging in value judgements. This choice of narrative makes it easier for the author to distance herself from

<sup>2</sup> See for instance: V. MALLET, M. KHAN, *Macron Makes His EU Election Plea to Europe*, in *Financial Times*, 4 March 2019, [www.ft.com](http://www.ft.com).

<sup>3</sup> As illustrated in some of the latest European Council Conclusions of 13 and 14 December 2018, paras 1 and 6; see further e.g. M. KHAN, *Rescuing the Eurozone Budget*, in *Financial Times*, 11 February 2019, [www.ft.com](http://www.ft.com).

<sup>4</sup> S. SCIARRA, *Solidarity and Conflict*, cit., p. 2.

<sup>5</sup> *Ibidem*.

<sup>6</sup> *Ibidem*, p. 3.

literature discussing the relationship between the market and the social from a normative perspective, and often taking a binary approach. It also allows the book to be tainted by the distinctively positive and constructive narrative already mentioned.

This is not to say that the tone is naïve. Silvana Sciarra is critical, if not highly critical, of a number of legal developments affecting European labour law such as the failure of the Open Method of Coordination<sup>7</sup> or rulings by the Court of Justice of the European Union as in *Viking*.<sup>8</sup> The author also regrets the side lining of trade unions in the context of European Semester. Nevertheless, a resolute choice is made to addressing problems by moving beyond *status quo* without calling into question the grand scheme of things. She thereby offers a valuable counter narrative to radical and protectionist discourses, that are increasingly frequent in contemporary politics, although they may not be realistic and threaten the stability of the polity.

This powerful choice is supported by the extraordinary *scope of the research*. Silvana Sciarra understands European social law and governance very broadly. She does not seek to specifically circumscribe it by reference, for instance, to a set of given legal instruments adopted at European level. Instead, the approach transcends problems of allocations of competences between the Member States, the European Union, the Council of Europe as well as other layers of relevant stakeholders. The point being that the transnational nature of today's labour markets and limits inherent in existing inter-state solidarities call for a renewed focus on actors at sub-national level, flexible enough to adjust to new transnational settings.

The book therefore touches upon a very broad set of sources ranging from traditional legal norms understood in their sophisticated and multi-layered legal context such as European Union directives, CJEU rulings, domestic constitutions, the Social Charter to numerous soft-law instruments. The author engages with new governance techniques related to the functioning of soft-law in the form of the Europe 2020 strategy or the European Semester, and its well-known Country Specific Recommendations.

This integrated approach is not only justified given the complexity of social questions at European level, it also feeds into the solutions advocated by the author. Silvana Sciarra argues for instance that the central role of social partners in articulating and constructively channelling social conflicts across Europe could be combined with reliance on social governance through funding as suggested by the Barca report for a reformed cohesion policy from 2009.<sup>9</sup>

<sup>7</sup> As set out, for instance, in the Lisbon Strategy: European Council Presidency Conclusions of 23–24 March 2000.

<sup>8</sup> Court of Justice, judgment of 11 December 2007, case C-438/05, *International Transport Workers' Federation and Finnish Seamen's Union v. Viking Line ABP and OÜ Viking Line Eesti*.

<sup>9</sup> F. BARCA, *An Agenda for A Reformed Cohesion Policy: A Place-based Approach to Meeting European Union Challenges and Expectations*, Independent Report prepared at the request of Danuta Hübner, Commissioner for Regional Policy, April 2009.

### III. REFLECTING ON THE FOUNDATIONAL CONCEPT: THE CENTRALITY OF COLLECTIVE BARGAINING

This decidedly positive, institutional as well as multi-layered approach to enhancing solidarity in Europe calls for a number of remarks. I come back here on some of the assumptions that allow the author to centre her argument on the promises of collective bargaining: the institutional approach to solidarity, collective bargaining in “Western democracies”<sup>10</sup> as a point of reference and the limited references to other forms of representation of interests.

The definition of *solidarity in institutional terms* has the advantage, as noted above, that it allows the author not to engage in a discussion of normative models of solidarity at European level. Such a strength may also constitute a weak point of the book’s narrative. It could be argued that the book fails to offer conceptual clarity on the type of social Europe called for by the author. It could also be noted that the institutional angle adopted, because it does not deeply call into question the current grand design of the European Union on social questions, implies normative support for such a model.

In response, the author expects that key normative choices emerge from a fruitful form of collective dialogue in a transnational context. Systemic change may thereby ensue from the sound operation of the processes of collective bargaining advocated in the book. If that is correct though, much would nevertheless depend on how the representation of interests is organized. This begs the question: What then is the model of collective bargaining on which the book rests?

The monograph indeed places much *faith in the sound functioning of collective bargaining*. Social partners and the processes for their interaction are central to the author’s thesis. A wealth of examples illustrating the ability of social partners to respond to the challenges raised by a transnational economy and labour market are provided. However, the author is not explicit on what the pre-conditions for such collective representation of interests to emerge are; other than for a few references to Western democracies which seems to define the standards of reference.

There is therefore little clarity on the choice of type of collective bargaining that may deliver the expected outcome. One area of concern is the well-known risk that social partners, due to limited membership, do not adequately and fairly represent the diversity of interests at stake. A related point of concern is that, as they are designed to protect their constituencies and the incumbents, social partners may only offer ill-suited structures to think beyond their own horizons as needed to respond to Silvana Sciarra’s call to embrace the transnational nature of today’s economy.

Even if such concerns were overcome, through the change of mindset advocated by the author and to which I expect that specific policies would have to be devoted, the narrative on collective bargaining may have to be adjusted to different cultures and tradi-

<sup>10</sup> See for instance: S. SCIARRA, *Solidarity and Conflict*, cit., pp. 9, 105, 135.

tions of collective bargaining across Europe. The approach to collective bargaining in regimes having been marked by years of soviet communism may for instance be very different from those prevailing in Italy or the Nordic countries.

One way of nuancing these objections to the book's approach, could be to elaborate on concrete suggestions to address the concerns, possibly building on some prongs of the European Pillar of Social Rights recently proclaimed by the three main EU institutions.<sup>11</sup> The role of *other forms of representation of collective interests* could also be explored. The European Union legislator has for instance been increasingly often requiring the creation or empowerment of organs at national level, such as equality bodies<sup>12</sup> or non-governmental organizations, designed to support the development of a given EU policy. In link with its institutional approach, the book may also further be related to broader reflections on democratic involvement with the European project.

To conclude, Silvana Sciarra powerfully brings together her thoughts on how to address the crisis of European social law identified in the sub-title of her book. I share the concerns expressed by the author and the sense of urgency in finding ways in which collective interests can be expressed as well as duly represented at national and transnational level. I have much sympathy for the institutional and integrated approach adopted. I also adhere to the call to constructively address the reality of the current transnational economy to which we belong. Yet, I fear that social partners may only constitute one of the highly complex set of actors to which we ought to turn to, and through which change may come. This book is therefore an important contribution to the debate on the future of European social law as much as invitation to further reflect on governance with a view to channelling conflicts, as well as to attracting political support, for engaging with social questions at European level.

<sup>11</sup> European Parliament, Council and European Commission, *Solemn Proclamation of the European Pillar of Social Rights*, Gothenburg, 2017.

<sup>12</sup> See for instance the work of the European Network of Equality Bodies, [www.equineteurope.org](http://www.equineteurope.org).





## DIALOGUES SOLIDARITY AND CONFLICT

# THE FUTURE OF SOCIAL EUROPE AND OF EUROPEAN INTEGRATION AT A CROSSROADS: HOW CAN WE RECOVER AND ENFORCE SOLIDARITY AS A FUNDAMENTAL PRINCIPLE OF EUROPEAN CONSTITUTIONAL LAW (OR DIE)?

PIETRO MASALA\* AND FERNANDO VALDÉS DAL-RÉ\*\*

**ABSTRACT:** This *Dialogue* is conceived as a conversation with Silvana Sciarra about the present crisis of social Europe and European integration, starting from the ideas she has proposed in her recent book *Solidarity and Conflict. European Social Law in Crisis* (Cambridge: Cambridge University Press, 2018). A special focus is put on possible ways of restoring and enforcing solidarity as a fundamental principle of European Constitutional Law. After placing the book in context, including references to the current debate, we highlight Sciarra's general approach towards the crisis of solidarity in the EU and point out her understanding of two main issues: the role played by Courts, especially Constitutional Courts; the potential role of cooperation and "synergies", both at judicial and institutional level, both within and beyond the EU, in order to develop the social dimension of the integration process. In so doing, we also wish to contribute to such a debate. Finally, considering the growing risk of disintegration, we wonder if we are still in time to avoid a new European dark age, by applying Sciarra's proposal as an antidote to "fears" and as a remedy which should lead to a reconciliation between the European project and the principles of social Constitutionalism. We conclude that policy makers should listen to her call to action and engage with no delay to achieve this absolutely primary objective.

**KEYWORDS:** European Union – solidarity – crisis – synergies – Constitutional adjudication – institutional cooperation.

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## I. A REFERENCE POINT IN THE CRUCIAL DEBATE ABOUT SOCIAL EUROPE

All those who care about the “European Social Model”, about the “Social and Democratic State, subject to the Rule of Law”<sup>1</sup> and, ultimately, about the future of social Constitutionalism in the continent, as well as anyone who takes the future of the European ideal to heart, should be very grateful to Silvana Sciarra for the contribution she has given in the fields of Labour Law and especially of European Social Law over the course of her long academic career. Our appreciation grows after the publication of her recent book *Solidarity and Conflict: European Social Law in Crisis*.<sup>2</sup> Here, this scholar summarises and presents her analyses and reflections about the transcendent and even dramatic changes of the European Union’s legal system we have witnessed during the last decade, with a special focus on their implications for “social Europe”. With this new contribution,<sup>3</sup> she participates in the current debate on the social dimension of the European Union and such a debate is now, more than ever, crucial for the success of the European integration process as a whole and for its survival.

Rather than considering in detail all the topics Sciarra deals with in the chapters of her book – a synthetic and yet very dense book – the intention of the present writers is to ideally engage in conversation with her about the social dimension of the European integration and about her ideas and suggestions. This will be done with a reference to the current academic discussion.<sup>4</sup> In particular, we wish to emphasise Sciarra’s understanding of two main issues, which are of topical importance in the current debate on social Europe: the role played by Courts and especially by some Constitutional Courts, in the context of the crisis of solidarity within the European Union and the driving force of synergies, at different levels, in the same context. This allows us to compare her point of view with those of other scholars researching on “social Europe”. By so doing, we intend also to refer to our own contributions to this ongoing discussion.<sup>5</sup>

<sup>1</sup> This is the translation of the expression “Estado social y democrático de derecho”, used in Art. 1 of the Spanish Constitution, recalling the similar expression used in Art. 20 of the German Basic Law (“demokratischer und sozialer Bundestaat”).

<sup>2</sup> S. SCIARRA, *Solidarity and Conflict: European Social Law in Crisis*, Cambridge: Cambridge University Press, 2018.

<sup>3</sup> Updated and significantly revised version, presenting new analyses, of a book the Author published in her mother tongue some years ago: S. SCIARRA, *L’Europa e il lavoro. Solidarietà e conflitto in tempo di crisi*, Roma, Bari: Laterza, 2013.

<sup>4</sup> This contribution is, in fact, the continuation of a conversation which took place in Madrid, at the Centro de Estudios Políticos y Constitucionales, on 4 April 2018, when Silvana Sciarra participated, together with the Authors of this contribution, in a seminar on “Europe and employment”, in which she presented her still unpublished book.

<sup>5</sup> We allude in particular to F. VALDÉS DAL-RÉ, *El constitucionalismo laboral europeo y la protección multinivel de los derechos laborales fundamentales: luces y sombras*, Albacete: Bomarzo, 2016; P. MASALA (ed.), *La Europa social: alcances, retrocesos y desafíos para la construcción de un espacio jurídico de solidaridad*, Madrid: Centro de Estudios Políticos y Constitucionales, 2018, and P. MASALA, *¿Qué perspectivas*

## II. SOCIAL EUROPE AND EUROPEAN INTEGRATION TODAY: A WORRYING PICTURE

As for the present context, it cannot be ignored that, during the last decade, the financial crisis and, especially, the new economic governance which has been taking shape in the Eurozone have significantly increased the pre-existing “constitutional imbalance between ‘the market and ‘the social’ in the European Union”.<sup>6</sup> The asymmetry between these two components was justified, at the early stages of the integration process, by a clear separation of powers and tasks between the European Communities (the market) and the Member States (the social), but it is no longer tolerable in the present Union. Both external and internal factors affect the sovereignty of Member States in defining and implementing their social and employment policies, in a way that has reduced substantive equality and internal solidarity in European societies. Globalisation entails new challenges for the “European Social Model”; moreover, the development of the European Single Market and of the Economic Monetary Union has had a strong impact on national welfare states. All this implies that the conferral of more extended powers (and resources) to the Union, allowing the partial federalisation of the social domain, is desirable, as it would entail a more effective protection of social rights, through a fair cooperation between the Union and the Member States.<sup>7</sup>

It is well known that some attempts were made, in the decade before the crisis, in order to reduce the original gap, by providing some legal foundations for the partial development of a social dimension of the Union: namely, since the approval of the Treaty of Amsterdam, when some limited competences were conferred to the European institutions (especially the Commission and the Council) in the fields of social and employment policies. Later, the Treaty of Lisbon reinforced the social aims and objectives of the Union and “constitutionalised” the Charter of Fundamental Rights of the European Union, which includes a quite rich and detailed list of social rights in its title about “Solidarity”. However, even on that occasion, the Union’s powers and resources in that specific domain were not increased. Positive integration in “the social” has remained weak and ineffective, and made recourse quite often to soft law, for example in the open method of coordination, implemented within the Lisbon strategy and then within the Europe 2020 strategy.<sup>8</sup> Finally, the

*para el constitucionalismo social en Europa? (buscando, e intentando encender, luces en tiempos oscuros), in Lex Social: Revista jurídica de los derechos sociales, 2018, p. 58 et seq.*

<sup>6</sup> S. GARBEN, *The Constitutional (Im)balance between ‘the Market’ and the ‘Social’ in the European Union*, in *European Constitutional Law Review*, 2017, p. 23 et seq. See also, among others, S. GIUBBONI, *Cittadinanza, lavoro e diritti sociali nella crisi europea*, in M. CINELLI, S. GIUBBONI (eds), *Cittadinanza, lavoro, diritti sociali. Percorsi nazionali ed europei*, Torino: Giappichelli, 2014, p. 85 et seq.; M. BENVENUTI, *Libertà senza liberazione. Per una critica della ragione costituzionale dell’Unione europea*, Napoli: Editoriale scientifica, 2016.

<sup>7</sup> As timely argued, in particular, by S. GIUBBONI, *Diritti sociali e solidarietà in Europa. I modelli sociali nazionali nello spazio giuridico europeo*, Bologna: Il Mulino, 2012, pp. 231-234.

<sup>8</sup> The persisting contrast between “faiblesse de l’intégration législative positive” and “force de l’intégration pretorienne negative” in the areas of Employment and Social Policy is highlighted by P.

institutional changes introduced in the context of the crisis have prompted – instead of a momentous development of the social potential of the recently reformed Treaties – a drastic subordination of the social objectives to financial stability and to the market. The “collision” between these priorities and the European Social Model<sup>9</sup> has determined, in practice, the “displacement of social Europe”<sup>10</sup> and this has occurred as a result of a “constitutional mutation”, which has affected democracy and the rule of law as well, both at the European and at the national level.<sup>11</sup> Such an impact has been asymmetric, concerning especially some “peripheral”, financially more vulnerable, Member States: mainly Southern European states, where the implementation of the new economic governance has entailed austerity measures and more flexible labour markets.<sup>12</sup> The corresponding “competence *coup*”<sup>13</sup> affecting national welfare states (even more seriously than the “competence creep” determined by the well-known pro-market case law of the CJEU) has not been compensated by an extension of the powers and resources the Union may use to ensure better protection of social rights. On the contrary, there has been a regression even in those fields where some progresses had been made: it is enough to mention the recent involution of the CJEU’s case law which, on the grounds of the Union citizenship and of the principle of non-discrimination, had previously assured equal conditions for mobile European citizens (including the “inactive” ones) in their access to social benefits within the Union.<sup>14</sup> In constitutional terms, the moving back of social Europe has meant the “amputation” of solidarity (redistributive solidarity, condition for social justice), enshrined in the Charter of Funda-

RODIERE, *Actualité des solidarités sociales en droit européen*, in A. SUPIOT (ed.), *La solidarité: Enquête sur un principe juridique*, Paris: Odile-Jacob, p. 311 *et seq.*, in particular, pp. 314-319.

<sup>9</sup> M. FERRERA, *Rotta di collisione: Euro contro welfare?*, Roma, Bari: Laterza, 2016.

<sup>10</sup> This is the title of a workshop that took place at the European University Institute, Florence, on 15 and 16 December 2016 (see at [www.eui.eu](http://www.eui.eu)) and of a paper by C. KILPATRICK, *The displacement of social Europe, a productive lens of inquiry*, in *European Constitutional Law Review*, 2018, p. 62 *et seq.*

<sup>11</sup> See, in particular: A.J. MENÉNDEZ, *La mutación constitucional de la Unión Europea*, in *Revista Española de Derecho Constitucional*, 2012, p. 41 *et seq.*; C. KILPATRICK, *On the Rule of Law and Economic Emergency: The Degradation of Basic Legal Values in Europe’s Bailouts*, in *Oxford Journal of Legal Studies*, 2015, p. 325 *et seq.*; T. BEUKERS, B. DE WITTE, C. KILPATRICK (eds), *Constitutional Change through Euro-Crisis Law*, Cambridge: Cambridge University Press, 2017.

<sup>12</sup> For an overview: S. CIVITARESE MATTEUCCI, S. HALLIDAY (eds), *Social Rights in Europe in an Age of Austerity*, London, New York: Routledge, 2017.

<sup>13</sup> S. GARBEN, *The Constitutional (Im)balance*, cit., p. 51.

<sup>14</sup> See, among others, A. SILVEIRA, *Cidadania social na União Europeia – quo vadis? Avanços e recuos entre forças de coesão e fragmentação*, in E. PAZ FERREIRA (ed.), *União Europeia. Reforma ou declínio*, Lisboa: Nova Vega, 2016, p. 293 *et seq.*; S. GIUBBONI, *Free movement of persons and transnational solidarity in the EU. A melancholic eulogy*, in S. CIVITARESE MATTEUCCI, S. HALLIDAY (eds), *Social rights*, cit., p. 273 *et seq.*; P. MASALA, *Libertad de circulación y de residencia y acceso a las prestaciones sociales de los ciudadanos europeos “inactivos”: construcción y deconstrucción de un estatuto de integración social transnacional*, in A. CARMONA CONTRERAS (ed.), *Construyendo un estándar europeo de derechos fundamentales: Un recorrido por la jurisprudencia TJUE tras la entrada en vigor de la Carta*, Cizur Menor: Thomson, Reuters, Aranzadi, 2018, p. 219 *et seq.*

mental Rights of the European Union and in post-war democratic Constitutions of the Member States<sup>15</sup>. On the other hand, the new conditional solidarity implemented in the Eurozone, particularly through the European Stability Mechanism, has deepened tensions and divides among Member States (creditors and debtors, hosts and “migrants”) and has increased the levels of social inequality both within the Union and in the Member States, especially in the ones that received financial aids. Overall, these constitutional changes have increased the distance between the Union and European citizens, in a way that is seriously endangering the future of the integration process.

If this discomfoting diagnosis is correct, then it is evident that a radical change in the opposite direction is needed: this should be based on the politicisation of social issues at the European level,<sup>16</sup> hence on the restoration of the rule of law and democracy, especially by extending the role of the legislative<sup>17</sup> (and primarily the role of the European Parliament in the legislative process, in general and in particular in the social domain), within the framework of a relaunch of the process of constitutionalisation and federalisation of the Union. A complete “reconstruction of the European constitutional order”, recovering real solidarity, is necessary,<sup>18</sup> both for preserving the jeopardised European Social Model and for restoring the Union’s legitimacy. The destinies of the Union and of that Model are clearly intertwined: on one hand, the failure of the European project would definitely make it impossible to defend and update the latter in a globalised world; on the other hand, if the integration process is not reconciled with solidarity it will definitely lose its legitimacy and its chance to survive.

### III. A CONSTRUCTIVE APPROACH

Faced with the present crisis of European solidarity – the “social question”, which is at the same time an effect and a cause of the crisis of democracy and of the rule of law in the continent<sup>19</sup> – Sciarra’s first contribution in her recent book consists of a careful assessment of the reactions of the main actors within the EU, both at national and supranational levels. Secondly and more importantly, she coherently proposes some ideas which help us to reflect about what should be done in order to overcome the continuing crisis and to recover and enforce solidarity as a fundamental principle of European Constitutional Law.

<sup>15</sup> S. RODOTÀ, *Solidarietà: Un’utopia necessaria*, Roma, Bari: Laterza, 2014, pp. 105-106.

<sup>16</sup> See S. GIUBBONI, *Diritti e solidarietà in Europa*, cit., especially pp. 231-234.

<sup>17</sup> As conclusively argued by S. GARBEN, *The Constitutional (Im)balance*, cit.

<sup>18</sup> S. RODOTÀ, *Solidarietà*, cit., pp. 105-106.

<sup>19</sup> With special reference to the Italian case: P. MASALA, *Crisi della democrazia parlamentare e regresso dello Stato sociale: note sul caso italiano nel contesto europeo*, in *Rivista AIC*, 4/2016, [www.rivistaaic.it](http://www.rivistaaic.it). More in general, a reference point among the recent contributions on the “democratic question” and the “crisis of the rule of law” in the EU, also and particularly in a proactive perspective, is C. CLOSA, D. KOCHENOV (eds), *Reinforcing Rule of Law Oversight in the European Union*, Cambridge: Cambridge University Press, 2017.

Sciarra's overall attitude towards the present situation is of course critical, but it seems to us that what characterises her work is the constructive approach she adopts: her purpose is to shed light on present problems and especially to try to identify possible solutions. In the opening of the book, after warning that "this should be the time to thoroughly rethink the European architecture and finding ways to reconcile European citizens with supranational institutions", she shows a specific "intention" to disguise "possible synergies among existing policies and to look at ways in which solidarity and conflict face new social demands [...] looking at developments in recent years".<sup>20</sup> The book is in fact an attempt to reconstruct all recent initiatives in policy-making, in view of proposing some "paths for reflections" in the fields of European employment and social law.<sup>21</sup>

Sciarra's commitment is to "dissolve" and overcome the "fear from Europe" and the "fear of Europe" (citizens and social partners' increased disaffection and mistrust), starting from the firm conviction (we openly agree with) that the solution can only be found in a shared project of the EU as a whole. In the aftermath of the crisis, there should be an overall attempt at "rethinking institutional changes and enhancing reforms".<sup>22</sup> In particular – she argues – "protectionism[...] is not an adequate solution", whereas "an antidote can be found in closer synergies within a multilevel legal system, with the creation of new places for negotiations treasuring in a virtuous manner the financial resources the EU provides and giving new responsibilities to social partners".<sup>23</sup> In sum, the "suggestion" made by the book "is to continue on the path of better synergies among existing policies, in view of sturdier political stability, which could encourage more structural reforms at an institutional level".<sup>24</sup> Insufficiently known positive practices are identified and analysed in order to put forward concrete proposals. In particular, it is proposed to address the problems of wage competition by means of a better cooperation and exchange of information among European and national administrations; to promote collective autonomy within the European social dialogue and especially transnational collective agreements (for which Sciarra claims a proper European legal framework); to make better use of structural funds in order to strengthen social cohesion.<sup>25</sup>

The Author's constructive approach does not lead her to underestimate the gravity of present challenges and the reasons for fears. She recognises that these are "not unjustified and need to be taken in serious consideration by policy makers": overcoming fear re-

<sup>20</sup> S. SCIARRA, *Solidarity and Conflict*, cit., pp. XI-XI.

<sup>21</sup> *Ibid.*, p. 4.

<sup>22</sup> *Ibid.*, pp. 2, 3 and 7.

<sup>23</sup> *Ibid.*, p. 46.

<sup>24</sup> *Ibidem*.

<sup>25</sup> Specific chapters of S. SCIARRA, *Solidarity and Conflict*, cit., deal with these topics. In particular, the issue of structural funds is considered in some detail at pp. 42-45, drawing on the inspiring proposals of the "Barca Report" (F. BARCA, *An agenda for a reformed cohesion policy. Independent report prepared at the request of Danuta Hübner, Commissioner for Regional Policy*, April 2009, available at ec.europa.eu).

quires credible changes, reforms, and especially the development of “better synergies”, as said.<sup>26</sup> However, first of all, we should be aware of existing synergies, of current misunderstanding and inadequate communication, taking into account that fear is also “fuelled by the references, instrumentally made in domestic policies, to obligations imposed by the EU”: obligations which are, “in fact, the outcome of political negotiations frequently made at intergovernmental level, rather than within the European institutions”.<sup>27</sup>

#### IV. JUDICIAL ENFORCEMENT OF SOLIDARITY: POSSIBILITIES AND LIMITATIONS

Let us now look first at the role played by Courts and then at the role of cooperation and synergies, within the EU and beyond the EU.

As for Sciarra’s assessment of the role played by Constitutional Courts in the context of the crisis, it is especially interesting to consider her review of the most significant case-law concerning austerity measures, specifically with regard to the reduction of wages and pensions. She examines, in particular, selected cases of the Greek Council of State and of the Portuguese, Italian and Spanish Constitutional Courts<sup>28</sup> and, on this basis, she argues for “the independence of the judiciary from political contingencies and the need to rebalance political priorities within a coherent constitutional network”.<sup>29</sup> She also observes that Constitutional Courts and international organisations enforcing labour standards “have been called to play a central role” in the crisis and post-crisis context and concludes that, in general, “judicial strategies have, by all means, been relevant to re-establish a balance and to broaden the interpretation of EU-Law”: this is “a fully accountable process, which preserves the rule of law and strengthens parliamentary discretionary powers”.<sup>30</sup> Finally, she notes that “judicial and quasi-judicial activism has reinvigorated the circulation of international standards and provoked a beneficial contamination of legal sources”,<sup>31</sup> hence arguing that these are “valuable and should be further pursued”.<sup>32</sup> This implies a favourable opinion about the development of judicial synergies beyond the EU legal order, with other international organisations and institutions and concretely among national Constitutional Courts and European and international Courts. A chapter of the book is devoted to the positive implications, in terms of strengthened protection of fundamental social rights, which are the outcomes of interactions among the Luxembourg Court, the Strasbourg Court, the Committee of experts

<sup>26</sup> S. SCIARRA, *Solidarity and Conflict*, cit., p. 46.

<sup>27</sup> *Ibid.*, p. 28.

<sup>28</sup> *Ibid.*, pp. 13-18.

<sup>29</sup> *Ibid.*, p. 18.

<sup>30</sup> *Ibid.*, pp. 135-138.

<sup>31</sup> *Ibid.*, p. 137.

<sup>32</sup> *Ibid.*, p. 7.

of the International Labour Organisation and the European Committee of Social Rights of the Council of Europe<sup>33</sup>.

We can therefore conclude that Sciarra highlights and looks favourably at the possibilities of the “judicial enforcement of solidarity”.<sup>34</sup> However, we must immediately add that she is also aware of its structural limitations: judges cannot replace politics, neither would this be, of course, desirable. Indeed, in her overall reflection, she stresses the need to strengthen cooperation at the institutional level, to re-politicise social issues and to revitalise the role played by social partners and collective autonomy at transnational and supra-national levels. We are going to consider all this in the next part of our conversation.

Before that, we just want to openly agree with Sciarra’s understanding of the role played by Courts in the context of the crisis. In particular, we believe that some concrete reactions of some Constitutional Courts to the “dismantling of the social and democratic state, subject to the rule of law”<sup>35</sup> which has taken place in Europe during the last decade, particularly in Southern European Member States, have been fully justified and legitimate. We allude, specifically, to some important judgements of the Portuguese and the Italian Constitutional Courts, which held unconstitutional some of the austerity measures adopted by national legislators (or rather, in most cases, by national Governments which widely used decree-laws and marginalised national Parliaments), as they considered those measures in breach of constitutional principles of proportionality, equality and (especially in the Italian case) solidarity. We believe that Courts must apply a strict scrutiny when deciding about the constitutionality of such measures, in particular when using the proportionality or reasonableness test. Likewise, they should be demanding in relation to the compliance with constitutional principles relating to the exercise of legislative power, especially in emergency situations: they should reaffirm the prescriptive nature of those principles and consequently counter the abuses committed by Governments.<sup>36</sup> Finally, we also firmly believe that judicial dialogue and the development of synergies in this domain, also beyond the EU, must be welcomed: in particular, they are necessary in order to overcome the present “asymmetry” between

<sup>33</sup> *Ibid.*, pp. 118-132.

<sup>34</sup> A. SUPLOT, *Judicial Enforcement of Social Solidarity in View of Recent European, German and French Jurisprudence*, in J. VAN DER WALT, J. ELLSWORTH (eds), *Constitutional Sovereignty and Social Solidarity in Europe*, Baden-Baden: Nomos, 2015, p. 109 *et seq.*

<sup>35</sup> L. JIMENA QUESADA, *Devaluación y blindaje del Estado social y democrático de derecho*, Valencia: Tirant lo Blanch, 2017.

<sup>36</sup> In this sense, P. MASALA, *Crisi della democrazia parlamentare e regresso dello Stato sociale*, cit. We openly agree with C. KILPATRICK, *Constitutions, Social Rights and Sovereignty Debt States in Europe: A Challenging New Area of Constitutional Inquiry*, in T. BEUKERS, B. DE WITTE, C. KILPATRICK (eds), *Constitutional Change through Euro-Crisis Law*, p. 279 *et seq.*, when she argues that the charge of “juristocracy”, with regard to the alluded constitutional case law concerning austerity measures, must be refuted.

the density of the recognition of fundamental social rights in European Constitutionalism, especially at the supranational level, and the ineffectiveness of their protection.<sup>37</sup>

## V. STRENGTHENING COOPERATION AND SYNERGIES (*IL FAUT CULTIVER NOTRE JARDIN*)

The idea of “synergies” is a *leitmotiv* in Sciarra’s reflection. Not only it is stressed with reference to judicial dialogue, but it is also proposed, in general, as an “antidote” which should be applied at different levels to overcome fears<sup>38</sup>. In particular, there is a call to strengthen cooperation and to develop synergies at the institutional level, within the EU (among supranational institutions and Member States) including social partners in all such efforts, by revitalising collective autonomy and collective bargaining, especially at supranational level.<sup>39</sup> The development of synergies beyond the EU, namely with other international organisations such as the International Labor Organisation and the Council of Europe, for the definition and implementation of better standards of protection of social rights, is also an important component of this recommended strategy, as we have just seen.

Of course, Sciarra is not unaware that, rather than virtuous cooperation and synergies, negative interactions in the social domain have been produced by the choices made (mainly at intergovernmental level) in the context of the crisis; and she is well aware that, even prior to the reform of the economic governance of the Eurozone, a well-known case-law of the Court of Justice of the European Union had seriously affected fundamental workers’ rights, collective bargaining and traditional national conflict rules.<sup>40</sup> Indeed, it is in her search for solutions to the problems arising from this negative kind of interaction, that she highlights the possibilities of “synergies” within the EU. However, she also highlights the shortcomings and limitations of the cooperation which has been implemented so far. She does so, in particular, when she considers the use of soft law and the unsatisfactory outcomes of the open method of coordination in the fields of employment and social protection. She underlines that the severe impact of the crisis requires a reconsideration of the employment policies and of the overall ra-

<sup>37</sup> This “asymmetry” is highlighted in F. VALDÉS-DAL RÉ, *El constitucionalismo laboral europeo y la protección multinivel de los derechos laborales fundamentales*, cit.: see, in particular, pp. 110-125. With special reference to the possible synergies between national Constitutional Courts and the case law of the European Committee of Social Rights, see L. JIMENA QUESADA, *Social Rights and Policies in the European Union. New Challenges in a Context of Economic Crisis*, Valencia: Tirant lo Blanch, 2016, pp. 140-143.

<sup>38</sup> S. SCIARRA, *Solidarity and Conflict*, pp. 45-46.

<sup>39</sup> *Ibid.*, *passim* and especially pp. 65-90.

<sup>40</sup> We allude, in particular, to the *Viking* and *Laval* judgements (Court of Justice: judgement of 11 December 2007, case C-438/05, *International Transport's Workers Federation and Finnish Seamen's Union v. Viking Line ABP and OÜ Viking Line Eesti*; judgement of 18 December 2017, case C-341/05, *Laval un Partneri Ltd v. Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avdelning 1, Byggetan and Svenska Elektrikerförbundet*); see S. SCIARRA, *Solidarity and Conflict*, cit., pp. 91-117.

tionale supporting the OMC and she argues for a “shift to hard law” in order to reassess active labour market policies and to enhance exchanges of information among national administrations. One proposal is sketched with great emphasis, to counterbalance the impact of monetary policies, namely a European Unemployment Benefit Scheme for the euro area, which should provide support to Member States undergoing fiscal constraints in order to avoid cuts of automatic stabilisers, while implying benefits also for countries not in need of support, but interested in macroeconomic stability.<sup>41</sup>

Re-politicisation of social issues<sup>42</sup> is another fundamental goal which should be achieved in a context of cooperation: at the end of the book, Sciarra argues that, “in order to re-politicise deliberations” in the areas of employment and social protection, in particular with the view of rescuing the most disadvantaged groups from a condition of marginality and under-representation, “the adoption of a pragmatic view and of shared consensus is needed”. At this respect, she stresses once again that “re-politicising EU-decision making implies an expansion of hard law [...] and a link to incentives provided by structural funds”.<sup>43</sup>

Finally, Sciarra’s attitude towards the recent initiatives of the Juncker Commission, particularly the “European Pillar of Social Rights”, solemnly proclaimed in Gothenburg in November of 2017, seems to imply a cautious optimism. She welcomes the “commitment” shown by the Commission “in making structural and investment funds available for social policies in the 2014-2020 budget” and the declared intention to “complement” the EU social *acquis*. She looks favourably at the recommendation establishing the twenty principles of the Pillar that should inspire future actions, such as the European Labour Authority, which should favour the adoption of fairer rules in the internal market, in order to ensure equality in wages, especially for mobile workers. She is not unaware, however, of the many obstacles in current developments of European social policies and she underlines that such announcements “*should be promptly implemented*”.<sup>44</sup>

At first glance, especially if compared to the severe attitude of other scholars, Sciarra’s cautious optimism could perhaps seem to be too confident and indulgent.<sup>45</sup> But what re-

<sup>41</sup> S. SCIARRA, *Solidarity and Conflict*, cit., pp. 140-141. The proposal for a European Unemployment Benefit Scheme was first released by the Italian Minister of Finance in October 2015 and further developed: Ministero dell’economia e delle finanze, *European Unemployment Benefit Scheme*, August 2016, [www.mef.gov.it](http://www.mef.gov.it).

<sup>42</sup> Especially recommended also, among others, by S. GIUBBONI, *Diritti sociali e solidarietà in Europa*, cit. and by S. GARBEN, *The Constitutional (Im)balance between the 'Market' and the 'Social' in the European Union*, cit. (see, in particular, the conclusions of both works).

<sup>43</sup> S. SCIARRA, *Solidarity and Conflict*, cit., pp. 141-142.

<sup>44</sup> *Ibid.*, pp. 142-143 (emphasis added).

<sup>45</sup> Sciarra’s evaluation of the European Pillar of Social Rights is quite different, for instance, from the assessment made by S. Giubboni, which is openly critical and sceptical: see S. GIUBBONI, *Appunti e disappunti sul pilastro europeo dei diritti sociali*, in *Quaderni costituzionali*, 2017, p. 953 et seq. (this criticism is also largely shared by P. MASALA, *The European Pillar of Social Rights: A first step in the right direction or*

ally matters is that she develops throughout the book a complete overview of the many threads of social and employment policies that could be pulled together in an optimal scenario of political convergences. Hence, it is clear that Sciarra is not at all Voltaire's Pangloss; neither she adopts a too radical, maximalist approach. She seems aware of the complexities underlying this phase of European integration and this is why we can say that, through her book, she shows how to recognise and balance the best part of Don Quixote and the best part of Sancho. To add yet another example, she is as wise as Candide at the end of its vicissitudes, when, settled in Constantinople, he warns us that our garden must be cultivated and that we must engage in this work all together.

## VI. *NON PRAEVALEBUNT?*

In conclusion, it seems to us that Sciarra's cautious optimism is very similar to the "un-resigned realism" which was pointed out by Stefano Rodotà as the attitude which should lead to success in overcoming the present crisis of solidarity:<sup>46</sup> pragmatism, reformism (not forgetting that "more structural reforms at an institutional level" are the final aim), cooperation and synergies in a multilevel legal system, shared commitment, hence Europeanism, are also in our opinion the only approaches which can avoid a new dark age upon Europe. What is certain is that, if the EU and the Member States still aspire to have a bright future, then they should base their action on suggestions such as those made by Sciarra in her book: as implementing such proposals would allow them to cope with the present crisis of solidarity and democracy and to provide concrete proof of their understanding of European citizens' "fears". In this sense, there is no reasonable alternative to Sciarra's wise pragmatism, as the sole alternative would be resignation and, in this case, the achievements and dreams the Union has represented would definitely be lost and fade: hence, scholars could only write an "obituary"<sup>47</sup> or a "melancholic eulogy"<sup>48</sup> for the European project, the celebration of a glorious – albeit imperfect – recent past like in Pericle's funeral oration; and then, as Europeans, we could only express our grief over the world of yesterday.<sup>49</sup>

*rather a palliative, cosmetic care? Some critical remarks from a constitutional perspective*, in *Unio EU Law Journal: The Official Blog*, 17 December 2018, officialblogofunio.com.

<sup>46</sup> See S. RODOTÀ, *Solidarietà*, pp. 136-137: the original expression is "realismo non rassegnato".

<sup>47</sup> R. GILLINGHAM, *The European Union: An Obituary*, London, New York: Verso Books, 2016.

<sup>48</sup> As S. Giubboni properly does with specific reference to "Free movement of persons and transnational solidarity in the EU", in his mentioned contribution about this topic (S. GIUBBONI, *Free movement of persons and transnational solidarity in the EU*, cit.).

<sup>49</sup> We allude to the well-known memoir of S. ZWIG, *Die Welt von Gestern. Erinnerungen eines Europäers*, Stockholm: Bermann-Fischer Verlag, published in 1942: it seems to us that reading (or re-reading) this book and especially its first pages today is as disturbing as recommendable for any living European, as it sounds like a dramatic *memento* which should not be ignored.

Thus, can we finally say: *non praevalerunt* (uncertainty, fears and darkness)? What is clear, at this point, is that preventing them from prevailing is a shared responsibility. In other terms, the answer depends on choices which shall be made by policy makers, by European citizens, and also by scholars. We can already say, in this sense, that Silvana Sciarra has taken part in the effort: overall, her book should be regarded as a successful effort to illuminate reality through thought and as a call – especially to policy makers – to act, to take social Europe seriously, to restore and strengthen European solidarity before it is too late. The further question is then: are we still in time to cooperate to reconcile European integration with social Constitutionalism (and with European citizens)? Unfortunately, we cannot hide that our uncertainty and fear, at this respect, grow as time goes by: we cannot ignore that, after the publication of the book, in just a few months, darkness and fears (new nationalisms, anti-Europeanism, xenophobia, division) have grown much faster than light (awareness of the urgency to act and agreement for cooperation). However, we support Sciarra's call without hesitation, as we are convinced (and our belief has been strengthened after reading her book) that, despite uncertainty, fears and growing concern – actually, because of all of this – no effort must be spared to achieve that absolutely primary goal.



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