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# Legal briefing EP Legal Service Opinion on ICS in CETA

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## Executive summary

The transparency exercised by the European Parliament in disclosing the European Parliament's Legal Service Opinion is laudable and a future precedent for the disclosure of documents of the institutions, in particular Legal Opinions. As such, the document's release is a positive step for transparency and accountability of EU institutions.

ClientEarth has been able to assess the Legal Opinion and in this briefing raises the following legal issues that the European Parliament's Legal Service has not sufficiently addressed:

1. The Legal Opinion does not sufficiently appreciate many of the similarities between the (limited) powers of the investment Tribunals in CETA and the European Court on Human Rights under the European Convention on Human Rights; and the consequences of the negative Opinion of the European Court of Justice in Opinion 2/13 for investment arbitration.
2. The Legal Opinion does not sufficiently recognize the powers of the ECJ on claims for damages against the EU.
3. The Legal Opinion also does not sufficiently recognize the problems investment arbitration poses for the EU internal market, in particular the potential for discrimination among EU undertakings.
4. The Legal Opinion also does not address the risks and consequences of a successful challenge to a Council decision concluding CETA. The EU and its Member States might be faced with international legal obligations they cannot honour under EU law if such a challenge is successful in the future.

Investment arbitration in CETA poses fundamental legal problems to the EU's legal and judicial system that can only be properly assessed by the European Court of Justice.

## Introduction

On June 1 2016 the European Parliament Legal Service circulated a Legal Opinion upon request of the chairman of the European Parliament's trade committee (INTA) Bernd Lange on the compatibility of the Investment Court System (ICS) in the EU-Canada Comprehensive Economic and Trade Agreement (CETA). The Opinion was published on 5 September 2016.<sup>1</sup> The decision to disclose the Legal Opinion is an important precedent on this issue and will assist the debate on the legality of ICS and ISDS in EU trade agreements. It will allow the Opinion to be publically scrutinized and should be an example for other institutions to disclose documents on the same issue.

ClientEarth has been able to assess the Legal Opinion. In this briefing, we would like to raise four legal issues that the European Parliament's Legal Service has not sufficiently addressed:

1. The issue of uniformity of interpretation of EU law and the similarities between the (limited) powers of the investment Tribunals in CETA and the European Court on Human Rights under the European Convention on Human Rights;
2. The exclusive powers of the ECJ on claims for damages pursuant Article 340 TFEU;
3. The problems ICS in CETA poses for the EU internal market;
4. The risks and consequences of a successful challenge to a Council decision concluding CETA.

This briefing will address these points in turn.

## 1 The Legal Service assessment on the uniform interpretation of EU law

The Legal Service notes in paragraph 50 of its Legal Opinion that CETA is different from the Accession Agreement of the EU to the ECHR and that these differences suggest that CETA does not pose the same adverse effects on the EU legal order as the Accession Agreement. However, the arguments of the Legal Service on this point are unfortunately flawed.

The Legal Service firstly notes that the jurisdiction of the investment tribunals in CETA '*will be in essence limited to the resolution of claims regarding the interpretation or application of the provisions of the CETA investment Chapter, concerning whether there has been a breach of the investment standards.*' However, the same can be said of the ECHR which was the subject of the Court's adverse Opinion in *Opinion 2/13*.<sup>2</sup> The jurisdiction of the ECtHR covers according to article 32 ECHR '*all matters concerning the interpretation and application of the convention and the Protocols thereto which are referred to it as provided in Articles 33, 34, 46 and 47*'. The Court still found the draft accession agreement incompatible with EU law.

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<sup>1</sup> The Opinion can be found at <http://www.europarl.europa.eu/committees/en/inta/publications.html?tab=Other>

<sup>2</sup> *Opinion 2/13 Accession to the ECHR* EU:C:2014:2454

While it is true that there is a basic principle under EU law that the EU may conclude international agreements providing for the creation of a court responsible for the interpretation of its provisions and whose decisions are binding on the institutions, the Court of Justice has nevertheless also immediately qualified that principle: *'an international agreement may affect its own powers only if 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'*. In the case of the ECHR, the ECJ required inter alia prior involvement of the ECJ in deciding on all questions of EU law, including the interpretation of EU Directives and Regulations. Quite clearly, therefore, the statement that the CETA investment tribunals' jurisdiction is limited to the resolution of claims regarding the interpretation or application of the provisions of the CETA investment Chapter is not in itself an indication that the investment arbitration system in CETA is compatible with the Treaties.

Secondly, the Legal Service notes that the CETA investment tribunals *'have no jurisdiction to rule on the legality of a measure under the domestic law of the Parties.'* The Legal Service notes in that regard that because the *'only possible consequence'* of an adverse award would be financial, and therefore *'an effect on the interpretative powers of the ECJ is excluded'*.

This argument is incorrect, as the ECtHR also has no jurisdiction to rule upon the legality of a measure under the domestic law of the Parties. The ECtHR only has jurisdiction according to article 41 ECHR to provide just satisfaction in a case brought before it. In essence, this means that the ECtHR has the power to make a declaratory judgment stating that the rights of the applicant under the ECHR have been violated, and in specific circumstances can award damages. Article 41 ECHR states:

*'If the Court finds that there has been a violation of the Convention or the Protocols thereto, and if the internal law of the High Contracting Party concerned allows only partial reparation to be made, the Court shall, if necessary, afford just satisfaction to the injured party.'*

It is entirely upon the Parties to the ECHR to remedy the situation of incompatibility with the ECHR and the ECtHR therefore has no jurisdiction to rule on the legality of a measure under the domestic law of the Parties. Article 46 ECHR states:

*'The High Contracting Parties undertake to abide by the final judgement of the Court in any case to which they are parties'*

More importantly, however, is that the fact that international tribunals would be ruling on the legality of a measure under EU law is not part of the Court's reasoning in *Opinion 2/13*. What matters is that these tribunals would be in the position to give a definitive interpretation of EU law without prior involvement of the ECJ.

Thirdly, the Legal Service argues that the requirement under article 8.31 CETA that the Tribunals are required to follow the prevailing interpretation of EU law without binding the ECJ would not impinge on the exclusive jurisdiction of the ECJ to provide a definitive interpretation of EU law. This argument is flawed for two reasons.

Firstly, the requirement that arbitration tribunals would be required to follow the prevailing interpretation of EU law is inadequate to ensure that the ECJ has exclusive jurisdiction to give a definitive interpretation of EU law, because it only addresses the situation where such prevailing interpretation exists. Moreover, as is clear from the case-law of the ECJ, such a situation where

there is clarity on the interpretation does not occur very often. The ECJ has maintained that the highest courts of the Member States may only refrain from the obligation to make a preliminary reference where *'the correct application of [EU] law may be so obvious as to leave no scope for any reasonable doubt as to the manner in which the question raised is to be resolved'*.<sup>3</sup>

Secondly, the Legal Service maintains that the interpretation of EU law given by these tribunals shall not be binding on the ECJ, because CETA article 8.31 says so. While this provision certainly may limit the effect of arbitration awards in terms of setting a formal precedent in future cases in domestic legal orders that allow for such a precedent<sup>4</sup>, there may certainly still be important effects of tribunals' assessment of domestic law on domestic legal systems, including the EU's legal system. Moreover, the issue of direct effect of ECtHR judgments was not part of the ECJ's ruling in *Opinion 2/13*. Article 8.41 CETA states that an award 'shall be binding between the disputing parties and in respect of that particular case'. By virtue of Article 216 (2) TFEU these arbitration awards are binding on the EU institutions, including the Court of Justice of the European Union. A mere provision stating that the interpretation given is not binding on the ECJ is at odds significant financial consequences of the award, the precedence of such rulings may set for future claims, and the more general legal principle that courts should state the reasons for their decisions.

## 2 The jurisdiction of the ECJ to decide on the extra-contractual liability of the EU

The Legal Service argues that the ECJ's jurisdiction to rule on extra-contractual liability is only exclusive in relation to the powers of the courts of the Member States and cannot be extended to the international responsibility of the EU due to a violation of an international agreement concluded by the EU. The Legal Service position is unfortunately speculative.

Firstly, there is nothing in the case-law of the ECJ that suggests that the exclusive nature of the jurisdiction of the ECJ to hear claims for damages by individuals is only exclusive vis-à-vis the courts of the Member States. It is settled case-law of the ECJ that

*'With regard to the [EU]'s non-contractual liability, such disputes fall within the jurisdiction of the Court of Justice. Article [19 TEU] provides that the Court of Justice has jurisdiction to hear and determine actions seeking compensation for damage brought under the second paragraph of Article [340 TFEU], which covers such non-contractual liability. That jurisdiction of the [EU] Courts is exclusive.'*<sup>5</sup>

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<sup>3</sup> Case 283/81 CILFIT [1982] ECR3417, para 16

<sup>4</sup> Not all parties to the ECHR give direct effect to ECtHR judgements, for instance.

<sup>5</sup> Case C-377/09 Hanssens\_Ensch v. European Community [2010] ECR I- 7751, para 16. See also Case C-275/00 European Community v First NV and Franex NV [2002] ECR I- 10943, para 43; Case C-282/90 Vreugdenhil v Commission [1992] ECR I-1937, para 14; Case 281/84 Zuckerfabrik Bedburg AG and others v Council and Commission [1987] ECR 49, para 12; Case 101/78 Granaria BV v Hoofdprodukschap voor Akkerbouwprodukten [1979] ECR 629, para 14.

The Court thus makes clear that the jurisdiction of the EU Courts is exclusive generally, and does not caveat that exclusivity only in relation to the courts of the Member States. This point of the Legal Service is therefore speculative at best.

Secondly, while it is true that article 340 TFEU does not preclude the EU from incurring international responsibility *generally*, it is questionable whether the possibility of incurring international responsibility automatically makes the ICS mechanism in CETA compatible with article 340 TFEU.

First of all, being able to incur international responsibility does not mean that the EU can circumvent its constitutional framework, the EU Treaties.<sup>6</sup> While the EU may assume international obligations towards third states such as the United States and assume liability for breaching those obligations, it does not necessarily entail that the creation of an external judicial body that can award damages against the EU in response to claims made by third country nationals (investors) through an international agreement is compatible with the EU Treaties.<sup>7</sup>

Secondly, it is not true that the exclusive jurisdiction of the Court under article 340 TFEU would make it impossible for the EU to incur international responsibility simply because international responsibility is not necessarily the same as claims for damages by individuals against public authorities. The concept of international responsibility is traditionally understood as a concept that applies between entities that have international legal personality.<sup>8</sup> That concept only in certain cases encompasses individuals and usually refers to states or international organisations. Article 340 TFEU, by contrast, is a remedy internal within the EU legal order open to individuals claiming damages for losses suffered caused by the EU. It is obvious therefore that the EU may still incur international responsibility for numerous other international agreements even if CETA's ICS were to be found incompatible with article 340 TFEU.

Even if a damages claim on the basis of an international agreement by individuals can be formally distinguished from a claim under article 340 TFEU, it is clear that CETA's ICS would *de facto* significantly undermine the EU Courts' competences to rule on the EU's non-contractual liability. Investment protection provisions guarded by ISDS mechanisms (and there is no reason to assume ICS tribunals will be any different) employ lower standards for damages claims.<sup>9</sup> The EU Courts employ high standards, both procedurally and substantively, in allowing claims for damages for reasons that do not necessarily apply to investment tribunals. In addition, foreign investors may bring claims on behalf of EU companies owned or controlled by that investor.<sup>10</sup> Moreover, ICS in CETA specifies that investors may not bring a claim under article 340 TFEU when they bring a claim under the investment provisions (the "no u-turn" approach), further undermining the jurisdiction of the EU Courts under article 340 TFEU.<sup>11</sup>

The main reason for this approach is that the Court, in contrast to investment arbitration tribunals in the past, is wary of a regulatory chill that may result out of awarding damages. The Court attaches greater importance to the public interest than to the rights of individuals when in relation to awarding damages. In the words of the Court, the

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6 Case 294/83 Parti écologiste "Les Verts" v European Parliament [1986] ECR 1339, para 23.

7 A potential accession to the ECHR is different in this regard as accession is explicitly mandated by article 6 (2) TEU.

8 Malcolm N. Shaw, *International Law* (Cambridge University Press 2003), at 175-247.

9 As Jan Kleinheisterkamp notes in Jan Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of The Energy Charter Treaty' (2012) 15 *Journal of International Economic Law*, 85-109, at 100 'It is not all that clear why and how arbitral tribunals should on [the basis of broad investment provisions] engage in a balancing of private and public interests that is equivalent to the mechanisms of judicial review of administrative acts under national laws and, by extension, under EU law.'

10 Article 9.14 draft EU-Singapore FTA

11 Article 8.22 of CETA

*'exercise of the legislative function must not be hindered by the prospect of actions for damages whenever the general interest of the Community requires legislative measures to be adopted which may adversely affect individual interests.'*<sup>12</sup>

As a result, damages are only awarded if there is *'a sufficiently flagrant violation of a superior rule of law for the protection of the individual'*.<sup>13</sup> The sufficiently serious breach entails that the EU public authority in question *'manifestly and gravely disregarded the limits on its discretion'*.<sup>14</sup> Accordingly, it is very difficult to claim damages for lawful acts of the EU.<sup>15</sup>

Such general considerations do not apply to CETA's ICS. This chapter is explicitly created to give individuals (foreign investors) an additional remedy and additional individual rights against the state irrespective of the legality of the measure under domestic law. Moreover, CETA's ICS do not mandate arbitrators to be concerned with the effects of regulatory chill their awards may have, nor are arbitrators part of the system of government of the host state. Their necessary independence from the host state precludes such reasoning and CETA's investment chapter does not require them to show sufficient deference towards public interests.

The stricter approach by the Court is exemplified by the obligation of the injured party to *'show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the loss or damage himself'*.<sup>16</sup> As a result, investors bringing a claim under article 340 TFEU must generally seek annulment of the act causing damage insofar as it is reasonable to pursue annulment.<sup>17</sup> By contrast, ICS in CETA does not require the foreign investor to exhaust local remedies, and allow a claim to be brought directly. Investment arbitration in CETA would therefore change the existing balance of judicial recourses established under the Treaties.<sup>18</sup>

### 3 The adverse consequences of ICS in CETA for the EU internal market

The Legal Service considers that the obligation of the EU institutions to respect primary law is guaranteed by merely pointing out to the carve out in article 8.9 (3) CETA. However, the effects of awards on primary law cannot be solely confined to the obligation to pay back unlawfully granted state-aid. Equally, problems may arise when foreign investors challenge competition law decisions containing fines for companies breaching competition law provisions in the Treaties.

For instance, an undertaking such as Intel could opt to challenge the Commission's 1 billion Euro fine for its abuse of a dominant position on the microprocessors market, because it considers the Commission to have violated the principle of presumption of innocence and therefore a breach of due process under the 'fair and equitable treatment' standard.<sup>19</sup>

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12 Joined cases C-46/93 and C-48/93 *Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others* [1996] ECR I-1029, para 45

13 Case 5/71 *Aktien-Zuckerfabrik Schöppenstedt v Council* [1971] ECR 116, para 11.

14 Case C-352/98P, *Laboratoires Pharmaceutiques Bergaderm SA and Jean-Jacques Goupin v Commission* [2000] ECR-I 5310, para 43.

15 Joined Cases C-120 & 121/06P *FIAMM and Fedon v Council and Commission* [2008] ECR I-6513, paras 175-176.

16 Case C-445/06 *Danske Slagterier v Germany* [2009] ECR I-02119, para 61

17 See Jan Kleinheisterkamp, 'Financial Responsibility in European International Investment Policy' (2014) 63 *International and Comparative Law Quarterly*, 449 at 460

18 *ibid*

19 Intel lost its appeal at the General Court against the Commission's fine and the General Court dismissed Intel's argument that the Commission had breached the principle of presumption of innocence. See Case T-286/09, *Intel Corp. v European Commission* (12 June 2014). However, an arbitration tribunal might come to a different conclusion.

Secondly, the Legal Service, in considering whether CETA's ICS violates the EU's discrimination standards, compares foreign investors to domestic ones and finds that *'the position of foreign investors is different from that of domestic investors in the Union and in Canada inasmuch as the conditions for investment within a Party may be less adapted to foreign investors than to domestic investors and that, moreover, investors in a foreign market may as such face obstacles. They may perceive a possible bias in the treatment on the part of political, administrative or judicial authorities in the territory where they make their investment'*. The Legal Service also notes that foreign investors *'may naturally be resistant to taking risks in investing in the other Party on account of political, linguistic, legal, or other differences.'* The Legal Service therefore appears to be making somewhat of an affirmative action argument in defending foreign investor privileges, a collection of entities and people that belong to the wealthiest in the world.<sup>20</sup>

However, there is no legal precedent by the ECJ that supports this type of justification for discriminatory treatment of domestic investors. The Legal Service Opinion is therefore speculative on this point.

More problematic legally speaking is that the Legal Service completely ignores that CETA's ICS also privileges EU undertakings over others, in violation of the internal market provisions contained in the Treaties. Article 8.23 (1) (b) CETA specifies that a claim may be brought *'on behalf of a locally established enterprise which it owns or controls directly or indirectly'*.

Therefore, CETA's ICS may be found to be incompatible with articles 54, 49, 56, and 63 TFEU. Article 54 requires natural persons who are nationals of Member States to be treated in the same way as companies or 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. As a result, an EU company owned by a foreign investor has more rights and a specific additional mechanism for judicial relief under ICS that are not conferred on all EU nationals.<sup>21</sup>

In a similar vein, the provisions on the freedom of establishment (article 49 TFEU) and freedom to provide and receive services (article 56 TFEU) is breached. Foreign owned undertakings established under the laws of one Member State will receive better treatment than EU undertakings owned by EU nationals established under the laws of another Member State. For example, a foreign owned Slovakian undertaking would be able to sue the Slovakian government for breaching investment provisions by changing its health care system, whereas a Czech undertaking owned by Czech nationals in a similar situation in Slovakia would not have recourse to ICS. The fact that the EU itself is concluding an international agreement introducing such discrimination and not solely the Member States is immaterial. The internal market provisions are not only binding on the Member States but also on the EU institutions.<sup>22</sup>

In addition, article 63 TFEU prohibits restrictions on capital movements to and from Member States, as well as third countries. ICS would create a distinction in treatment between capital movements between EU Member States and capital movements between the EU and third countries and could therefore breach article 63 TFEU. ICS does not only formally distinguish between these two types of capital movement, by providing foreign investors an additional

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20 Gus van Harten and Pavel Malysheuski, 'Who Has Benefited Financially from Investment Treaty Arbitration? An Evaluation of the Size and Wealth of Claimants' Osgoode Legal Studies Research Paper No. 14/2016

21 See Angelos Dimopoulos, 'The Compatibility of Future EU Investment Agreements with EU Law' (2012) 39 Legal Issues of Economic Integration, 447-471, at 454

22 So far, only article 34 TFEU has been applied to EU measures: Joined Cases C-154/04 and C-155/04 National Association of Health Stores and Others [2005] ECR I-449, para 47. However, nothing in the text of articles 49, 56, and 63 TFEU suggest that they do not apply to the EU institutions that are bound to respect primary EU law.

remedy and a court system that is not open to investors from Member States, but also materially discriminates between Member State investors and foreign investors. It is recalled that the standards for awarding damages differ between the EU standard and the standard afforded under international investment law, enabling foreign investors to rely on stricter standards than Member State investors. These findings suggest that such a system may breach article 63 TFEU. Moreover, it is clear that article 63 TFEU (at least partially) covers the subject matters contained in the investment chapters in the EU's future trade agreements. Article 63 TFEU concerns portfolio investment.<sup>23</sup>

It is not self-evident that the EU would be able to rely on any derogation contained in the TFEU or case-law based justifications.<sup>24</sup> It is true that the Court has given the EU institutions a broad discretion to enact measures that may breach the internal market provisions: the Court will only invalidate an EU measure where it *'is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue'*.<sup>25</sup> Nonetheless, it remains for the EU institutions to provide a public interest justification for the inclusion of investment provisions and ICS in particular. In that regard, Takis Tridimas notes the more critical exercise of EU competence *'through an exhaustive examination of the institutions' reasoning, a re-creation of the decision-making process'*.<sup>26</sup> The justification put forward by the Legal Service has not been tested before the Courts and it is a speculative position at best that it is in the EU's public interest that Canadian investors who are financially able to bring an ICS claim need a privileged position on the EU internal market.

## Concluding remarks

In light of the foregoing, ClientEarth would like to point out the serious legal difficulties that might arise out of concluding an incompatible international agreement containing investment arbitration. If such a decision would successfully be challenged in front of the ECJ, the EU and the Member States can, as a matter of EU law, no longer adhere to its provisions. However, under international law, such an agreement remains valid, ensuring that investment Tribunals can still issue awards that the EU and the Member States cannot honour under EU law, but are required to honour under international law. This would fundamentally upset the rule of law within the EU.

A legal challenge of a future Council decision concluding CETA is not unimaginable. Currently, there is a pending case before the ECJ where the ECJ will have to consider the legality of an award issued in the context of the Dutch-Slovak Bilateral Investment Treaty.<sup>27</sup> Such a case could find itself to the ECJ in the context of CETA. Alternatively, an individual or an NGO could seek annulment of a Council decision through a preliminary reference by a court of a Member State to the ECJ.

In light of these highly critical issues and in order to avoid significant legal complications that may result out of the entry into force of an agreement that is incompatible with the Treaties, ClientEarth urges the European Parliament, the Commission, the Council or one of the Member

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23 Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141, para 19

24 In particular articles 51, 52 (1), 62, 64, 65, and 66 TFEU

25 Joined Cases C-154/04 and C-155/04 *National Association of Health Stores and Others* [2005] ECR I-449, para 52

26 Takis Tridimas, *The General Principles of EU law* (2nd edn, OUP 2006), 145-146

27 Case C-284/16 *Achmea*

States to obtain legal certainty by making a request for an Opinion pursuant article 218 (11) TFEU.

Laurens Ankersmit  
Lawyer (non-practising) EU Trade  
& Environment  
+32(0)20 808 4321  
lankersmit@clientearth.org  
[www.clientearth.org](http://www.clientearth.org)

ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

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#### Brussels

Rue du Trône 60  
5ème étage  
1050 Bruxelles  
Belgique

#### London

274 Richmond Road  
London  
E8 3QW  
UK

#### Warsaw

ul. Żurawia 45  
00-680 Warszawa  
Polska

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