Commission of the European Communities v Sweden [2009] (C-249/06) & *Commission of the European Communities v Austria* [2009] (C-205/06) (European Court of Justice, 3 March 2009)

PETER ANAGNOSTOU*

Introduction

On 3 March 2009, the European Court of Justice ('ECJ') issued two separate judgments against Sweden and Austria. The cases dealt with their alleged continuous failure to adopt appropriate legal measures to eliminate incompatibilities with European Union ('EU') law arising out of bilateral investment treaties ('BITs'), which they entered into with third countries prior to their accession to the EU. The Court ruled that Austria and Sweden had breached obligations under article 307 of the *Treaty Establishing the European Community* ('*EC Treaty*')[1] by maintaining, with third countries, BITs that could interfere with the EU's powers to restrict capital movements.[2]

This was the ECJ's first venture into the booming international investment law field and is significant because it represents a substantial expansion of European Community competence and reflects the intentions of the *Treaty of Lisbon*[3] to expand the scope of the EU's common commercial policy to matters of 'foreign direct investment'.[4] The judgments' significance is also reflected in the number of other European countries intervening in support of Austria and Sweden, including Finland, Germany, Hungary and Lithuania. As noted by the Advocate General:

> [A]s some of the intervening Member States have pointed out, to impose an obligation on Member States to refrain from legislating, whether by national measures or international instruments, to prevent any potential conflict with future Community legislation would turn the free movement of capital to and from third

* BA (Hons) LLB (UNSW), Lawyer, Baulderstone Pty Ltd, Vice-Chair of NSW Young Lawyers International Law Committee.

[1] *Treaty Establishing the European Community*, opened for signature 7 February 1992, [1992] OJ C 224/6 (entered into force 1 November 1993) ('*EC Treaty*').
EC Treaty art 307 reads as follows:
1. The rights and obligations arising from agreements concluded ... before the date of their accession between ... one or more third countries ... shall not be affected by the provisions of this Treaty.
2. To the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established.

[2] *Commission of the European Communities v Republic of Austria* [2009] Case C-205/06, [1]: 'By not having taken appropriate steps to eliminate incompatibilities concerning the provisions on transfer of capital contained in the investment agreements entered into with [third countries] had failed to fulfil [their] obligations under the second paragraph of article 307 EC [Treaty].'

[3] *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community*, signed 13 December 2007, [2007] OJ C 306/01 (entered into force 1 December 2009) ('*Treaty of Lisbon*').

[4] *EC Treaty* art 133 reads:
1. The common commercial policy shall be based on uniform principles, particularly with regard to changes in ... the commercial aspects of ... foreign direct investment, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.

> countries into an area of exclusive competence. In fact, any area of shared competence would be liable to suffer the same fate.[5]

1. The facts

Both Austria and Sweden, prior to their accession to the *EC Treaty*, had concluded several BITs with third countries, such as China, Vietnam, Egypt, Pakistan, Argentina, and Korea. The BITs contained:

> [A] clause under which each party guarantees to the investors of the other party, without undue delay, the free transfer, in freely convertible currency, of payments connected with an investment.[6]

Essentially, these so-called 'transfer clauses' were comparable to the free movement of capital provisions contained in the *EC Treaty*. Under EU law, the European Community is authorised to regulate the movement of capital between EU Member States and third countries, including restricting capital flows in exceptional circumstances.

Therefore, upon accession in 2004, both countries received letters from the European Commission asking that they modify their BITs, noting that Member States are required to amend agreements that are incompatible with the *EC Treaty*:

> [B]ilateral agreements could impede the application of restrictions on movements of capital and on payments which the Council of the European Union might adopt under articles 57(2) EC, 59 EC and 60(1) EC [Treaty].[7]

In particular, article 56 of the *EC Treaty* prohibits any restrictions on the movement of capital as well as any restrictions on payments between Member States to and from third countries.[8] Nevertheless, according to the Commission, neither Sweden nor Austria took steps to implement appropriate legal remedies for the possible impediment.

2. Opinion of the Advocate General

Prior to the hearing, in an opinion issued on 10 July 2008,[9] the ECJ's Advocate General, Poiares Maduro, argued that provisions guaranteeing the free movement of capital in some of Austria and Sweden's BITs clashed with EU law.[10] In coming to his opinion, Mr Maduro agreed that Austria and Sweden could not be expected to change the treaties because of the potential for conflict with the *EC Treaty*. Instead 'only if the agreements are

---

[5] *Commission v Austria (Advisory Opinion of Advocate General Maduro); Commission of the European Communities v Kingdom of Sweden (Advisory Opinion of Advocate General Maduro)* [2008], [29].

[6] *Commission of the European Communities v Republic of Austria* [2009] Case C-205/06, [3].

[7] Ibid [4].

[8] *EC Treaty* art 56 reads as follows:

1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

[9] *Commission v Austria (Advisory Opinion of Advocate General Maduro); Commission of the European Communities v Kingdom of Sweden (Advisory Opinion of Advocate General Maduro)* [2008], [29].

[10] Ibid [46].

liable seriously to compromise the exercise of a Community competence will there be an incompatibility,' wrote Mr Maduro.[11]

Austria and Sweden embraced this position, arguing that their 'incompatibility' with EU law was hypothetical as the European Community had never acted on its right to restrict capital flow in the past. Moreover, Sweden and Austria stressed that in the case of an actual conflict between the BITs and adopted EC legislation, international law offered mechanisms to deal with the situation, such as suspension, renegotiation or even denouncement of the agreements. Moreover, such a mechanism could have been the *clausula rebus sic stantibus* principle as enshrined in article 62 of the *Vienna Convention on the Law of Treaties*.[12] This general principle of public international law provides precisely the possibility of suspending a treaty because of unforeseen circumstances, thereby enabling Austria and Sweden to fulfil their EU law obligations. Thus, both countries argued that they were still in a position to eliminate any incompatibility if and when it actually became necessary.

3. Judgment

However, the ECJ was not persuaded. Arguments by Sweden and Austria that an additional clause in their respective BITs could eliminate potential incompatibilities by leaving room for possible renegotiation, suspension, or denunciation, were rejected as insufficient to remove the incompatibility:

> While acknowledging that such a clause should, in principle, as the Commission admitted at the hearing, be considered capable of removing the established incompatibility, it is common ground that, in the cases referred to by the Commission, the Republic of Austria has not taken any steps, within the period prescribed by the Commission in its reasoned opinion.[13]

The position that no actual impediment had been created through these agreements was also rejected, with the ECJ holding that:

> In order to ensure the effectiveness of [EC Treaty] provisions, measures restricting the free movement of capital must be capable, where adopted by the Council, of being applied immediately with regard to the States to which they relate, which may include some of the States which have signed one of the agreements at issue with the Kingdon of Sweden.[14]

---

[11] Ibid [50].

[12] *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331, (entered into force 27 January 1980) art 62:

1. A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:
   (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
   (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

[13] *Commission of the European Communities v Republic of Austria* [2009] Case C-205/06, [42].

[14] *Commission of the European Communities v The Kingdom of Sweden* [2009] Case C-249/06, [37].

The Court's analysis is very brief. Nevertheless, the two judgments further clarify the duties of Member States regarding their pre-accession agreements with third States. According to article 307 of the *EC Treaty*, the rights and obligations arising from pre-Community or pre-accession agreements of the Member States shall not be affected by the provisions of the Treaty. However, the ECJ has chosen the broadest possible interpretation of this provision by claiming that article 307 is applicable already in case of the mere possibility that eventual Community measures might conflict Member States' obligations towards third States.

4. Ramifications

It appears that the ECJ's uncompromising position might be a reaction to the Court's concern that its exclusive jurisdiction over the free movement of capital is increasingly being undermined by investment arbitral tribunals that find themselves interpreting EU law. This concern was evidenced in the MOX Plant judgment,15 where the ECJ interpreted its jurisdiction as very expansive in order to protect its exclusive jurisdiction to interpret and apply EU law. Accordingly, the ECJ decision could have wider ramifications for EU Member States as the Court continues to insulate the EC legal order from the international legal system through an expanding list of exceptions to the rule of law.

A. Eastern Europe

In recent years, the countries of Eastern Europe have emerged as highly attractive destinations for foreign direct investment. One reason has been those States' numerous BITs with other States, including many EU Member States. However, as many of these countries in Eastern Europe have been granted accession to the EU, questions regarding the status of their various treaty commitments, including their commitments under BITs entered into before and after EU accession, have become increasingly complicated. To the extent that certain BIT obligations potentially conflict with EU legal requirements, there is a question whether investors from other States can continue to rely on the BITs' protections when making investment decisions. This has given rise to tensions between BITs with non-EU States, and BITs with other EU Member States.

The current judgments illustrate that uncertainty regarding the strength of the protections such treaties will provide to investors is very real, raising complex questions for investors in that region.

B. Scope of article 307

According to the case law of the ECJ, the purpose of article 307 is:

> [T]o lay down, in accordance with the principles of international law, that the application of the treaty does not affect the duty of the member state concerned to

[15] In the judgment in *Commission of the European Communities v Ireland* [2006] Case C-459/03, the ECJ for the first time explicitly determined the scope of its exclusive jurisdiction based on *EC Treaty* art 292.

> respect the rights of non-member countries under a prior agreement and to perform its obligations there under.[16]

It is clear that the ECJ took the view that the absence in the BITs of any specific provision expressly reserving the right of the two Member States to amend their respective BITs could make it 'more difficult, or even impossible, for that Member State to comply with its Community obligations'.[17] It appears that the Court's position is that nothing should stand in the way of the EC Council if and when it decides to take restrictive measures. It is questionable whether this approach, adopted by the ECJ to insulate the EC legal order, is the right approach towards an area of international law in which every EU Member State is active. What is certain, however, is that by identifying a conflict between the BITs and possible future Community measures, the Court's two judgments have the effect of significantly broadening the scope of article 307.

Interestingly, in the two judgments the ECJ did not invoke the obligation for either Austria or Sweden to denounce the treaties, as would follow from past case law.[18] This is even more striking considering significant weight placed on the powers of the Court to do so by other Member States under international law.[19] Perhaps this is a reflection of the delicacy of the situation and negative complications that might arise from a denunciation of the BITs.[20]

Irrespective of the absence of such an order, it is clear that these judgments will have an immediate impact on the nature of BITs between EU Member and non-EU Member States. It will, therefore, be worth carefully monitoring the developments taking place in this area – from the impact on investment into Eastern Europe, to the increase in the level of exclusive jurisdiction that the European Community commands over the free movement of capital within the region.

---

[16] *Burgoa* [1980] ECR 2787, [8]; *Commission of the European Communities v Portugal* [2000] ECR I-5171, [44]; *Commission of the European Communities v Portugal* [2000] ECR I-5215, [53]; *Budejovický Budvar* [2003] ECR I-13617, [144]–[145]; *Commission of the European Communities v Republic of Austria* [2009] Case C-205/06, [33]; *Commission of the European Communities v The Kingdom of Sweden* [2009] Case C-249/06, [34].

[17] *Commission of the European Communities v Republic of Austria* [2009] Case C-205/06, [16]; *Commission of the European Communities v The Kingdom of Sweden* [2009] Case C-249/06, [15].

[18] *Commission of the European Communities v Portuguese Republic* [2000] Case C-62/98; *EC Treaty* art 226.

[19] *Commission v Austria (Advisory Opinion of Advocate General Maduro); Commission of the European Communities v Kingdom of Sweden (Advisory Opinion of Advocate General Maduro)* [2008], [67]–[69], noting that: 'some Member States have argued that the interests of their investors abroad ought to be taken into account in determining the extent of the obligation to eliminate an incompatibility under article 307 EC [Treaty]'.

[20] See Michele Potestà, 'Bilateral Investment Treaties and the European Union. Recent Developments in Arbitration and Before the ECJ' (2009) 8 *The Law and Practice of International Courts and Tribunals* 225, 243.