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European Court of Justice Nixes “Investor-State Dispute Settlement” Intra EU, Raising Doubts About Its Future

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In a surprise move, the European Union’s top court has ruled that Investor-State Dispute Settlement (ISDS) clauses contained within almost 200 bilateral investment treaties (BITs) between EU member countries violate EU law, casting doubt on such deals as well as others struck by the bloc as a whole. ISDS clauses allow foreign investors or corporations to sue governments for passing laws or regulations that could undermine the value of their investments.

The Court of Justice of the European Union (ECJ) found that an award of damages to Dutch-based insurer Achmea from Slovakia under a bilateral investment treaty inherited from former Czechoslovakia contravened EU law since the arbitration tribunal that made the ruling was “not a court of a member state.” As such, it had no power to refer matters to the ECJ, the highest court of the EU.

“The arbitration clause in the BIT has an adverse effect on the autonomy of EU law, and is therefore incompatible with EU law,” the court said.

The ruling could have widespread repercussions, not only for EU-based investors seeking redress for changes in government regulation that affect their bottom line but also for investors from outside the bloc. In total 196 BITs between EU members contain such clauses, some concluded between western EU countries to protect investments of their companies in former Soviet countries before the latter joined the EU.

ISDS cases do not get heard in a court of law, under the scrutiny of a judge and/or jury, but rather in front of arbitration panels made up of three professional arbitrators — one representing the company, one representing the country and the other chosen by the first two to sit as president of the panel. None of these arbitrators are trained judges; they are very handsomely

paid private individuals, often representing some of the biggest international corporate law firms, mostly from the U.S. and Europe.

In recent years, ISDS has become such a toxic concept that even Beltway institutions such as the Cato Institute have called for its purging from future trade agreements — an idea that appears to be supported by US Trade Representative Robert Lighthizer and could even be applied to a newly negotiated NAFTA agreement.

Europe is already halfway there, but not everyone's on board. The Czech Republic, Estonia, Greece, Spain, Italy, Cyprus, Latvia, Hungary, Poland and Romania have all came out in Slovakia's defense against Achmea, as has the European Commission. By contrast, the governments of Germany, France, the Netherlands, Austria and Finland believe that the clause at issue and, more generally, clauses of a similar kind used in the 196 BITs currently in force between EU Member States are perfectly valid.

Besides dividing Europe, the ruling could also pit the EU, which is in the process of developing its own multilateral investment court, against powerful international arbitration tribunals that will be determined to protect their racket, including the International Centre for Settlement of Disputes (ICSID), which is part of the Washington-based World Bank. If the EU prevails, the cancellation of the investment dispute clauses could end up costing corporations and investors billions of euros in lost compensation.

A case in point is the cascade of lawsuits brought by dozens of European and other international investors against the Spanish government over its decision to withdraw a raft of renewable energy subsidies between 2011 and 2013.

The lucrative taxpayer-funded subsidies had triggered a stampede of investors and companies, domestic and international, into the sector. But when the financial crisis began biting hard, the Zapatero government announced a cut of 30% to the subsidies. When the conservative Popular Party came into office, it deepened the cuts. With the honey jar withdrawn, renewable energy consumers and companies suddenly saw their funds wither. Many projects collapsed.

While thousands of Spanish investors lodged appeals with the nation's Supreme Court, a group of large foreign businesses took the case to international arbitration, often through EU-based affiliates in the Netherlands and Luxembourg. Fifteen businesses that had invested in Spanish solar energy lodged their first international claim, using the Energy Charter of the United Nations Commission on International Trade Law (UNCITRAL).

They were joined by a further 20 investors, including sovereign funds, German municipalities, and a Canadian civil service pension fund. Even major Spanish companies such as Abengoa and Isolux presented compensation demands, arguing that their solar energy plants belonged to affiliates in the Netherlands and Luxembourg.

At one point Spain was the focus of so much legal action that it climbed to third place in the global leader board of nations facing Investor-State Dispute Settlement (ISDS) suits, just behind two notorious bugbears of international capital, Venezuela (24 complaints) and Argentina (20). It already has two rulings against it, to the tuneof some €128 million. The total settlement could

have reached €7.5 billion — enough to seriously impinge the government's already strained finances.

But then Brussels came to the rescue by arguing that awarding legal damages to European investors could be construed as State aid and would therefore be illegal. [As an aside, it's curious how the billions of euros of free debt gifted to Europe's biggest corporations as part of the ECB's corporate bond buying program never qualify as illegal State aid…]

Now, in its new ruling, the ECJ has set a very important precedent. Put simply, EU-based investors, including international investors operating through an EU-based affiliate, will no longer be able to sue European countries through international tribunals. Instead, they will have to go through European courts.

Given the deep flaws and inadequacies of the ISDS clause, which essentially enables foreign investors to ride roughshod over domestic laws and regulations, the ECJ's decision to invalidate it, at least as a mechanism to settle disputes between EU companies and Member States, is a long-awaited step in the right direction. If Brussels decides to go the whole hog and apply the ruling to the trade treaties it strikes as a bloc, it could spell the beginning of the end for ISDS.