Policy Papers on Transnational Economic Law

No. 14

The Long Goodbye – The Commission's Infringement Proceedings against Austria, Denmark, Finland and Sweden for Incompatibilities in their BITs with the EC Treaty

Katja Scholz

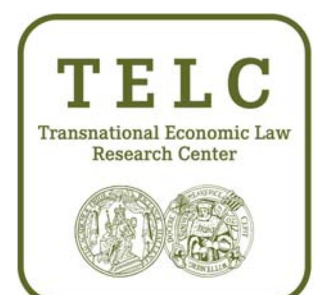
TRANSNATIONAL ECONOMIC LAW RESEARCH CENTER

Faculty of Law
Martin-Luther-University
Halle-Wittenberg
Universitätsplatz 5
06099 Halle (Saale)
Germany

Tel.: +49 345 / 55 23149
/ 55 23180
Fax: +49 345 / 55 27201

E-Mail: telc@jura.uni-halle.de
www.telc.uni-halle.de

May 2005



The Long Goodbye – The Commission's Infringement Proceedings against Austria, Denmark, Finland and Sweden for Incompatibilities in their BITs with the EC Treaty

1. Background

Taking infringement proceedings (Art. 226 EC) against Austria, Denmark, Finland and Sweden to the second stage, the Commission has now served these Member States with reasoned opinions concerning several of their bilateral investment treaties (hereafter BITs) with third countries. The Commission alleges that certain of their BITs concluded with non-EU countries prior to joining the European Union are incompatible with the Community's exclusive competence in the field of capital movements as enshrined in the EC Treaty.

The European Commission noted prior to the latest wave of enlargement that certain provisions in bilateral investment treaties concluded between the US and several Central and Eastern European accession candidates conflicted with EU law. But although the EU, US and all eight accession countries concerned came to a political understanding in 2003 which would preserve the BITs in question, the US pointed out that the indicted lack of safeguards on capital flows can also be found in some BITs of existing Member States, and rejected calls to remedy this point. In this context the Commission's attention was first drawn to those BITs in relation to which infringement proceedings are now in motion.

2. The Offending Provisions in the Light of the Law

The conflict of these BITs with the Treaty arises with regard to provisions concerning the transfer of funds between the contracting Member State and the third country. Being representative of the offending provisions in the thirty-two indicted investment treaties, Art. 5(1) of the Austria/Korea BIT reads as follows:

> „Each Contracting Party shall guarantee to investors of the other Contracting Party without undue delay the free transfer in freely convertible currency of payments in connection with an investment, in particular, but not exclusively, of:
> a) the capital and additional amounts for the maintenance or extension of investments,
> b) amounts assigned to cover expenses relating to the management of the investment,
> c) the returns,
> d) the repayment of loans,
> e) proceeds from total or partial liquidation or sale of the investment,
> […]."

Although the free movement of capital between Member States and third countries was extensively liberated under the EC Treaty, some exceptions remain. Thus Art. 59 EC provides that

> „Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council […] may take safeguard measures with regard to third countries […]."

And according to Art. 301 EC, the Council shall take the necessary urgent measures for the Community to interrupt or reduce economic relations with one or more third countries in order to safeguard the objectives of the common foreign and security policy. This is supplemented by the provision in Art. 60 (1) EC, stipulating that

> „If in the cases envisaged in Article 301, action by the Community is deemed necessary, the Council may […] take the necessary urgent measures on the movement of capital and payments as regards the third countries concerned."

Furthermore with regard to the movement of capital arising from direct investment, Art. 57 (2) EC provides:

> „Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries […], the Council may […] adopt measures on the movement of capital to and from third countries involving direct investment […]."

It follows from Art. 57 (1) EC that the offending BITs concluded by Austria, Denmark, Finland and Sweden with non-member countries prior to 31 December 1993 remained unaffected by the coming into force of the Maastricht Treaty. However, by virtue of Art. 307 (2) EC Member States are obliged to "take all appropriate steps to eliminate […] incompatibilities" with the EC Treaty in international agreements from their respective dates of their accession. This raises the question why the Commission has not previously pointed to this requirement in relation to the incompatibilities now targeted. The reason that these old cobwebs are finally falling pray to a burst of spring cleaning may be threefold:

The "Leading by Example" School of International Relations

When asked to amend certain provisions in her BITs with prospective EU Member States, the US noted that four existing EU members maintained similar provisions in their international agreements, and in this light baulked at calls to in-

troduce the requisite changes. Indeed it is hard to justify asking another to comply with rules disregarded by oneself. And although the shortcomings in Austria, Finland, Denmark, and Sweden's BITs were ignored without consequence over the past twelve years, they are now producing indirect adverse effects of an unexpected nature. But what seems, in common terms, a "fair" request by the US – namely that the EU put her own house in order before asking the US to introduce changes not yet made in the European Union – is on closer inspection no more than a political manoeuvre. Indeed on face value, the US has made an excellent point, and as a major international player and significant trading partner to the EU, it is little surprising that the Commission took her criticism to heart. While this circumstance can undoubtedly be credited with having brought the ball into motion, the more substantial reasons for Community action are examined below.

Protecting the European Union against Financial Terrorism

Having once been an alliance based on the idea of economic welfare, free trade and common development, the European Union has long grown beyond these ideals. This ever closer union is faced with an ever growing number of concerns, forcing it to legislate with the welfare of a gigantic social structure – not merely an economic partnership of convenience – in mind. The provisions to which the Commission's formal requests relate concern the movement of capital to and from non-EU countries. More specifically, the BITs at issue offer too free a movement of capital, failing to make provision for limitations on the transfer of funds.

The exclusive Community competence to restrict capital flows to and from non-Member States may in the Commission's view be undermined by provisions in those investment treaties with regard to which letters of formal notice were sent to Denmark, Austria, Finland and Sweden. While it is true that the BITs in question cannot serve to prevent Community measures being passed pursuant to Arts. 57(2), 59 and 60(1) EC, they deny such measures any effect in these Member States. By virtue of Art. 307 (1) EC, any of their BITs concluded prior to accession to the EU remain unaffected by the EC Treaty, and continue under international law to be binding upon those Member States – forcing them to adhere to the commitments therein regardless of Community legislation to the contrary.

It can be of no consequence to their compatibility with the EC Treaty that the BITs at the centre of this wave of infringement proceedings would not hinder the Council from passing valid legislation. The compatibility or incompatibility with the EC Treaty of these national

measures can be determined only in light of their true impact on the ability of the European legislature to meet its challenges effectively. And the true impact of these BITs would be to rob Community legislation of its effect vis-à-vis those third countries which had concluded investment treaties containing unrestricted, more liberal provisions with these Member States.

Indeed, if exceptional circumstances led the Council to invoke Arts. 57(2), 301 and 59 EC, and pass measures to restrict the flow of capital to and from third countries, nationals and undertakings of those third countries which maintained investment treaties with the Member States concerned could invoke the unrestricted rights granted by these BITs, thus circumventing the Community's protection against financial terrorism. And in light of an acutely prominent threat from international terrorism, the suggested changes would indeed be timely. Thus today more than ever, EU laws capable of averting a possible threat must not be robbed of their potency by potential loopholes.

Uniformity, Transparency, and the Bigger Picture

Insofar as the BITs in question run counter to the EU Council of Ministers' exclusive powers regarding the movement of capital to and from third countries (by virtue of Arts. 57, 59 and 60 EC), such agreements, having been concluded prior to the dates of accession of Austria, Denmark, Finland and Sweden, cannot be superseded by EU law. Article 307 (2) EC merely asks of the Member States that incompatibilities with the Treaty be eliminated from their international agreements. And although the investment treaties concerned have remained in force unchallenged for over a decade without coming into direct conflict with EU law, they are nonetheless contravening two of the most fundamental principles of the EU legal order – those of uniformity and transparency. An ever larger European Union increasingly relies on the uniformity and transparency of her rules. Thus although not in direct conflict with a textually contrary provision of EU law, these agreements do distort the picture of the European legal system as a whole, and create uncertainties the consequences of which may be even more serious.

3. Conclusions

Each of the three reasons analysed above for requiring the offending BITs to be amended can stand on its own. It is politically wise to show some goodwill when asking the US to amend her BITs to conform with EU law. It is imperative to the stability of the European Union and the validity of its legal system to maintain uniformity and transparency on the inside. And it is important to protect the EU from outside

threats with an intact shield of laws and provisions.

But there is another side of the coin. While curbing the right under investment treaties to freely conduct international capital transfers may smooth the appearance of the European legal system and eradicate potential loopholes, it also cuts deeply into one of the most fundamental rights of foreign investors. From their perspective, an investment is protected only if the host country assures the right to freely transfer capital and investment returns. It remains to be seen how added limitations on the free transfer of funds in the thirty-two BITs concerned will impact the world of foreign investment. But markets are quicker to react than the European Commission, so we may not have to wait another twelve years to see the results.

Katja Scholz LLB (King's College London), LL.M. (Amsterdam), Research Fellow, Transnational Economic Law Research Center (TELC), Martin-Luther-Universität Halle-Wittenberg, Germany.