Max Planck Institute Luxembourg
for International, European and Regulatory Procedural Law

Working Paper Series

MPILux Working Paper 4 (2014)

WHAT CAN A FOREIGN INVESTOR IN A FUTURE EU MEMBER STATE LEGITIMATELY EXPECT?: NEGOTIATING LEGAL CERTAINTY AND REGULATORY FLEXIBILITY DURING EU ACCESSION

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To be presented at the International Law Association Regional Conference, Lisbon, 11-12 September 2014

Max Planck Institute Luxembourg

Working Paper Series

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ISSN: 2309-0227
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Max Planck Institute Luxembourg
Luxembourg, 2014
Luxembourg

Cite as:
BLANCHARD, Sadie (2014), 'What Can a Foreign Investor in a Future EU Member State Legitimately Expect?: Negotiating Legal Certainty and Regulatory Flexibility During EU Accession',
MPILux Working Paper 4, available at: www.mpi.lu

ABSTRACT: Accepting that there is no conflict in a formal sense (under the Vienna Convention on the Law of Treaties) between EU law and investment treaty law, this paper observes that the legal change and uncertainty inherent in the accession process are in tension with investment treaty protections, and that arbitral tribunals must navigate between the legal certainty protected by investment treaties and the regulatory flexibility required for a State to satisfy the *acquis communautaire*. Tribunals have faced this tension when applying the fair and equitable treatment standard, the investment treaty standard most frequently invoked in investor claims. Fair and equitable treatment has been held to encompass various requirements including good faith, due process, non-discrimination, and the protection of investors' legitimate expectations. While tensions between EU law and investment protection obligations may be addressed through several of these branches of fair and equitable treatment, this paper focuses on one aspect—legitimate expectations—that is particularly pertinent to the tension between regulatory flexibility and legal certainty. The paper examines how arbitral tribunals hearing claims against newly acceded Member States have used the legitimate expectations doctrine to navigate investors' claims to enforce pre-accession expectations throughout and beyond accession. It finds significant points of agreement and one major divergence of views. It supports an approach that properly accounts for the time at which and context in which an investor's expectations are formed, as opposed to a blanket rule declining to protect expectations against State conduct required by EU law. It argues that such a blanket rule goes too far in undermining legal certainty, hampering the ability of candidate countries to attract investment by entering into long-term contracts or making specific assurances of regulatory stability.

KEYWORDS: fair and equitable treatment, investment treaty law, legitimate expectations, EU law, EU accession, policy space, regulatory flexibility, investment arbitration, Energy Charter Treaty, Micula, Electrabel, EU investment policy, BITs

The author wishes to thank Georgios Dimitropoulos and Matteo Gargantini for helpful comments. All errors and omissions remain the author's responsibility.

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I. Introduction

The geographical expansion of the European Union[1] has raised questions about the compatibility of newly applicable EU law in recently acceded Member States with their pre-existing treaties protecting foreign investment. Provisions of EU law governing the movement of capital, non-discrimination among nationals of Member States, and dispute resolution on matters of EU law have been argued to conflict with provisions of bilateral investment treaties (BITs) with other Member States and the investment chapter of the Energy Charter Treaty (ECT) as it relates to investors of other Member States.[2] The position of the European Commission is that "intra-EU BITs are not compatible with the EU single market."[3] Nevertheless, 190 bilateral investment treaties are in force among Member States.[4] In addition, nine States are on the EU accession agenda, among which Serbia alone, for example, has twenty BITs in force with current Member States.[5]

[1] Many of the facts of the disputes discussed herein occurred before the Lisbon Treaty, under the European Community; however, for the sake of simplicity I will refer throughout the paper to the European Union.
[2] *See, e.g.*, Eureko B.V. v. Slovak Rep., PCA Case No. 2008-13 (*Eureko I*), Award on Jurisdiction, Arbitrability and Suspension, paras. 175-186 (26 Oct. 2010); European Commission, Monitoring Activities and Analysis, Bilateral Investment Treaties Between Member States, http://ec.europa.eu/internal_market/capital/analysis/monitoring_activities_and_analysis/index_en.htm#maincontentSec5 (last visited 24 July 2014).
[3] *See* European Commission, Monitoring Activities and Analysis, *supra* note 2.
[4] Erhard Bohm, Marie-Christine Motaabbed, Chapter IV: Investment Arbitration, The European Union and the Unloved BITs of Its Member States, in Christian Klausegger, Peter Klein, et al. (eds.), Austrian Yearbook on International Arbitration, Vol. 2014, pp. 371-392, at 372.
[5] Serbia, Bilateral Investment Treaties, UNCTAD Investment Policy Hub, http://investmentpolicyhub.unctad.org/IIA/CountryBits/187#iiaInnerMenu.

While arbitrations initiated by investors under intra-EU BITs are by no means limited to newly acceded Member States or to measures taken as part of the accession process,[6] this paper considers the particular scenario of claims arising from pre-accession investments in which investors challenge conduct of newly acceded Member States related to the requirements of accession. Investment treaty tribunals have unanimously decided that EU accession does not invalidate a State's investment treaties with other Member States. Accepting that there is no conflict in a formal sense (under the Vienna Convention on the Law of Treaties) between EU law and investment treaty law, this paper observes that the legal change and uncertainty inherent in the accession process are in tension with investment treaty protections, and that arbitral tribunals must navigate between the legal certainty protected by investment treaties and the regulatory flexibility required for a State to satisfy the *acquis communautaire* and ultimately accede to the EU.

Tribunals have faced this tension when applying the fair and equitable treatment standard, the investment treaty standard most frequently invoked in investor claims. Fair and equitable treatment has been held to encompass various requirements including good faith, due process, non-discrimination, and the protection of investors' legitimate expectations.[7] While tensions between EU law and investment protection obligations may be addressed through several of these branches of fair and equitable treatment,[8] this paper focuses on one aspect—legitimate expectations—that is particularly pertinent to the tension between regulatory flexibility and legal certainty. The paper examines how arbitral tribunals hearing claims against newly acceded Member States have used the legitimate expectations doctrine to navigate investors' claims to enforce pre-accession expectations throughout and beyond accession. It finds significant points of agreement and one major divergence of views. It supports an approach that properly accounts for the time at which and context in which an investor's expectations are formed, as opposed to a blanket rule declining to protect expectations against State conduct required by EU law. It argues that such a blanket rule goes too far in undermining legal certainty, hampering the ability of candidate countries to attract investment by entering into long-term contracts or making specific assurances of regulatory stability.

The paper proceeds as follows. Part II explains the current state of the investment treaty jurisprudence unanimously holding that investment treaty protections survive EU accession. Part III describes the competing values at stake during the accession process and the role of the legitimate expectations doctrine in mediating the tension between them, then briefly explains the contours of the doctrine in investment treaty law. Part IV summarizes the facts presented in the four EU accession investment treaty disputes decided to date: *Eastern Sugar v. Czech Republic*,

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[6] See, for example, the claim against Germany by Swedish investor Vattenfall, several recent claims brought by UK and Dutch investors against Spain, and claims against Hungary and Slovakia based on measures unrelated to accession. Vattenfall v. Germany, ICSID Case No. ARB/09/6; *Eureko I*; Achmea v. Slovak Republic, PCA Case No. 2013-12; Luke Eric Peterson, *Despite Plunge in Venezuela claims, ICSID Sees 40 Cases Come through Its Doors in 2013; Intra-EU Treaty Claims Continue to Proliferate*, IA Reporter, www.iareporter.com/articles/20140119_2 (19 Jan. 2014); Luke Eric Peterson, *Investors in Hungary's Radio Industry Fail to Persuade Arbitrators that They Had Rights Capable of Expropriation Under Swiss and Dutch BITs*, IA Reporter, www.iareporter.com/articles/20140418 (18 April 2014).

[7] *See* Dolzer & Schreuer, Principles of International Investment Law 142-160 (2d ed. 2012).

[8] For example, tribunals have also considered how EU law and accession obligations impact the rationality, reasonableness, and arbitrariness of an acceding State's conduct. *See* AES v. Hungary, ICSID Case No. ARB/07/22, Award, paras. 7.6.9, 9.2.13, 9.2.16, 10.2.3, 10.3.16 (23 Sept. 2010); Micula v. Romania, ICSID Case No. ARB/ARB/05/20, Award, paras. 748-754 (11 Dec. 2013); Electrabel v. Republic of Hungary, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, paras. 6.38-6.39 (30 Nov. 2012).

AES v. Hungary, *Electrabel v. Hungary*, and *Micula v. Romania*. Part V analyzes the tribunals' legal findings on legitimate expectations, and Part VI concludes.

II. The Absence of a Legal Conflict Between Investment Treaty Protections and EU Law

Both jurisdictional and substantive arguments put forward by the European Commission and respondent States that, upon accession, EU law supersedes investment treaty protections have consistently failed.

Investment tribunals have unanimously decided that they retain jurisdiction over investment treaty disputes between Member States and investors of other Member States.[9] The tribunals have held that, under the rules of treaty interpretation in the Vienna Convention, the EU accession treaties concluded to date have not expressly or implicitly terminated pre-existing investment treaties or otherwise invalidated the right to investor-State arbitration granted in BITs. That right can be terminated only by the procedure set out in the relevant BIT, typically requiring one treaty party to formally notify the other of its intent to terminate.[10] While the European Commission has asked Member States to terminate their intra-EU BITs, few have complied.[11] Termination cannot retroactively affect pre-existing disputes.[12] Furthermore, the treaties typically include a clause maintaining the treaty's protections for existing investors for a number of years (typically ten or fifteen) after termination.[13] Thus, even if a future EU accession treaty expressly terminated existing BITs with Member States, or if Member States terminated their BITs with one another according to the treaties' procedures, they could still be subject to investor claims under the treaties for more than a decade.

Investment tribunals have also rejected arguments that EU law displaces investment treaties' substantive protections.[14] The European Commission, while acknowledging that intra-EU BITs are not implicitly terminated by EU accession under Article 59 of the Vienna Convention,[15] has argued that investment treaty provisions are inapplicable under several theories:

(i) *lex posterior*, in particular under Article 30(3) of the Vienna Convention, which governs successive treaties relating to the same subject matter;[16]

(ii) "internal EU conflict rules of supremacy" where the relevant investment treaty specifies that the applicable law includes the domestic law of the treaty parties or other relevant rules of international law applicable between them;[17]

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[9] *See Electrabel*, paras. 4.158-4.166; Eastern Sugar v. Czech Republic, SCC No. 088/2004, Partial Award, paras. 104-176 (27 March 2007); Oostergetel v. Slovak Republic, Decision on Jurisdiction, para. 74 (30 April 2010); *Micula*, pp. 86-97; *AES*, pp. 27-33; *Eureko I*, Award on Jurisdiction, Arbitrability and Suspension, pp. 60-77 (26 Oct. 2010).

[10] *See, e.g.*, Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Republic, art. 13, 1 Oct. 1992.

[11] *See* European Commission, Monitoring Activities and Analysis, *supra* note 2; Damon Vis-Dunbar, *EU Member States Reject Call to Terminate Intra-EU Bilateral Investment Treaties*, Investment Treaty News, 10 Feb. 2009, http://www.iisd.org/itn/2009/02/10/eu-member-states-reject-the-call-to-terminate-intra-eu-bilateral-investment-treaties/ (last visited 24 July 2014).

[12] *See Eastern Sugar*, paras. 176-177.

[13] *See, e.g.*, Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Republic, art. 13(3), 1 Oct. 1992.

[14] *See, e.g.*, *Eureko I*, Final Award, paras. 272-276.

[15] *Eureko I*, Award on Jurisdiction, Arbitrability and Suspension, para. 187.

[16] *See, e.g.*, *id.* paras. 188-193.

(iii) that the Energy Charter Treaty should be interpreted subordinately to EU law in light of its the special historical grounding in the European integration project and the EU's status as a contracting party.[18]

While accepting the above theories in principle,[19] investment tribunals have not found any conflict between investment treaty law and EU law relevant to the disputes before them that have required the latter legal provisions to displace the former.[20] In some disputes the challenged conduct occurred before accession, so EU law was not yet applicable in the host State.[21] In the post-accession context, tribunals have rejected the argument that the relevant norms should be compared in the abstract in search of hypothetical incompatibilities, instead reasoning that, for a conflict to arise, a specific provision of EU law relevant to the dispute at hand would have to be at odds with a relevant provision of the BIT. High-level overlap in the matters regulated was not sufficient.[22]

Thus, the usual tools for resolving conflicting norms of international law have been held to support the continued validity of investment treaty law after accession. Investment tribunals have (correctly, in my view) found that, in the cases before them, there has been no material conflict between the relevant norms that would justify disregarding investment protection standards or revoking recourse to investor-State arbitration as a means of enforcing them. However, even if there is no conflict of legal rules, there remains a situation of values in tension with one another under two systems of relevant law.

III. The Tension Between Legal Certainty and Change During Accession: A Role for Legitimate Expectations

One tribunal identified the "competing values" at stake during accession as "the substantive and procedural protections of the rights of a foreign investor and the economic integration of EU Member States into the European Union operating under the rule of law."[23] I would refine that definition somewhat by reference to the purpose of each legal regime.

In investment treaties, States promise foreign investors certain protections in order to attract capital into their territories to promote economic development. It should be noted that in the case of EU accession candidates, attracting foreign investment is an integral part of the accession process, supporting the development of the economy to a level that can compete in the common market.[24] Indeed, the stability and association agreements concluded by the candidate countries involved in the disputes discussed in this paper called for the candidate countries to conclude bilateral investment treaties with Member States to promote a favorable investment environment.[25] On the other hand, a goal of EU stability and association agreements and of accession agreements is to quite drastically alter the domestic regulatory environment to conform

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[17] *See, e.g.*, *id.*, paras. 11, 188-193. For example, Article 26(6) of the Energy Charter Treaty requires a tribunal to apply "this Treaty and applicable rules and principles of international law."
[18] *See Electrabel*, paras. 4.132-4.169.
[19] *See Eureko I*, Jurisdiction, paras. 288-292; *Electrabel*, paras. 4.130-4.133; *Eastern Sugar*, paras. 142-181.
[20] *See, e.g.*, *Eureko I*, Final Award, paras. 272-277; *Eastern Sugar*, paras. 104, 160-165, 180; *Oostergetel*, paras. 74, 79, 86-87; *Electrabel*, para. 4.191.
[21] *Micula*, para. 319; *Eastern Sugar*, para. 176.
[22] *Eureko I*, Final Award, paras. 274-276.
[23] *Electrabel*, para. 4.112.
[24] *See Micula*, paras. 190-195, 677-678.
[25] *See, e.g.*, Europe Agreement Establishing an Association Between the European Economic Communities and their Member States, of the One Part, and Romania, of the Other Part, art. 74(2) (1994).

it to EU norms (the *acquis communautaire*), particularly in the area of economic governance. Thus, a key value at stake during the transition process is regulatory flexibility. A tension thus exists between the regulatory flexibility necessary to permit the far-reaching reforms required for European integration and the maintenance of sufficient legal certainty to attract foreign investment (itself instrumental to achieving European integration).

The legitimate expectations doctrine—found across domestic legal systems and in international law[26]—is well suited to mediating this tension. The following definition of the doctrine is drawn from a comparative study of national systems: "[A]ny individual who, as a result of governmental conduct, holds certain expectations concerning future governmental activity, can require those expectations to be fulfilled unless there are compelling reasons for not doing so."[27] Legal protection of legitimate expectations may be rooted in several theories. Like the principles of estoppel and good faith, the doctrine protects reliance, placing "a responsibility [on] the party making [a] statement as a necessary assumption of the risk of another party acting upon the statement,"[28] especially where the party making the statement "secures some advantage" to itself.[29] From an economic perspective, the protection of legitimate expectations promotes legal certainty to incentivize the productive allocation of resources and thus the creation of economic value. The jurisprudence of legitimate expectations across jurisdictions grapples with the limits of protection of expectations—with where to place the boundary between legal certainty for private actors and regulatory flexibility for the State.[30]

Investment treaty jurisprudence has elaborated legitimate expectations as a strand of the fair and equitable treatment standard typically inscribed in investment protection and promotion treaties. A recent award stated, "It is widely accepted that the most important function of the fair and equitable treatment standard is the protection of the investor's reasonable and legitimate expectations."[31] The doctrine includes two broad aspects. First, it holds a State liable for violating specific undertakings it has made vis-à-vis foreign investors, including contractual agreements and unilateral promises that meet certain conditions. Second, and more controversially, it has been found to protect the general stability of the legal framework.[32]

The protection of investors' expectations has raised concerns about the ability of a State to change its policy.[33] It may appear that an investor who cannot establish objectively wrongful conduct by the State (such as bad faith, arbitrariness, discrimination, lack of transparency, or failure of due process) can try to clear the lower hurdle of proving that the State undermined subjective expectations. Such concerns are particularly pertinent when the general stability of the

[26] *See* Elizabeth Snodgrass, *Protecting Investors' Legitimate Expectations: Recognizing and Delimiting a General Principle*, 21 ICSID Review 1 (2006); Michele Potesta, *Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept*, 28 ICSID Review 88 (2013); W. Michael Reisman & Mahnoush H. Arsanjani, *The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes*, *in* Volkerrecht Als Wertordnung—Common Values in International Law. Essays in Honour of Christian Tomuschat, at 409, 420-421, (Dupuy et al., eds. 2006).

[27] Robert Thomas, Legitimate Expectations and Proportionality in Administrative Law, at xv (2000).

[28] D.W. Bowett, *Estoppel Before International Tribunals and Its Relation to Acquiescence*, 33 British Y.B. of International Law 176 (1957), quoted in Reisman & Arsanjani, at 420.

[29] *Id. See also Case Concerning Territorial Dispute (Libyan Arab Jamahiriya v. Chad)*, Judgment of Feb. 13, 1994, I.C.J. Reports 1994, at 6.

[30] *See* Potesta, *supra* note 26, at 93-98; Snodgrass, *supra* note 26, at 30-48.

[31] *Electrabel*, para. 7.75.

[32] *See* Potesta, *supra* note 26, at 100-116; Snodgrass, *supra* note 26, at 5-11.

[33] *See* EDF v. Romania, ICSID Case No. 05/13, Award para. 217 (8 Oct. 2009); Douglas, *Nothing if Not Critical for Investment Treaty Arbitration:* Occidental*,* Eureko *and* Methanex, 22(1) International Arbitration 27, 28, 35, 51 (2006).

legal framework is found to be protected, and even more so in the context of reform processes such as EU accession. When a State implements extensive regulatory changes to comply with EU law, it is arguable that no real tension arises from the application of investment treaty norms that require the State to execute any changes transparently, rationally, and non-discriminatorily, and to afford due process of law to those affected. By contrast, the idea that beyond those fundamentals of fairness and good governance, an investor's expectation of a particular regulatory outcome should be upheld might give greater cause for concern.

That basic background sets the stage for examining how investor-State tribunals have applied this doctrine in the context of EU accession.

IV. The EU Accession Investment Treaty Disputes

In four arbitrations—*Eastern Sugar v. Czech Republic*, *AES v. Hungary*, *Electrabel v. Hungary*, and *Micula v. Romania*—treaty-based investor-State arbitration tribunals considered arguments that EU accession impacted what an investor could legitimately expect when it made its investment in an EU candidate country. This section gives a brief factual overview of each case, while the next section analyzes the tribunals' legal reasoning.

Eastern Sugar v. Czech Republic

Eastern Sugar, a Dutch corporation, invested in sugar production factories in the Czech Republic beginning in 1994, when the country had in place a liberalized sugar market. In 1993, the Czech Republic had signed the Europe Agreement, becoming a candidate for EU membership[34] and agreeing to adapt its law to EU standards.[35] Between 2000 and 2003, the Czech government issued three decrees that deliberalized the sugar production industry, ostensibly to comply with EU common agricultural policy.[36] In 2004, the Czech Republic acceded to the EU.[37] The same year, Eastern Sugar brought a claim for violation of the fair and equitable treatment obligation of the BIT between The Netherlands and the Czech Republic challenging the three decrees.[38]

AES v. Hungary

AES v. Hungary involved a claim by a UK corporation and its subsidiary (collectively, AES) under the Energy Charter Treaty arising out of Hungary's transition to a market-based electricity sector, which overlapped in time with its accession to the EU.[39] The Europe Agreement entered into force in 1994.[40] In 1996, during the early stages of Hungary's electricity market liberalization, AES purchased two power generation facilities in the country. In 2001, the Electricity Act provided that the price control regime then in force would end in 2004. Also in 2001, AES entered into Amended Power Purchase Agreements (Amended PPAs) requiring the Hungarian State-owned power distribution entity to purchase power from AES until 2016 under

[34] *Eastern Sugar*, para. 7.
[35] *Id.*, paras. 7-8.
[36] *Id.*, paras. 243-338.
[37] *Id.*, para. 14.
[38] *Id.*, para. 199.
[39] *AES*, para. 2.1.2, 3.2, 4.1-4.4.3.
[40] Europe Agreement Establishing an Association Agreement Between the European Communities and Their Member States, of the One Part, and the Republic of Hungary, of the Other Part (1994).

prices set by the State as long as the price control regime was in effect, and thereafter under a contractually specified price formula.[41]

The price control regime ended in January 2004 as anticipated, from which point the formula set out in the Amended PPAs took effect.[42] Also in 2004, Hungary acceded to the EU.[43] In 2005, a political debate emerged in which it was argued that power generators were making excessive profits.[44] Simultaneously, the European Commission was investigating whether Hungary's PPAs with electricity generators constituted unlawful State aid.[45] In 2006, the Hungarian parliament reintroduced price controls,[46] and subsequently the government issued two decrees fixing a price for each power generator, nullifying the pricing formula set out in the Amended PPAs. AES alleged that the new price decrees reduced its prices by up to 45 percent.[47] It filed the Request for Arbitration under the Energy Charter Treaty in 2007.[48]

Electrabel v. Hungary

The tribunal in *Electrabel v. Hungary* also heard a claim under the Energy Charter Treaty based on Hungary's electricity privatization process. Electrabel purchased a power generation facility in 1995 and concluded a PPA with the Hungarian State-owned electricity purchaser with a term through December 2010, which was extended in 1998 for one unit to 2015.[49] Like AES, Electrabel complained that the reintroduction of price controls violated its legitimate expectations that pricing regulation would end.[50] But Electrabel also complained that Hungary's termination of its PPA in 2008 (after EU accession in 2004) violated its legitimate expectations. The European Commission had decided that Hungary was providing illegal State aid to power generators, and Hungary responded by terminating the PPA.

Micula v. Romania

Two brothers, Ioan and Viorel Micula, invested together in food and drink production facilities in Romania beginning in 1999. (The brothers and the corporations through which they invested are referred to herein collectively as "the Miculas.") The Europe Agreement had come into force in 1995.[51] In 1997, the European Commission decided not to accept Romania's application to join the EU at that time, concluding that it had not reached a level of development that would permit it to compete in the common market.[52] The 1998 Annual Report of the European Commission highlighted that regional development would be key to Romania's satisfaction of the economic criteria for EU accession.[53] In 1998 and 1999, the European Commission issued Guidelines on Regional Aid, setting out criteria for assessing when regional aid would be permitted under the EU treaty, and the Council issued a regulation governing the

[41] *AES*, paras. 4.10 *et seq.*
[42] *Id.*, para. 4.13.
[43] *Id.*, para. 4.12.
[44] *Id.*, para. 4.16-4.17.
[45] *Id.*, paras. 9.2.13, 10.3.15-10.3.19.
[46] *Id.*, para. 4.20.
[47] *Id.*, para. 4.21-4.23.
[48] *Id.*, para. 4.27.
[49] *Electrabel*, paras. 6.1-6.2.
[50] *Id.*, paras. 2.1 et seq. ; para. 6.4-6.7.
[51] *Micula*, paras. 179-185.
[52] *Id.*, paras. 193-192, 194-195.
[53] *Id.*, para. 194-195.

application of Article 93 of the EU Treaty concerning state aid measures.[54] In 1998 and 1999 Romania established a framework to grant incentives for investment in "disfavored" regions.[55] It also created a Competition council with authority to regulate State aid.[56]

Within that framework, the Miculas began their investment in 1999 in the disfavored region of Stei-Nucet-Draganesti. Throughout the term of the investment, Romania repeatedly amended its regulations on regional State aid to comply with EU law. The Constitutional Court occasionally struck down changes, so there was a series of withdrawals and reinstatements of incentives.[57] Finally, in 2005, all but one of the incentives were revoked. The same day, the European Commission issued its affirmative opinion on Romania's accession.[58] Romania signed the accession treaty several months later.[59] The Miculas brought a claim under the Romania-Sweden BIT challenging the revocation of the incentives.

V. What Can an Investor in a Future EU Member State Legitimately Expect?

A. The Presumption of Non-Stabilization

Following the trend of more recent cases,[60] the EU accession cases have emphasized the host State's right to regulatory flexibility over any right of the investor to general stability of the legal framework. Even in earlier cases, tribunals held that not just any change to the law would support a claim, but only fundamental changes to the legal framework. For example, in *CMS v. Argentina*, the tribunal reasoned that "[t]he measures complained of did in fact entirely transform and alter the legal and business environment under which the investment was made," thwarting the investor's legitimate expectations in violation of the investment treaty.[61] Even that high standard of liability, however, could hamstring a State undergoing an extensive reform process like EU accession, and the trend away from protection of general regulatory stability allows more leeway for harmonization with EU law.

The EU accession cases in particular emphasize general regulatory leeway of the acceding State.[62] That is true even of the awards rendered under the Energy Charter Treaty, which expressly provides in Article 10(1) that the Contracting Parties "shall . . . encourage and create stable . . . conditions for investors of the other Contracting Parties." The *AES* tribunal elaborated the limits of the ECT's protection of stability as follows:

> 9.3.29 The stable conditions that the ECT mentions relate to the framework within which the investment takes place. Nevertheless, it is not a stability clause. A legal framework is by definition subject to change as it adapts to new circumstances day by day and a state has the sovereign right to exercise its powers which include legislative acts. . . .

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[54] *Id.*, para. 193.
[55] *Id.*, para. 145.
[56] *Id.*, para. 199-200.
[57] *Id.*, paras. 213-244.
[58] *Id.*, para. 245.
[59] *Id.*, para. 246.
[60] Parkerings v. Lithuania, Award, paras. 327-38 (11 Sept. 2007); BG Group v. Argentina, Final Award, paras. 292-310 (24 Dec. 2007); Plama v. Bulgaria, Award, paras. 258-61 (27 Aug 2008); AES v. Hungary, Award, paras. 9.3.27 (23 Sept 2010); Paushok v. Mongolia, Award, 28 April 2011, para. 302; Impregilo v. Argentina, Award, 21 June 2011, paras 290-91; El Paso v. Argentina, Award, paras. 344-55, 365-74 (31 Oct 2011); *EDF*, paras. 216-220.
[61] CMS v. Argentina, Award, paras. 274-276 (12 May 2005) (internal citations omitted).
[62] *Micula*, paras. 529, 666; *AES*, paras. 9.3.28-9.3.35; *Electrabel*, paras. 7.75-7.77.

> 9.3.34 . . . [A]bsent a specific commitment from Hungary that it would not reintroduce administrative pricing . . . Claimants cannot properly rely on an alleged breach of Hungary's Treaty obligation to provide a stable legal environment . . . . This is because any reasonably informed business person or investor knows that laws can evolve in accordance with the perceived political or policy dictates of the times.

The *Micula* tribunal, interpreting a typical fair and equitable treatment provision, reasoned,

> In the Tribunal's view, the fair and equitable treatment standard does not give a right to regulatory stability per se. The state has a right to regulate, and investors must expect that the legislation will change, absent a stabilization clause or other specific assurance giving rise to a legitimate expectation of stability.[63]

Therefore, the cases demonstrate a presumption against regulatory stabilization, requiring specific assurances in order for any expectation of stability to be protected.

B. The Importance of the Time at which Expectations Are Formed

It is well established that the relevant expectations are those that exist at the moment the investment is made.[64] Like the presumption of non-stabilization, this aspect of the doctrine preserves space for regulatory change. An investor cannot complain about aspects of the legal framework that existed before it made its investment.[65] Preexisting instability in the legal and regulatory framework has been found to impact the reasonableness of expectations.[66]

Central to this issue is when the investment was made. In each of the four EU accession cases, the investment was made, and the relevant expectations thus formed, before accession but after the host State had entered into a stability and association agreement with the European Union (the Europe Agreements), which required the State to harmonize its law with EU law and also indicated that the State would likely eventually become an EU Member State. Therefore, it is uncontroversial that legal and regulatory reforms that moved toward the EU regulatory environment and eventual accession were foreseeable and must be considered when determining what the investor legitimately expected.

For example, in *Eastern Sugar*, the tribunal determined that the investor's expectations about the future regulatory environment at the time it made its investment had to take into account the Czech Republic's "obvious" desire to join the EU.[67] Thus, Eastern Sugar "had to expect that the regulation of the sugar market would, as accession neared, become roughly the protectionist regime prevailing in European Union countries."[68] The tribunal thus looked to the history of EU agricultural regulation as forming the relevant expectations that Eastern Sugar could have held about the future of its regulation in the Czech Republic. Similarly, in *Micula*, the

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[63] *Micula*, para. 666.
[64] Dolzer & Schreuer, Principles of International Investment Law 146 (2d ed 2012); AES, para. 9.3.7-9.3.8.
[65] Duke Energy v. Ecuador, ICSID Case No. ARB/04/19, Award, para. 340 (18 Aug. 2008); Tecmed, ICSID Case No. ARB(AF)/00/2, Award, para. 154 (29 May 2003).
[66] Bayindir v Pakistan, Award, paras. 192-197 (27 Aug 2009); Ursula Kriebaum, *The Relevance of Economic and Political Conditions for the Protection under Investment Treaties*, 10 The Law and Practice of International Courts and Tribunals 383, 387 (2011).
[67] *Eastern Sugar*, paras. 235-242.
[68] *Id.*, para. 237.

tribunal stated, "The overall context of EU accession in general and the pertinent provisions of EU law in particular may be relevant to the determination of whether . . . Claimants' expectations were legitimate."[69]

While, as explained in this and the previous section, the EU accession cases are consistent in declining to protect general regulatory stability during the accession process, they diverge on the treatment of specific commitments by the host State. This divergence departs from the general arbitral jurisprudence and commentary, in which the protection of specific commitments is the less controversial aspect of the legitimate expectations doctrine.[70] The next section discusses the two views on this issue.

C. Legitimate Expectations Arising from Host State Commitments

In each of the cases, the precise impact of reforms that would be made to comply with the *acquis communautaire*, as well as when accession would occur, was not foreseeable when the investments were made, as many as ten years before accession. EU candidate countries seeking to attract capital for development are negotiating with investors and implementing incentive schemes amid such uncertainty. Particularly murky issues include whether certain contractual arrangements will later be determined to constitute State aid, and whether incentives expressly labeled as State aid for disfavored regions will be determined to violate EU law. Given the absence of protection of general regulatory stability, one way that candidate countries can attract investment is by making specific commitments to maintain particular situations for a certain time period. Such commitments could include contracts with investors, unilateral undertakings, or other statements or conduct representing that a particular situation will be maintained or a regulation will not change.[71]

Two views have emerged in the EU accession cases regarding whether specific commitments of the host State during the accession process can give rise to legitimate expectations protected against EU law. Under one view, actions of the host State taken in a reasonable effort to comply with EU law can never violate an investor's legitimate expectations.[72] A second view holds that EU law and the harmonization requirements of the accession process are factual elements to be considered to determine what the investor legitimately expected when making the investment.

1. Electrabel*: No Legitimate Expectations Against EU Law Requirements*

The *Electrabel* tribunal held that EU law was part of the law applicable to the merits of the dispute; thus, the ECT had to be interpreted harmoniously with EU law.[73] It based this conclusion on what it found to be a recognition in Article 1(3) of the ECT that EU decisions are binding on EU Member States.[74] Article 1(3), falling under the heading "Definitions," states,

> "Regional Economic Integration Organization" [(RIEO)] means an organization constituted by states to which they have transferred competence over certain

[69] *Micula*, paras 327-328.
[70] *See, e.g.*, Snodgrass, *supra* note 26, at 30-32
[71] *See id.*
[72] This conclusion of the *Electrabel* tribunal is limited to actions taken by the host State after EU accession.
[73] *Electrabel*, paras. 4.132, 4.191.
[74] *Id.*, para. 4.132 ; Art. 1(3) ECT.

> matters a number of which are governed by this Treaty, including the authority to take decisions binding on them in respect of those matters.

The EU is a Contracting Party to the ECT as a RIEO. On that basis, the tribunal invoked the investor's legitimate expectations as impacting the applicable law:

> As regards protection under the ECT, investors can have had no legitimate expectations in regard to the consequences of the implementation *by an EU Member State* of any such decision by the European Commission. In other words, the possible interference with a foreign investment through the implementation *by an EU Member State* of a legally binding decision of the European Commission was and remains inherent in the framework of the ECT itself . . .
>
> [T]he ECT does not protect the Claimant, as against the Respondent, from the enforcement by the Respondent of a binding decision of the European Commission under EU law.[75]

Further, the tribunal elaborated a deferential standard to be applied to actions taken to comply with EU law: not only actions required by EU law but also those reasonably believed to be required could not be found to violate the investor's legitimate expectations, in addition to a margin of appreciation in implementation. Put another way, the principle elaborated in *Electrabel* is that investors of EU Member States investing in other Member States have a legitimate expectation only that Member States will implement their reasonably perceived EU law obligations in a rational and non-arbitrary manner, thus collapsing legitimate expectations into the more "objective" doctrines of FET.[76] Under the great deference the tribunal afforded to actions required by EU law or institutions, even specific assurances made by a Member State as to the maintenance of a particular situation would not be protected against changes required by EU law.

The glaring problem with the *Electrabel* tribunal's analysis is that it fails to consider the crucial question of the time at which expectations are formed. When Electrabel made its investments, it would be nine and six years, respectively, before Hungary was an EU Member State. Therefore, the analysis that "investors can have had no legitimate expectations in regard to the consequences of the implementation by an EU Member State of any such decision by the European Commission" is problematic.[77] The reasoning presumes that an investor in an EU candidate country must expect that when that country becomes an EU Member State—at some unspecified future time, possibly a decade or more hence[78]—it might be subject to a binding adverse State aid decision. As noted above, when an investment is made in a candidate country, there is often great uncertainty regarding when accession will happen and how compliance with the *acquis* and, later, accession might impact the investment. In *Electrabel*, there was no finding that the investor should have known that its contractual arrangement would later be found to constitute illegal State aid.

[75] *Id.*, paras. 4.142, 4.169 (emphasis added). The tribunal noted that any challenge against an action required by the EU would have to be brought against the EU and not the Member State. *See* paras. 4.170-4.171.

[76] Paras. 6.73 *et seq.*

[77] *Electrabel*, para. 4.142. Note also that there is no principled reason to limit such a holding to investors from EU Member States, since it rests on the host State's transfer of competences to the EU. It would thus appear to apply to any investor wishing to bring a claim under the ECT.

[78] The Agreement Creating an Association Between The Republic of Turkey and the European Economic Community was signed in 1963, and Turkey still has not acceded.

By applying the legitimate expectations doctrine in a novel way as impacting the applicable law rather than as a factual inquiry, the *Electrabel* tribunal placed all of the risk arising from the uncertainty inherent in accession on the investor. The tribunal declined to delve into the question of whether, as a matter of fact, Hungary represented to the investor that the pricing formula in its contract would continue beyond EU accession. Contractual promises are usually considered the strongest evidence of undertakings creating legitimate expectations,[79] and Electrabel had a contract whose term continued beyond accession.[80] In addition, Hungary's conduct indicated that it may have itself believed the contracts could continue: it argued before the European Commission shortly before accession that the contracts should be considered EU law-compatible State aid.[81] There are thus at least *prima facie* indications that Hungary may have given specific representations to Electrabel. Despite these circumstances, the *Electrabel* tribunal declined to examine whether, as a matter of fact, Hungary created in the investor legitimate expectations that it subsequently breached when it terminated Electrabel's contract.

2. *An Alternative: A Factual Inquiry into Whether State Commitments Created Legitimate Expectations*

In contrast to the *Electrabel* approach, three tribunals—including one constituted under the Energy Charter Treaty—have agreed that the harmonization requirements of the Europe Agreement (before accession) and EU law (after accession) would be considered as facts going to the existence and the legitimacy of the investor's expectations.[82] As the *Micula* tribunal stated,

> [F]actually, the general context of EU accession must be taken into account when interpreting the BIT. . . . The overall context of EU accession in general and the pertinent provisions of EU law in particular may be relevant to the determination of whether . . . Claimants' expectations were legitimate.[83]

That EU law (or harmonization obligations under the Europe Agreement) required some action was not dispositive of whether the State could be held liable, but was one element to be taken into account.[84]

The *AES* tribunal found that that, entirely apart from any question of EU law, the investor had no legitimate expectation to the continuation of the situation on which it based its claim.[85] The *Eastern Sugar* tribunal found that the challenged measures were not in fact required by EU law but were at odds with EU agricultural policy.[86] The analysis in those cases is thus of limited relevance for the present discussion.

Micula, however, extensively considered how the uncertainty inherent in the accession process should be taken to impact the investor's legitimate expectations. The investors were found to have a legitimate expectation that the incentives they were granted by the State to invest

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[79] *See* Potesta, *supra* note26, at 100-101.
[80] *See supra* text accompanying note 49.
[81] *Electrabel*, paras. 6.67.
[82] *Eastern Sugar*, paras. 232-242; *Micula*, paras. 327-328; *AES*, para. 7.6.6. The tribunal in *AES* followed this approach even though like *Electrabel* it was decided under the Energy Charter Treaty and considered post-accession host-State actions. *See AES*, para. 7.6.6.
[83] *Micula*, paras 327-328.
[84] *Id.*, para. 513-514.
[85] *AES*, para. 9.3.18.
[86] *Eastern Sugar*, paras. 265-266, 274, 286-296, 314, 332, 335, 338.

in underdeveloped regions would be maintained beyond accession because Romania took the requirements of accession into account in granting those incentives and in decisions thereafter to maintain them.[87] Romania also gave investors various assurances that the incentives would be maintained for ten years.[88] The tribunal analyzed EU State aid rules and determined that it was reasonable for the investor to believe that the aid it was granted conformed to EU law as permissible aid to promote underdeveloped regions.[89] Indeed, the tribunal concluded that Romania believed as much up to the point that the European Commission concluded otherwise.[90]

As compared with *Electrabel*, *Micula* is more protective of legal certainty while giving due consideration to the exigencies of the transition to EU membership. Instead of a blanket rule holding that acts reasonably taken to comply with EU law cannot breach an investor's legitimate expectations, the *Micula* tribunal recognized that an investor's expectations about future regulation in an EU candidate country are based on more than the fact that a State has concluded a stability and association agreement with the EU and thus might at some future time become a Member State. It also appreciated the need of candidate countries to make credible commitments.

VI. Conclusion

The EU accession investment treaty decisions reveal one important point of agreement and one major doctrinal split. There is agreement on a presumption against regulatory stability, perhaps strengthened where an investment is made in an inherently fluid environment such as that of an EU candidate country. This agreement should alleviate fears that investment treaties will hamstring acceding States.

It is tempting to label the two views in the doctrinal split in pro-investor versus pro-State terms. On that spectrum, one might call *Electrabel* pro-State (or pro-EU), because the tribunal gave greater deference to State conduct taken in pursuit of EU harmonization. *Micula* could be labeled pro-investor because it did the converse. But such a conclusion misses much because it only looks backwards. Looking instead at the incentives created by each approach highlights that the *Electrabel* analysis is not only detrimental to investors. It also diminishes the ability of a candidate country to make credible promises to induce investment. Any commitment by the State that might later conflict with European regulation essentially loses a major avenue of enforcement, since under *Electrabel* a tribunal will not review the facts to determine whether the State created a legitimate expectation that the commitment would be maintained in spite of the EU harmonization process. The potential impact of such a rule is exacerbated by the inherent uncertainty in the accession environment and the presumption against general regulatory stability. The *Electrabel* approach might thus impede the ability of candidate countries both to negotiate medium- and long-term contracts (like those at issue in *AES* and *Electrabel)* and to induce investment through regional aid for disfavored regions (as in *Micula*). Given the uncertainty facing a prospective investor in a candidate country, particularly early in the accession process, such a rule jeopardizes even investments involving contracts or aid that ultimately would be compatible with EU law.

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[87] *Micula*, para. 677.
[88] *Id.*, para. 872.
[89] *Id.*, paras. 691-707.
[90] *Id.*, para. 691-707.

Postscript

As is standard in investment treaty awards, the ICSID award in *Micula* ordered Romania to compensate the investors for the damage caused by its breach. Also in keeping with usual practice, the award does not interfere with Romania's compliance with EU law by ordering it to reinstate the incentive schemes that have been revoked. However, in mid-August 2014, the European Commission published a suspension injunction it had issued several months earlier enjoining Romania from paying the *Micula* award until the Commission has determined whether doing so is compatible with EU State aid law.[91] It remains to be seen whether a permanent injunction will be issued and whether the award will nonetheless be paid. However, the Commission's attack on the arbitral award threatens the same consequences for current and future candidate countries as those flowing from the *Electrabel* decision.

[91] *See* SA 38517, Micula v. Romania (Arbitral Award), http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38517; Luke Eric Peterson, *European Commission Enjoins Romania from Paying ICSID Award, Thus Throwing a Wrench into Enforcement of Intra-EU BIT Ruling*, IA Reporter, http://www.iareporter.com/articles/20140807? (7 Aug. 2014). The Commission did not release the text of the injunction.