In-depth trade briefing

Mixed exclusivity

The Court of Justice of the EU's Opinion on the EU Singapore FTA

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Overview

Nikos Lavranos explains in detail the key conclusions of Opinion 2/15 of the CJEU on the status of the 2014 EU Singapore Free Trade Agreement under the EU's division of competences under EU law released on 16 May 2017.

Lavranos discusses the ruling's implications for:

- *the impact on the content of future EU trade agreements;*
- *the implications for investment chapters in EU trade agreements;*
- *the ratification of future trade agreements;*
- *the UK leaving the EU – Brexit.*

One can say the verdict is 'mixed exclusivity'. In the long-awaited opinion of the Court of Justice of the EU regarding the question whether or not the EU is exclusively competent to sign and ratify the 2014 free trade agreement between the EU and Singapore EUSFTA, the judges concluded that the EU's competence is mixed and that the agreement cannot be concluded by the EU alone.

According to the CJEU, the EU is exclusively competent for most parts of the EUSFTA, but that some parts fall within the mixed or shared competence. Consequently, the EUSFTA must be signed and ratified together by the EU and its Member States.

This conclusion does not come as a surprise as it was expected by most experts and is broadly, though not entirely, in line with the opinion of the Advocate General issued in December 2016.

In the following analysis, I will highlight some noteworthy points of the opinion, starting off with its general scope.

Sans prejudice or the elephant is still in the room

The Court kicked off by emphasising that this opinion is "entirely" sans prejudice or without prejudice to the question whether or not certain elements of the EUSFTA such as the investor to state dispute settlement - ISDS - provisions may be incompatible with EU law.

In the subsequent paragraphs of its opinion regarding the dispute settlement provisions, which also includes state to state dispute settlement – SSDS - the Court repeatedly stressed that this opinion is not touching these issues.

However, between the lines one can read that the Court is not overly enthusiastic about the provisions. In particular the references to its previous opinions on the Unified Patent Court (1/09) and the Accession of the EU to the ECHR (2/13) seem to suggest that the Court would apply the same approach. In these opinions, the Court essentially rejected the creation of other judicial organs by international agreements, which may trespass on its own jurisdiction or may have impact on the autonomy of EU law.

In short, the elephant is still in the room. Belgium is expected – as it had promised to Wallonia – to request an opinion on the ISDS/ICS provisions as contained in CETA in the coming months. Only in that case will the Court be able to clarify the question whether, and if so, to what extent ISDS/ICS provisions are compatible with EU law.

After having set out the scope of this opinion, the Court analysed which of the 17 chapters of the EUS FTA are part of the EU's exclusive competence.

Investment protection - exclusive competence

Unsurprisingly, the standard trade, market access, services, intellectual property and competition chapters all fall within the exclusive competence of the EU.

More interestingly and relevant in the current debate is the issue of investment protection. The Court concluded that all standard provisions such as national treatment, most favoured nation treatment - MFN - and fair and equitable treatment – FET, which make up investment protection, all fall within the exclusive competence of the EU as they are directly related to trade.

However, the Court distinguished investment protection from the ISDS provisions, which is slightly artificial because effective investment protection needs ISDS provisions for their enforcement.

The ISDS provisions will be discussed below.

Sustainable development, environmental protection, labour rights - directly linked to trade

In an apparent nod to the current criticism against global trade agreements, the Court sent a strong signal, emphasizing that international trade can only take place by taking sustainable development, environmental protection and social protection of workers into account.

Accordingly, the Court declared that they are directly connected to international trade and thus form an integral part of the exclusive trade competence of the EU.

In this way, the Court strengthens the importance of Article 21 of the Treaty of the EU, which prescribes a holistic approach of the external activities of the EU. This gives the European Commission significant leeway to promote and include such aspects in all future EU free trade agreements.

Non-direct foreign investments - mixed competence

One of the most notorious issues, which has been splitting from the very beginning the European Commission and European Parliament on the one hand, and the Council (i.e. the member states) on the other hand has been the exact scope of 'foreign direct investment'.

The European Commission and European Parliament have always adopted a maximalist view by claiming that foreign direct investment covers all types of investments, including non-direct foreign investments, such as portfolio investments. In contrast, the member states have always furiously defended the restrictive literal interpretation of the treaties, which would mean that all types of non-direct foreign investments fall outside the exclusive trade competence under Article 207 TFEU.

However, these non-direct foreign investments may be considered as capital movement, which fall within the scope of Article 63 TFEU, which is a mixed competence unless the EU has adopted secondary legislation that has significantly regulated this area. Since the EU has not adopted any secondary legislation regarding non-direct foreign investments, this competence has not yet become exclusive EU competence, so the argument.

The Court also rejected the final argument of the European Commission that the conclusion of international agreement may prove "necessary in order to achieve objectives of the EU Treaties" (Article 216 Treaty on the Functioning of the EU).

As a result, non-direct foreign investments remain within the mixed competence.

This conclusion, however, does not solve the problem of where exactly the difference lays between direct and non-direct investments. This lack of clarity will certainly be the source for more court cases.

The EU superseded the member states in their BITs with Singapore

One of the most surprising outcomes of this opinion relates to a rather technical but nonetheless very important point, namely, the question of what happens with the dozen or so existing bilateral investment treaties – BITs – which the member states have concluded with Singapore, many dating back 20 years or more.

The EUSFTA simply states in Article 9.10 that "upon the entry into force of the EUSFTA, all BITs between the Member States and Singapore, including the rights and obligations derived therefrom, shall cease to have effect and shall be replaced and superseded by this agreement."

The Court argued that with the entry into force of the Lisbon Treaty, which conferred the EU exclusive competence regarding foreign direct investments to the EU, means that once the EUSFTA enters into force it replaces all member state BITs as far as foreign direct investment is concerned.

Neither the so-called grandfather Regulation 1219/2012 nor Article 351 TFEU, which protects the existence and performance of pre-EU accession agreements of the member states, prevents the EU from replacing the member states as regards their BITs – at least as far as foreign direct investments are concerned.

Accordingly, by virtue of obtaining exclusive competence, the EU can replace and subsequently in effect terminate bilateral treaties of the member states to which the EU itself is not even a contracting party.

This is a very far-reaching conclusion, which was explicitly rejected by the Advocate General in her opinion released in December 2016, which helped shape the judges' final decision

The Court's approach creates legal uncertainty for all third states which have concluded international agreements with EU member countries. They can never be sure anymore whether or not the EU may have 'replaced' the Member State as a contracting party simply by virtue of an internal shift of competence within the EU.

Also, from the perspective of international law, it seems impossible that an outside party (i.e. the EU) can intrude in international treaties which it is not even a party.

As a justification for its argument, the Court refers to the single case of the old GATT 1947 in which the EEC, later EC, de facto replaced the member states while never having been contracting party to the GATT 1947. However, de jure the member states always remained contracting party to the GATT 1947 and remained legally bound by it. That was exactly also the position of the Advocate General.

In short, the Court seems to have equated the obtainment of exclusive competence by the EU, i.e., the power to act externally by exclusion of the member states, with the power to replace member states in their international treaties, which seems to me to be of an entirely different order.

This solution further creates problems of delineation. Does this mean that the BITs with Singapore as far as they concern non-direct foreign investments are not replaced by the EU or that member states retain the competence to modify or terminate them? Are we talking about a mixed competence to modify or terminate member states' BITs? What happens if a Member State, for example the UK, refuses to terminate its BIT with Singapore?

Finally, the Court did not discuss the issue of what happens with the so-called sunset clauses, contained in the member states' BITs with Singapore. These sunset clauses provide for continued protection and access to ISDS for all investments made before the termination of the BITs. Typically, sunset clauses have a duration of between 10-20 years. But what does this "partial replacement" by the EU of the Member States' BITs mean for the application of the sunset clause? Will they continue to be applicable to non-direct foreign investments?

It is unclear how this could work in practice.

Dispute settlement provisions - mixed

The other most contested competence issue concerns the dispute settlement provisions contained in the EUSFTA. The European Commission has always argued that ISDS is directly connected with foreign direct investments and therefore falls squarely within its exclusive competence, whereas the Council argued that ISDS is a mixed competence.

This is the first time that the Court is called upon to give its views on ISDS. Although, the Court remained careful not to reveal its view on investment treaty arbitration and its (non)compatibility with EU law, the Court instead focuses on the position of the national courts of the member states. The Court argued that arbitration "removes disputes from the jurisdiction of the courts of the Member States, [which] cannot be of a purely ancillary nature and therefore cannot be established without the Member States' consent". Accordingly, ISDS provisions remain mixed.

Apart from the fact that this is a simplification of the arbitration process since domestic courts remain involved in the recognition, enforcement and annulment of arbitral awards, this argument echoes the main reason for rejecting international tribunals in its previous opinions, namely, the fact that such international courts operate outside the preliminary ruling mechanism between the CJEU and national courts. This could be already a hint of how the Court would judge the ICS provisions in CETA.

In addition to ISDS, the EUSFTA also contains state-state dispute settlement - SSDS - provisions.

The Court recalls that the EU has the power to submit itself to SSDS provisions when concluding an international agreement, as was the case with the WTO, but it avoids expressing a view whether SSDS is (in)compatible with EU law. It simply refers to its arguments made with regard to ISDS in order to conclude that SSDS is also of mixed nature.

Transparency

Another issue which the Court considered were the various transparency obligations, which are scattered around the treaty. The Court opined that to the extent that substantive provisions fall within the mixed competence, the related transparency provisions, which must be considered to be of an "ancillary" nature, also fall within the mixed competence. This means that the transparency rules regarding ISDS, in particular the UNCITRAL Transparency Rules 2014, which are referred to in EUSFTA, must be considered to be mixed. Accordingly, the so-called 'Mauritius Convention' must be signed and ratified as a mixed agreement. That is something the Commission certainly would have wanted to avoid.

Implications for future EU free trade agreements

Overall, the outcome of this opinion is in line with the general expectation that all so-called 'new generation' EU free trade agreements must be considered to be mixed. This was already clearly the case with the WTO agreement, which covered many similar issues.

However, due to the increased politicisation of the global trade debate the ratification process both at the EU and Member States' level has become an uncertain bet. Wallonia has shown that it can hijack the conclusion of a free trade deal in order to extract political commitments. Given the number of EU member states, it is not difficult to imagine that other parliaments may follow this example.

This means that the European Commission must further increase the involvement of the Member States and their regional and local constituencies in order to maintain support until the deal is concluded. One could think of 'mixed' negotiation teams, which would include also trade negotiators of the member states. In any case, this will make the negotiation process even more complex and political than is already the case.

Hence, the European Commission may also opt for a different strategy, which is to strip free trade deals from any mixed elements, thereby carving out the member states in the ratification process. In line with this opinion, such a 'limited' free trade deal would not include ISDS and SSDS and neither any provisions regarding non-direct foreign investments.

Such limited but exclusive free trade deals may lose some of their attractiveness for both the EU as well as the third states concerned, although they would still cover a large chunk of the usual trade and market access issues.

However, at the end of the day, this is not matter to be decided by the European Commission but by the Council which mandates the European Commission to negotiate a trade deal. It seems unlikely to me that the Council would voluntarily give up the control it exercises over the European Commission's trade negotiations, which it continues to enjoy by virtue of the fact that some elements still remain mixed.

Mixity and Great Britain

For Great Britain mixity will become a very important buzzword in the various trade negotiations.
Firstly, what will Great Britain do regarding the ratification process of the EUSFTA?

As explained above, if it ratifies the EUSFTA, it essentially loses its old school BIT with Singapore, which dates back to 1975.

In light of the on-going Brexit negotiations, this would mean that Great Britain would have to negotiate a new BIT or FTA with Singapore after it left the EU. That does not appear to be an attractive option.

But Great Britain could also play the 'Wallonia card' and try to extract something in return during the Brexit negotiations. Alternatively, Great Britain could also delay its ratification of the EUSFTA until after Brexit, so that the 'problem' is resolved by itself, i.e., the EUSFTA enters inter force only after Brexit and without Great Britain, while it keeps its BIT with Singapore.

Mixity may also play an important role in the future trade agreement between Great Britain and the EU. Assuming that such a UK-EU FTA contains similar elements as EUSFTA or

CETA, one must assume that such a treaty will also be mixed. Accordingly, the European Commission may for strategic reasons ensure maximum involvement of the remaining 27 member states during the UK-FTA negotiations. In addition, learning the lesson from the relatively confidential TTIP negotiations, the European Commission may have to be much more transparent regarding the draft negotiation documents, which may undermine its negotiation power vis-à-vis the UK.

Finally, also the question of which dispute settlement system may be acceptable to the Court will pop up again.
In this context, one must make a distinction between the future UK-EU FTA and the withdrawal or exit agreement.

As far as the UK-EU FTA is concerned, one can assume that it will look very similar to the EUSFTA or CETA. Accordingly, ISDS/ICS and SSDS provisions would be included, although it remains uncertain whether these will be considered by the Court to be compatible with EU law.

As far as the exit agreement is concerned, in light of the massive amounts of money that is at stake in the Brexit process, disputes are likely to arise, so a dispute settlement body must be established to resolve any disputes in a binding manner. Such a system may be limited to SSDS provisions, but could also include some type of ISDS/ICS provisions.

However, in light of the Court's aversion against international courts and tribunals, it would seem that only the CJEU itself could be an acceptable solution, which for obvious reasons would not be acceptable to Great Britain.

Another option could be the International Court of Justice (ICJ) but that is only open to states, so the EU could not make use of it. The Permanent Court of Arbitration (PCA) could be another option but that would mean that the Court would have to accept and be bound by arbitration, which seems unlikely.

Maybe the WTO Appellate Body could be assigned to this task? The advantage being that the EU and all member states are party to it, but for that the Appellate Body's jurisdiction would have to be redefined.

One could also think of the European Court of Human Rights (ECHR). Again the problem is that the EU is not party to it and the opinion of the Court on the possible accession of the EU to the ECHR illustrated that it does not wish to be bound by its rulings.

A final option may be the EFTA court, which has the advantage of covering non-EU Member States while still having some links with the EU. Moreover, the EFTA court is essentially the only international court, which the CJEU has accepted alongside itself.

Conclusions

The Opinion of the Court is clear and unsurprising: deep and comprehensive free trade and investment treaties are mixed.

The Court clarified that the definition of 'foreign direct investment' is limited to just that, thereby excluding non-direct foreign investments from the exclusive competence of the EU.

So, while the EU has exclusive competence over large parts of the trade and investment policy, the bottom line is that the EU still lacks full exclusive competence concerning one very important aspect of global trade, namely, non-direct foreign investments.

Also, dispute settlement provisions and transparency fall within the mixed competence.

While the Court stressed that this opinion does not cover the potential incompatibility of dispute settlement provisions with EU law, a close reading of the relevant parts of this opinion combined with its previous opinions implies that the creation of arbitral tribunals – whether under the ISDS system or the new ICS system – may violate the 'autonomy of EU law'. The Court mentions this criterion only in passing in para. 301 as warning sign.

However, it should be recalled that this was the very same criterion in combination with the lack of a preliminary ruling mechanism which led the Court to reject the accession of the EU to the ECHR and the Unified Patent Court. This may explain why the European Parliament has voted not to bring CETA with its ICS to the CJEU for an opinion. Similarly, Belgium seems to be in no hurry to ask the CJEU for guidance as it promised to Wallonia.

More generally, it is important to understand that the mixity of the areas earmarked as mixed works through all relevant chapters, in particular the Chapter 1 (objectives and general definitions) and Chapter 17 (institutional, general and final provisions). This means that the European Commission continues to be restricted in how it can operate in the common commercial policy area, which it considers to be totally its exclusive competence.

As a result, the European Commission may have to re-design some of those chapters in order to bring them into line with this opinion.

Finally, the question arises whether the European Commission must go back to Singapore and re-open the agreement in order to include ICS into the EUSFTA. After all, the European Parliament has made clear that it will not ratify any trade deal without ICS, which may also apply to some of the parliaments of the member states.

As far as the 'winners' and 'losers' of this opinion are concerned, it seems that the Commission did not get what it hoped for, namely, total exclusive competence regarding all areas of EU free trade agreements.

In contrast, the member states managed to retain a few mixed elements, thereby maintaining significant control over the trade negotiations and ultimate ratification process.

As far as the special situation of Great Britain is concerned, it also 'lost' in the sense that it will not be able to struck a quick trade deal with the EU alone. However, at the same time it also 'won' because due to the mixity it can threaten to delay or even refuse the ratification of the EUSFTA and in return extract some commitments in its complex negotiations with the EU and the other member states.

In sum, this opinion has only partly clarified some of the outstanding issues regarding EU free trade agreements. More clarifications are needed, in particular, regarding the compatibility of ICS provisions with EU law. It is therefore hoped that Belgium or any other Member State will request an opinion on CETA from the Court.