Substantive Paper

Arbitration in Central and Eastern Europe
Speakers

Chair, Milan Lazic, Partner, Karanovic & Nikolic Serbia
Jeffery Sullivan, Partner – International Arbitration, Allen & Overy LLP London
Dr. Markus Burgstaller, Partner Hogan Lovells LLP London
Gabor Bardosi, Partner Wolf Thiess Budapest
Dr. Jiri Hornik, Esq. Partner, Kocian Sole Balastik, Advocates Prague
Andrius Smaliukas, Partner, Lawin Lithuania

Contents

01 Dispute Settlement in EU International Investment Agreements with Third States: Three Salient Problems 3
02 Cooperation between in-house counsel and external counsel 15
03 Things Too Good to Be True Don't Usually Last 20
Dispute Settlement in EU International Investment Agreements with Third States: Three Salient Problems*

Markus Burgstaller*
Hogan Lovells, London, United Kingdom
markus.burgstaller@hoganlovells.com

Abstract
The EU institutions are committed to include investor-State arbitration clauses in EU IIAS with third States. However, there are at least three unresolved problems in doing so. First, the EU is not, and is unlikely to become, a Contracting Party to the ICSID Convention. While this deficiency may be remedied by replicating relevant provisions of the ICSID Convention, EU investors cannot benefit from ICSID’s institutional clout which could facilitate enforcement of awards. Secondly, there may be problems from an EU law perspective. Arguably, the EU could only include investor-State arbitration clauses in EU IIAS with third States following a change in EU primary law such that investment tribunals could request a preliminary ruling from the CJEU in accordance with Article 267 TFEU. Thirdly, to date there appears to be no agreement within the EU on the question who will be the proper respondent in an arbitration.

Keywords
Investor-State arbitration – ICSID Convention – Court of Justice of the European Union – Article 267 TFEU – financial responsibility

1. Introduction
The Treaty of Lisbon extended the common commercial policy (CCP) to include also foreign direct investment (FDI). It thus shifted the allocation of competences between the EU and its Member States in the field of FDI towards the EU. Article 207 of the Treaty on the Functioning of the European Union 1 (TFEU) states: “The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment …” (emphasis added). The extension of the CCP to FDI under the Treaty of Lisbon means that the EU has exclusive competence to negotiate and conclude investment treaties with respect to FDI. 2 As a matter of EU primary law, upon the entry into force of the Treaty of Lisbon on 1 December 2009, Member States lost their competence to negotiate and conclude international investment agreements (IIAS) covered by the exclusive Union competence. However, a regulation clarified that EU Member States may, subject to certain conditions, continue to negotiate and conclude IIAS with third States3. Further, principally, existing IIAS of Member States with third States remain in force and investors may continue to rely on them4.

More than four years after the entry into force of the Treaty of Lisbon, the EU slowly, but surely exercises its competence on FDI and its policies begin to take shape. At the time of writing, the EU, represented by the Commission, was in the process of negotiating or at least starting discussions with a number of third States, including, for example, Canada, China and the United States5.

2 Article 2(1) TFEU states: “When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts.”
4 Ibid., Articles 2 to 6.
5 A summary of the status of these negotiations is provided in European Commission, Memo, The EU’s Bilateral Trade and Investment Agreements – Where Are We?, 18 October 2013.
However, to date, none of these negotiations led to the conclusion of an EU IIA with a third State. Notwithstanding the lack of any concluded agreement, it is possible to discern certain aspects of these agreements.

This contribution will focus on one aspect of these agreements, though an important one, namely the inclusion, if any, of investor-State arbitration clauses in EU IIAS with third States. Investor-State arbitration has become the standard method to settle international disputes between an investor and the host State. Commonly, it is said that investor-State arbitration carries advantages for both the investor and the host State: the investor gains access to an effective international remedy and the host State, by offering an international procedure for dispute settlement, improves its investment climate and is likely to attract more foreign investment. The importance of investor-State arbitration to the system of international investment law is such that it prompted the Commission, in a Communication titled “Towards a comprehensive European international investment policy” dated 7 July 2010, to state that it “is such an established feature of investment agreements that its absence would in fact discourage investors and make a host economy less attractive than others”. The Commission thus appears to be committed to include investor-State arbitration clauses in EU IIAS with third States. At the same time, the Commission is mindful that this “raises challenges relating, in part, to the uniqueness of investor-State dispute settlement in international economic law and in part to the fact that the Union has not historically been a significant actor in this field. Current structures are to some extent ill-adapted to the advent of the Union”. In particular, the Commission stresses that it “will explore with interested parties the possibility that the European Union seek to accede to the ICSID Convention.”

Since the Commission outlined its main policies in the Communication, these policies have become more detailed, though many questions still remain open. Most recently, on 26 November 2013 the Commission issued a ‘Fact sheet’ titled “Investment Protection and Investor-to-State Dispute Settlement in EU Agreements.” In this paper, as far as dispute resolution is concerned, the Commission identified certain issues that, in its view, need improvement. It listed four items:

(a) preventing investors from bringing multiple or frivolous claims (an investor who loses its case will be obliged to pay all arbitration costs including those of the State);

(b) making the arbitration system more transparent (documents will be made available to the public, access to hearings will be granted and interested parties (e.g. NGOS) will be allowed to make submissions);

(c) dealing with conflicts of interests and consistency of arbitral awards (e.g. by introducing a binding code of conduct for arbitrators);

(d) introducing safeguards for Parties (according to the Commission, this will allow States to maintain control over how the investment provisions are interpreted).

---


13 The Commission also states that it aims “for the creation of an appellate mechanism to ensure consistency and increase the legitimacy of the system by subjecting awards to review.” See European Commission, supra note 7, p. 9.

14 Ibid.
At the time of writing, the negotiations with Canada for the conclusion of the so-called Comprehensive Economic and Trade Agreement (CETA) appear to be the most advanced IIA negotiations by the EU with any third State.\(^\text{15}\) With respect to these negotiations the Commission published a paper titled “EU-Canada CETA: main achievements” (“CETA Commission Paper”) on 3 December 2013.\(^\text{16}\) With regard to the investor-State arbitration clause, the CETA Commission Paper states that it “has a number of key features designed to ensure that the system is effective and efficient, whilst providing important procedural safeguards which will improve the control of the parties of the interpretation of the agreement and ensure that frivolous cases are discouraged or swiftly dismissed.”\(^\text{17}\) These features include, but are not limited to:

i. a limitation period of three years;

ii. protection against possible conflicts of arbitrators through the need for agreement on the arbitrators, failing which the arbitrator will be chosen from a list of arbitrators;

iii. protection against unfounded claims – the losing party bears the costs;

iv. full transparency – all documents will be public, all hearings open and interested parties may make submissions;

v. a possible appellate mechanism; and

vi. effective mechanisms for the Parties to the agreement (the EU and Canada) to issue binding interpretations.\(^\text{18}\)

It would therefore seem that the EU’s negotiations with Canada are fairly far advanced. This contribution does not seek to comment on ‘leaked’ details of the investor-State arbitration clause in any draft CETA texts, but rather seeks to address three apparently unresolved problems with respect to investor-State arbitration clauses in EU IIA with third States generally. First, it will identify potentially applicable arbitration rules and will highlight problems in relation to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States \(^\text{19}\) (ICSID Convention). Secondly, it will discuss EU law problems to investor-State arbitration clauses in EU IIA with third States. Thirdly, it will discuss certain aspects of the division of responsibilities between the EU and its Member States.

2. Potentially Available Arbitration Rules: The Problem with ICSID

The contents of the Communication were put on the agenda of the European Parliament (EP). On 6 April 2011 the EP adopted a Resolution in which it addressed several issues contained in the Communication, including investor-State arbitration\(^\text{20}\). As was the case with the Commission’s Communication, in the Resolution the EP clarified its commitment to investor-State arbitration in EU IIA with third States.\(^\text{21}\) The EP also commented that it was “aware that the EU cannot use existing [ICSID] and United Nations Commission on International Trade Law (UNCITRAL) dispute settlement mechanisms since the EU as such is a member of neither organisation.”\(^\text{22}\) The EP also “calls on the EU to include a chapter on dispute settlement in each new EU investment treaty in line with the reforms suggested in this resolution.”\(^\text{23}\) Finally, the EP “requests that the Commission and the Member States take up their responsibility as major international players to work towards the necessary reforms of the ICSID and UNCITRAL rules.”\(^\text{24}\)

This Part will briefly analyse whether these

\(^{15}\) Certain draft texts of the CETA have been leaked. It is not entirely clear what the status of these texts is. In this contribution, no reference will be made to any of these draft texts. Reference will only be made to documents that have been duly published.


\(^{17}\) Ibid., pp. 2–3.

\(^{18}\) Ibid., pp. 3–4.

\(^{19}\) ICSID Convention, Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, 575 UNTS 159.


\(^{21}\) Ibid., para. 32.

\(^{22}\) Ibid., para. 33.

\(^{23}\) Ibid.

\(^{24}\) Ibid.
statements of the EP in the Resolution withstands scrutiny.

2.1 (Non-) Availability of the ICSID Convention and the ICSID Additional Facility Rules

ICSID is the most important arbitral institution in the field of investment disputes. The availability of ICSID presents numerous advantages for the settlement of investment disputes. Two of the main advantages of the ICSID system are the limited possibility of annulment of ICSID awards and perceived easier enforcement of ICSID awards as a result of the self-contained enforcement regime of the ICSID Convention. According to its Article 67, the ICSID Convention is open “for signature on behalf of States members of the Bank.” Notably, the Convention is not open for signature for a supranational organisation such as the EU. It is doubtful, at least, whether Article 67 of the ICSID Convention would allow for the Union to sign “on behalf of States”. Rather, it would seem that the EU cannot become a Contracting Party to the ICSID Convention. Until and unless it may do so, however, the EU may not offer its treaty partners to arbitrate under the ICSID Convention. To be clear: as a matter of international law, there is no obstacle for the EU to include a reference to the ICSID arbitration rules in EU IIA with third States. The inclusion of these arbitration rules would permit EU investors to commence ICSID arbitration against the third State. But even in

Markus Burgstaller and Charles Rosenberg, “Challenging International Arbitral Awards: To ICSID or not to ICSID?” (2011) 27 Arbitration International 91–107. More recently, the tide may seem to swing again in ICSID’s favour as a result of the annulment of an UNCITRAL award in an Appeal from the United States District Court for the District of Columbia in Republic of Argentina V. BG Group plc, 17 January 2012, at least with respect to arbitral tribunals seated in the District of Columbia. However, following the decision by the US Court of Appeals for the DC Circuit which vacated the award (in which the arbitral tribunal had ordered Argentina to pay over US$185 million (plus, interest, legal fees and expenses)), the US Supreme Court granted BG Group’s petition for certiorari. On 5 March 2014 the US Supreme Court held that the Court of Appeals erred when it set aside the UNCITRAL award. The decision of the US Supreme Court is available at <www.supremecourt.gov/opinions/13pdf/12-138_97be.pdf> (5 March 2014).

---


26 See Article 52(1) ICSID Convention: Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:
(a) that the Tribunal was not properly constituted;
(b) that the Tribunal has manifestly exceeded its powers;
(c) that there was corruption on the part of a member of the Tribunal;
(d) that there has been a serious departure from a fundamental rule of procedure; or
(e) that the award has failed to state the reasons on which it is based.

Recently, however, there has been criticism of ICSID because of certain annulment decisions by ICSID Annulment Committees that were said to have interpreted Article 52 ICSID Convention too broadly. See Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Decision on the Argentine Republic’s Request for Annulment of the Award, 29 June 2010; Enron Creditors Recovery Corp. and Ponderosa Assets, LP V. Argentine Republic, ICSID Case No. arb/01/13, Decision on the Application for Annulment of the Argentine Republic, 30 July 2010. As a result, ICSID may lose one of its advantages, certainly vis-à-vis traditionally ‘arbitration-friendly’ jurisdictions such as the United Kingdom, France or Switzerland. For a summary of this discussion see, for example, Juan Fernández-Armesto, ‘Different Systems for the Annulment of Investment Awards’ (2011) ICSID Review– Foreign Investment Law Journal 128–146;
this regard, there would not be a level playing field for all EU investors because there is one EU Member State, Poland, that is not a Contracting Party to the ICSID Convention. Thus, Polish investors could not commence ICSID arbitration against a third State under an EU IIA. In any case, the EU’s treaty partners are unlikely to agree to ICSID arbitration in EU IIAS since their nationals could not commence ICSID arbitration against the EU (without the EU being a Contracting State to the ICSID Convention). In other words, the EU could not guarantee reciprocity. Most importantly, EU IIAS could thus not benefit from ICSID’s enforcement regime.

The non-availability of the ICSID Convention could be remedied, to some extent, if the EU and its treaty partners were to include in their IIAS provisions that are similar to the provisions of the ICSID Convention, in particular as regards enforcement. These IIAS could thus ensure, in legal terms, the same standards as under the ICSID Convention and would accordingly avoid some of the shortcomings of enforcement of non-ICSID awards. But even then, the inclusion of ICSID standards in EU IIAS would not benefit from the institutional clout that is afforded by ICSID which is affiliated with the World Bank.

Convention. It would likely also require that the EU IIA is concluded as a mixed agreement.

30 Non-ICSID awards against States would be enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, entered into force on 7 June 1959 (New York Convention), assuming the State in question is a Contracting State to the New York Convention. On enforcement under the New York Convention see, for example, Gary Born, International Commercial Arbitration Volume III (2nd. ed., Wolters Kluwer 2014) 3394–3731. Pursuant to its Article IX the New York Convention is only open for accession for States and thus the EU may not become a Contracting State to the New York Convention either. Attachment of EU assets would be governed by Protocol 7 on the Privileges and Immunities of the European Union, Official Journal C 310/261, 16 December 2004, 261. Pursuant to this Protocol there could possibly be complicated proceedings before the Court of Justice of the European Union (CJEU) in case the EU were not to pay an award voluntarily.

31 For example, States, in particular those States with a significant amount of credit facilities given by the World Bank are often said to be more willing to comply with ICSID awards than with non-ICSID awards.

The non-availability of the ICSID Convention is unlikely to be remedied any time soon: it is to be expected that the Commission’s announcement that it “will explore with interested parties the possibility that the European Union seek to accede to the ICSID Convention” and the EP’s request “that the Commission and the Member States take up their responsibility … to work towards the necessary reforms of the ICSID” are likely to prove difficult to implement in practice. This is because according to Article 66(1) ICSID Convention each amendment to the Convention requires that all Contracting States have ratified, accepted or approved the amendment. In reality, such an amendment will be fairly difficult to achieve and would likely be only possible in exceptional circumstances.

The non-availability of the ICSID dispute settlement mechanism may be a drawback for investors protected only under an EU IIA with a third State. Given that unanimity is required to amend the ICSID Convention, the non-availability of ICSID is unlikely to be overcome by the EU. On the other hand, the threshold for an amendment to the Additional Facility Rules is significantly lower: an amendment to the Additional Facility Rules merely requires a simple majority in the Administrative Council of ICSID. As is well-known, ICSID’s Additional Facility Rules apply in proceedings between a State (or a constituent subdivision or agency of a State)

32 See supra note 7

33 See supra note 20

34 Article 66(1) ICSID Convention reads in relevant part as follows: “If the Administrative Council shall so decide by a majority of two-thirds of its members, the proposed amendment shall be circulated to all Contracting States for ratification, acceptance or approval.”

35 Compare Christoph Schreuer, Loretta Malintoppi, August Reinsich and Anthony Sinclair, The icsid Convention – A Commentary (cup 2009) 1265 (“Art. 66(1) makes any amendment extremely difficult. The requirement of a ratification by all States parties to the Convention means that the opposition or mere inaction by a single State can obstruct the adoption of an amendment”).

36 Compare Article 6 ICSID Convention. The Administrative Council is composed of one representative of each Contracting State (see Article 4 ICSID Convention).
and a national of another State. As the EU is not a State, the Additional Facility Rules cannot apply in EU IIAS with third States. Assuming that, following an amendment, the Rules are applicable, the obvious consequence is that since ICSID Additional Facility proceedings are outside the jurisdiction of the Centre, none of the provisions of the ICSID Convention are applicable.

2.2 Availability of Other Arbitration Rules

Next to the ICSID arbitration rules, the UNCITRAL arbitration rules are the arbitration rules which are most commonly used in investor-State arbitration.

The EP appears to be of the view that the EU “cannot use” the UNCITRAL arbitration rules since the EU “as such” is not a member of “[this] organisation.”

The EP’s view is misguided. The UNCITRAL arbitration rules are designed to be used by any actor. References to the UNCITRAL arbitration rules could therefore be made in EU IIAS with third States without any problems. The same is true for any other set of arbitration rules, such as the arbitration rules of the International Chamber of Commerce (ICC) or the Stockholm Chamber of Commerce (SCC). Both sets of rules are also used in investor-State arbitrations, though less frequently than the UNCITRAL arbitration rules. Of course, the availability of arbitration rules such as the ICC or the SCC arbitration rules does not necessarily mean that it may be desirable for the EU (or any of its treaty partners) to include them in IIAS. This is in particular the case because these rules are predominantly designed for arbitrations between commercial parties and may thus be not ideally designed for investor-State arbitration.

3. Investor-State Arbitration in EU IIAS with Third States: EU Law Problems

Additional limitations to the inclusion of investor-State arbitration clauses in EU IIAS with third States may follow from certain provisions of EU law, in particular Articles 267 and 344 TFEU as well as the jurisprudence of the CJEU. In particular, according to the CJEU’s jurisprudence, there are clear limits to establishing international dispute settlement mechanisms for resolving disputes between EU Member States. Further, it is clear from the CJEU’s jurisprudence that there are also limits to establishing an international dispute settlement for resolving disputes between private parties. The issue therefore is whether there

---

38 Ibid., Article 3
40 See supra note 20.
41 Compare UNCITRAL, supra note 39, Article 1(1): “Where parties have agreed that disputes between them in respect of a defined legal relationship, whether contractual or not, shall be referred to arbitration under the UNCITRAL Arbitration Rules, then such disputes shall be settled in accordance with these Rules subject to such modification as the parties may agree.”
42 But see the EU law limitations on investor-State arbitration clauses in EU IIAS below.
44 SCC, Arbitration rules 2010 <www.sccinstitute.com/filearchive/3/35894/K4_Sk
are also limits to establishing investor-State arbitration, i.e. an international dispute settlement mechanism for resolving disputes between a private party and a State, in EU IIAS with third States. This Part will outline why, from an EU law perspective, the main limitations to investor-State arbitration clauses in EU IIAS with third States are likely to stem from the CJEU’s jurisprudence on the autonomy of the EU legal order.48

3.1. Article 344 TFEU and the MOX Plant Case

Pursuant to Article 344 TFEU “Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein.” In the MOX Plant case 49 Ireland had instituted proceedings against the United Kingdom before the international arbitral tribunal under the United Nations Convention on the Law of the Sea50(UNCLOS) in relation to the failure to protect the marine environment with regard to the operation of the MOX plant situated on the Irish Sea coast. As a result, the Commission instituted infringement proceedings against Ireland for a violation of Article 292 EC (Article 344 TFEU). The CJEU ruled that because the dispute concerned the interpretation and application of the EC Treaty, it was within the terms of Article 292 EC (Article 344 TFEU).51 But whereas Article 344 TFEU and the MOX Plant case clearly limit Member States’ competence to settle disputes by other means than the ones provided for in the TFEU, there are at least two reasons why investor-State arbitration clauses in EU IIAS with third States would not be prevented from being included as a result. First, Article 344 TFEU clearly limits only Member States’ competence to settle disputes concerning the interpretation and application of the Treaties; it does not limit the Union’s competence.52 Secondly, neither the TUE nor the TFEU would appear to contain specific provisions that regulate the method of dispute settlement such as disputes that are likely to be settled in investor-State arbitrations pursuant to EU IIAS with third States.

3.2 Article 267 TFEU and Opinion 1/09

The main problem with including investor-State arbitration clauses in EU IIAS from an EU law perspective would be that investor-State arbitrations are likely to bypass preliminary ruling proceedings foreseen by Article 267 TFEU.53 This is because the CJEU has consistently ruled that arbitral tribunals are not ‘courts or tribunals of a Member State’ within the meaning of Article 267 TFEU.54 Moreover, in the case of investor-State arbitration clauses in EU IIAS with third States it would seem unlikely that the CJEU would be of the view that an arbitral tribunal constituted under such an IIA would be a ‘court or tribunal of a Member State.’ But even if the Court held this view, from the perspective of the EU’s treaty partners a preliminary ruling to the CJEU would probably not be an attractive

48 See already CJEU, Case 6/64, Costa v. enel [1964] ecr 1253.
49 The MOX Plant cases refer to three disputes that arose upon the decision of the United Kingdom to authorize the construction and operation of a plant to make mixed oxide fuel (MOX). Apart from the proceedings under the United Nations Convention on the Law of the Sea and before the European Court of Justice mentioned here, further proceedings were instituted by Ireland against the United Kingdom under the ‘OSPAR Convention’ (Convention for the Protection of the Marine Environment of the North-East Atlantic, 22 September 1992, 2354 UNTS 67).
51 CJEU, supra note 46, paras. 125–127.
52 This assumes that EU IIAS will be concluded as ‘pure’ EU agreements rather than mixed agreements. This seems to be the intention of the Commission
53 Article 267 TFEU reads in relevant parts as follows: The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:
(a) the interpretation of the Treaties;
(b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union.
Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.
Where any such question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.
feature of investor-State arbitration. However, from an EU law perspective it would likely be problematic if an investment tribunal had to interpret provisions of the EU Treaties, as it could not request a preliminary ruling from the CJEU, unless the CJEU changes its jurisprudence so that it would allow investment tribunals to request preliminary rulings. It is worth looking at Opinion 1/09 before delving into this question further.

The European Patent Convention (EPC) is a treaty to which 38 States, including all EU Member States, are parties. The EU is not a party to the EPC. The parties had envisaged an agreement that would establish a European and Community Patents Court (PC) composed of a court of first instance, and a court of appeal, that court having jurisdiction to hear appeals brought against decisions delivered by the court of first instance. In Opinion 1/09 the CJEU first clarified that Article 344 TFEU did not prevent the envisaged dispute settlement structure because it would concern merely disputes between individuals (and would not involve a State).56

But the Court went on to emphasise the ‘judicial dialogue’ between the national courts and the CJEU enshrined in Article 267 TFEU. The Court ruled that “the tasks attributed to the national courts and to the Court of Justice respectively [as] indispensable to the preservation of the very nature of the law established by the Treaties.”57 The CJEU was clear in stating that the Member States “cannot confer the jurisdiction to resolve … disputes on a court created by an international agreement which would deprive [national] courts of their task, as ‘ordinary’ courts within the European Union legal order, to implement European Union law and, thereby, of the power provided for in Article 267 TFEU.”58

However, the Court also recalled that the EU’s competence “in the field of international relations and its capacity to conclude international agreements necessarily entail the power to submit itself to the decisions of a court which is created or designated by such agreements as regards the interpretation and application of their provisions.”59 Moreover, the Court stated that “an international agreement with third countries may confer new judicial powers on the Court provided that in so doing it does not change the essential character of the function of the Court as conceived in the [EU Treaties].”60 Finally, the CJEU conceded that “an international agreement may affect its own powers that the indispensable conditions for safeguarding the essential character of those powers are satisfied and, consequently, there is no adverse effect on the autonomy of the [EU] legal order.”61

It is possible to conclude that the CJEU in Opinion 1/09 did not close the door to a dispute settlement mechanism such as investor-State arbitration clauses in EU IIA with third States to the extent that the autonomy of the EU legal order is maintained62. In the context of investor-State

55 Convention on the Grant of European Patents (European Patent Convention)
56 CJEU, supra note 47, para. 62
57 Ibid., para. 85.
58 Ibid., para. 80.
59 Ibid., para. 74.
60 Ibid., para. 75.
62 A stricter reading appears to be favoured by Roberto Barratta, ‘National Courts as ‘Guardians’ and ‘Ordinary Courts’ of EU Law: Opinion 1/09 of the ECJ’ (2011) 38/4 Legal Issues of Economic Integration 297–320. On the consequences of Opinion 1/09 on the possibility to include investor-State arbitration clauses in EU IIAS see Hindelang, supra note 61, p. 182. Hindelang argues that, not least with a view to Opinion 1/09, it is unlikely that investor-State arbitration clauses could be included in EU IIAS with third States, assuming that an investment tribunal would have exclusive jurisdiction and would directly apply and interpret EU law. It seems likely that in some, if not in many arbitrations, this would be the case.
arbitration in EU IIAS this would mean that, in order to maintain the autonomy of the EU legal order, the CJEU is unlikely to accept that investment tribunals may interpret and apply EU law without these tribunals being “courts or tribunals of a Member State” within the meaning of Article 267 TFEU. As indicated, in order for this to happen, the CJEU would need to change its view such that it would accept that investment tribunals may request preliminary rulings in accordance with Article 267 TFEU. While the Court has on at least one occasion ruled that it may be willing to accept, under certain conditions, that arbitral tribunals are “courts or tribunals,” the Court would, moreover, have to be willing to accept that investment tribunals are “courts or tribunals of a Member State.” Considering the nature of investment tribunals constituted under EU IIAS with third States, this would seem to be difficult. Without the possibility, however, of requesting a preliminary ruling from the CJEU, investment tribunals could not, as a matter of EU law, settle disputes under EU IIAS with third States, certainly not if the autonomy of the EU legal order would be endangered as a result.

4. The Problem of Competence and Proper Respondent in an Arbitration

Notwithstanding these potential EU law problems to investor-State arbitration clauses in EU IIAS with third States it seems very likely that such clauses will be included. Another (of the many) open questions is who will be the respondent in any arbitration commenced by a non-EU investor under such agreements (the EU and/or one of its Member States). In this regard, the Commission published a “Proposal for a Regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party” on 21 June 2012 (“Proposal for a Regulation on Responsibility”).

In the explanatory memorandum to the Proposal for a Regulation on Responsibility the Commission expresses the view that the EU has exclusive competence to conclude EU IIAS covering all matters relating to foreign investment. While it is the case that Article 207 TFEU refers to “foreign direct investment” only, in the Commission’s view, the EU’s competence for investment other than “foreign direct investment” stems from Article 63 TFEU. This provision provides that the movement of capital between Member States and third States is free of restrictions. Because Article 3(2) TFEU provides for the EU’s exclusive competence whenever rules included in an international agreement “may affect common rules or alter their scope,” the Commission is of the view that the EU, when concluding an EU IIa with a third State, has exclusive competence with respect to all forms of investment. The Commission is also of the view that the EU’s competence covers all of the standards typically provided in investment treaties, including protection against

63 Hindelang refers to the view that strictly speaking, as a matter of law, the autonomy of the EU legal order may not necessarily be “endangered.” However, it is clear that there would be a factual encroachment on the autonomy of the EU legal order. See Hindelang, supra note 61, p. 177


uncompensated expropriation. According to the Commission it therefore follows that where the agreement is concluded by the EU only, only the EU (and not the Member States) may be sued by an investor from a third State. However, the Commission also states that it “may be possible, as provided expressly in Article 2(1) TFEU, to empower a Member State to act as respondent in appropriate circumstances given the potential for significant demands (even temporary) on the Union budget and on Union resources were the Union to act as respondent in all cases.”

Accordingly, Chapter III of the Proposal for a Regulation on Responsibility sets forth the scenarios in which either the EU or a Member State shall act as respondent. Pursuant to the Commission’s proposal, the EU shall act as respondent where the dispute concerns treatment afforded by the institutions, bodies or agencies of the EU (Article 4 Proposal for a Regulation on Responsibility). Pursuant to Article 8(2) Proposal for a Regulation on Responsibility the EU shall also act as respondent if it decides to do so within 30 days of receiving notice of a claim if

(a) it is likely that the EU would bear at least part of the potential financial responsibility arising from the dispute;

(b) the dispute also concerns treatment afforded by the EU institutions, bodies or agencies;

(c) it is likely that similar claims will be brought under the same agreement afforded by other Member States and the Commission is best placed to ensure an effective and consistent defence;

(d) the dispute raises unsettled issues of law which may recur in other disputes under the same or other EU agreements concerning treatment afforded by the EU or other Member States.

Pursuant to Article 8(1) Proposal for a Regulation on Responsibility the EU shall also act as respondent if the Member State has not confirmed to the Commission in writing that it intends to act as respondent within 30 days of receiving a notice of claim. In all other cases (unlikely to be many), the Member State concerned shall act as respondent, provided that the agreement provides for the possibility (Article 8(1) Proposal for a Regulation on Responsibility). However, even if the Member State acts as a respondent, it is under certain obligations to inform the Commission (Article 9 (1) Proposal for a Regulation on Responsibility) and may even be required by the Commission to take a certain position as regards a point of law (Article 9(2) Proposal for a Regulation on Responsibility) or file for annulment, appeal or review of an arbitral award (Article 9(3) Proposal for a Regulation on Responsibility).

On 23 May 2013 the European Parliament adopted certain amendments to the Proposal for a Regulation on Responsibility. These suggested amendments include those in relation to Article 8(2)(c) and (d) referred to above. They also include the insertion of Article 8(2a) to the effect that the determination of the EU as respondent in an arbitration shall be binding on the claimant and the arbitral tribunal. They further seek to curtail the Commission’s right, suggested in Article 9(2), to require a Member State to take a certain position and to file for annulment.

67 This is probably the better view rather than the more restrictive interpretation which holds that the EU’s competence would not cover matters of expropriation. See, for example, Markus Burgstaller, ‘European Law Challenges to Investment Arbitration’ in M. Waibel, A. Kaushal, K. Chung and C. Balchin (eds.), The Backlash against Investment Arbitration – Perceptions and Reality (Kluwer 2010) 455–482.

68 European Commission, supra note 65, p. 4.

69 Ibid., p. 5.

70 Principally, according to Article 3 European Commission, supra note 65, the EU shall bear financial responsibility arising from treatment afforded by the institutions, bodies or agencies of the EU, whereas the Member State concerned shall bear financial responsibility arising from treatment afforded by that Member State, except where such treatment was required by EU law.

appeal or review of an arbitral award (in particular by adding that the Commission may only do so after consultations with the Member State concerned).

On 18 October 2013 the Council discussed the Proposal for a Regulation on Responsibility. Under the ordinary legislative procedure the Council will now negotiate with the EP with a view to reach a compromise agreement. Pursuant to a press release by the Council dated 18 October 2013 the aim is to enable the regulation to enter into force as soon as possible. 72 On 11 March 2014 the EP was scheduled to adopt its first reading position on the Proposal for a Regulation on Responsibility.

The Commission’s Proposal for a Regulation on Responsibility would seem to be far-reaching such that, in effect, the Commission could in virtually all cases decide that the EU shall act as respondent in an arbitration commenced under an EU IIA. This is in particular because of the broad wording of Article 8(2)(d) of the Proposal for a Regulation on Responsibility. The suggested amendments by the EP to that provision are unlikely to change this conclusion significantly. 73 This suggested competence by and for the Commission has to be viewed in conjunction with Article 17 of the Proposal for a Regulation on Responsibility (also in the amended version by the EP). This provision foresees that the Member State concerned effectively will have to pay any compensation due to an investor even in cases in which the EU acts as respondent. As the Member State concerned will have limited influence on the conduct of the arbitration, it is difficult to see that the Member States in the Council will agree to that proposal. Rather, it would seem likely that difficult negotiations between the EU institutions lie ahead and it may well take considerable time to reach an agreement. Without an agreement within the EU, however, it would seem difficult to finalise any EU IIA with a third State. Thus, even if the negotiations with certain treaty partners, in particular Canada, appear to be at an advanced stage, it may well take a significant amount of time before such an agreement will be concluded.

5. Conclusion

The EU institutions appear to be committed to include investor-State arbitration clauses in EU IIAs with third States. However, the EU is not, and is unlikely to become, a Contracting Party to the ICSID Convention. As a matter of international law, this does not prevent the EU from arbitrating disputes under the ICSID arbitration rules, but it prevents the EU from offering EU investors some of the benefits of the ICSID Convention, in particular ICSID’s annulment and enforcement system. While this deficiency may be remedied to some extent by replicating the relevant provisions of the ICSID Convention in EU IIAS, EU investors still cannot benefit from the institutional clout of ICSID which could possibly facilitate enforcement of awards.

The main obstacle to investor-State arbitration in EU IIAs with third States is likely to stem from the jurisprudence of the CJEU which may limit the possibility to include investor-State arbitration clauses in EU IIAs with third States. To the extent that investment tribunals may apply and interpret EU law in an international arbitration under an EU IIA, which seems likely to be the case, investment tribunals could not settle such disputes. This is because they would, as a matter of EU law, have to be in a position to request a preliminary ruling on the interpretation of the EU Treaties from the CJEU in accordance with Article 267 TFEU. In effect, it would seem that the EU could only include investor-State arbitration clauses in EU IIAS with third States following a change in EU primary law such that investment tribunals could request a preliminary ruling. 74 Even if the EU were to make this change, the EU’s treaty partners are unlikely to accept a dispute settlement mechanism which would require, or even provide the possibility of a tribunal to request a preliminary ruling from the CJEU.

At this point, the EU and its Member States appear pre-occupied with negotiating EU IIAS


73 Such that the provision reads: “similar claims or requests for consultations concerning similar claims have been lodged under the same agreement against treatment afforded by other Member States and the Commission is best placed to ensure an effective and consistent defence.”

74 See also Hindelang, supra note 61, p. 183
with third States and agreeing a regulation on financial responsibility, including the question of who will be respondent in an arbitration. However, there appears to be disagreement in particular between the Commission and the ep on the one hand and the Council on the other hand on some fundamental questions, including on whether EU IIAS will be concluded as “pure” EU agreements (the Commission’s and the ep’s view) or as ‘mixed’ agreements (the Council’s view). It seems likely that it will ultimately be the CJEU who decides this question. As suggested here, it may, however, be that the CJEU has more fundamental problems with the inclusion of investor-State arbitration clauses in EU IIAS with third States.

* This article was originally published in The Journal of World Investment & Trade 15 (2014) 55-569

* The author is Partner at Hogan Lovells in London. The views expressed herein are solely those of the author, and do not represent the views of Hogan Lovells or its clients. Parts of this contribution, in particular parts of Parts 1 and 2 below, draw on a previous article published as Markus Burgstaller, ‘Investor-State Arbitration in EU International Investment Agreements with Third States’ (2012) 39(2) Legal Issues of Economic Integration 207–222, reproduced in Markus Burgstaller, ‘Investor-State Arbitration in EU International Investment Agreements with Third States’ in N.J. Calamita, D. Earnest and M. Burgstaller (eds.), The Future of ICSID and the Place of Investment Treaties in International Law – Investment Treaty Law Current Issues IV (BIICL 2013) 149–164. This article takes into account developments until and including 12 December 2013, unless otherwise indicated.
Cooperation between in-house counsel and external counsel*

Milan Lazić*
Karanović & Nikolić, Belgrade, Serbia
milan.lazic@karanovic-nikolic.com

Representing and leading an arbitration case requires an in-depth understanding of the client’s business. This is the only way the external counsel can truly grasp the factual background of the case, build up the strategy and fundamentally understand the significance and impact the arbitral proceedings may pose on the client’s business.

The only way to achieve this goal is to create an environment of close cooperation between the in-house counsel and external counsel. The client (through its in-house counsel) needs to be fully involved in the case to achieve the best outcome.

The in-house counsel should be the person who is most involved in each and every segment of the business of a company (client), the person who is most familiar with the branch of law that the dispute concerns; he or she is the provider of information and documentation and the person who controls the costs. Most importantly, he or she is the point of contact between the external counsel and the management of the client and therefore bears an important role in decision making. He or she is the person who builds the strategy in the case together with the external counsel and should be a part of the team.

It should be noted that it is sometimes necessary that the in-house team should not only consist of the lawyer, but also to include the people from the business that were mainly involved in the particular transaction (such as engineers, financial people, negotiators of a deal, etc.).

Prompt and efficient cooperation between the in-house counsel and external counsel is quintessential throughout the proceedings, especially in the phase of preparing the answer to the request for arbitration. It is necessary for the external counsel to get acquainted with the factual background of the claim, and the relevant information and documents in order to build the strategy of the case and ultimately, prepare the answer. Unlike situations where the client is the claim-ant and where there is plenty of time to prepare the request for arbitration, the filing of the answer to the request is usually limited with short deadlines (e.g. 30 days, according to ICC and UNCITRAL rules) and the tribunal may not grant extensions of the deadline. For instance, in order to appoint an external counsel (attorney), publically owned companies in Serbia need to go through the process of public procurement. This process can last up to 90 days. In one particular arbitration case, the client was forced to prepare and file the answer to the claim by itself because the tribunal in the ICC arbitration would not allow for an extension of the deadline. In this case, it was the in-house counsel who set the strategy of the case and set up the basis for all other actions that the external counsel would take in the further course of arbitration. Having this in mind, the role of the in-house counsel was even more important in the later stages of the proceedings, since the main arguments in the case were structured by the in-house counsel and the strategy of the external counsel was somewhat defined and limited by arguments from the answer prepared and filed by the in-house counsel.

The role of the in-house counsel and communication with the external counsel does not decrease in the further course of the proceedings, on the contrary: through years of practise, two fields where this communication is essential were identified:

- examination of witnesses and
- experts.

■ Examination of witnesses

Examination of witnesses is an important part of the evidence process, creating important roles for both in-house counsel and external counsel. External counsel is the one who is leading the case and usually determines which facts are important for the case and should therefore be substantiated by witness statements.

On the other hand, the in-house counsel is the one who is familiar with the situation in the field and the people who were involved in the
particular deal. This makes him or her most competent to suggest useful witnesses to the external counsel. Also, the in-house counsel usually knows the witnesses in person, and may contribute to handling them on a more personal level. In this way, it is easier to build a relationship of trust between the witness and the external counsel. In this respect, it is highly recommendable that both counsels are involved in the preparation of written witness statements. Each of them should phrase questions for the witnesses and in that way control the content of their statements.

Article 4 (1) of the IBA Rules on Taking of Evidence in International Arbitration (“IBA Rules”) prescribes:

“It shall not be improper for a Party, its officers, employees, legal advisors or other representatives to interview its witnesses or potential witnesses and to discuss their prospective testimony with them.”

It is commonly debated whether the witness should prepare a written statement by himself or herself or should such a statement be prepared by the counsel. It has proven efficient that the witness prepares the written statement with assistance from the external counsel. Then the witness statement is submitted to the in-house counsel for his or her comment and review. The final text is then confirmed and signed by the witness.

As far as the preparation for the examination of witnesses goes, the presence of the in-house counsel is highly recommended, since the in-house counsel can contribute with his or her own interpretation of the circumstances and can suggest the best approach towards the witness as normally a personal connection exists. Also, the presence of the in-house counsel is advisable during the hearing, given that the in-house counsel is most familiar with the factual background and may ask the witness questions should the witness and the external counsel miss something. Additionally, the in-house counsel may often have an essential role in the analysis of the written statements of the opposite party’s witness and give important notions and inputs for the cross-examination.

Further, the in-house counsel may have another important role in taking the witness stand. External counsel counts on the in-house counsel to be persuasive and confident and to explain the case better than any written submission. This possibility is provided in Article 4 (2) of the IBA Rules:

“Any person may present evidence as a witness, including a Party or a Party’s officer, employee or other representative.”

Communication between the in-house and external counsel is essential when it comes to preparing and presenting the right facts and also the right amount of facts to the Tribunal, which is why their collaboration and effective teamwork in preparing witnesses to take the stand is crucial for the course, and often also for the outcome of the arbitration.

Expertise

When it comes to evidence given by experts, the role of the in-house counsel is even more important than the role of the external counsel, because the in-house counsel is the one who will provide the expert with the relevant facts and documentation and often be in direct communication with the expert. Communication between in-house counsel and experts is especially important:

— during the pre-dispute stage;
— in the case of party appointed experts; and
— in the case of tribunal appointed experts.

The pre-dispute stage

In disputes where the main question is related to a subject that requires expert knowledge, it is advisable to consult the expert before even deciding whether to initiate the dispute. Most commonly, this applies to construction disputes and generally all disputes where the quality and characteristics of goods or services performed require expert evaluation. This includes disputes in the food industry, pharmaceutical industry, mechanics etc.

For example, in a construction dispute in an ICC arbitration that was concerning construction works under the FIDIC contract, the subject of the claim filed by the contractor against the employer were the variations in the works allegedly requested by the employer as well as the value and costs arising from these variations. The main question in the dispute was whether the variations in works (requests of the employer) were in accordance with the technical documentation fixed in the contract
or were they out of the scope of works stipulated in the contract. This question could only be resolved by an expert engineer. In my opinion, before initiating this dispute, the claimant should have engaged the expert who would have given an initial opinion about the merits of the dispute. In this way, the dispute could have even been avoided and possibly solved through negotiations and settlement.

It is the task of the in-house counsel to identify the situations where the expertise in the pre-dispute stage is necessary. Also, it is the task of a good in-house counsel to advise the client to take this step before initiating the dispute.

- Party appointed experts

Party appointed experts are common in the common law systems, where the adversarial approach is applied. For instance, in the UK, parties submit their own expert reports and the judges/arbitrators make a decision on the basis of evaluation of the two reports. Lately, this concept is becoming a common fixture in arbitration proceedings.

Guidance on the party appointed experts is provided by Article 5 of the IBA Rules and is increasingly common also in continental practice. However, it is questionable whether this phase is necessary. It goes without saying that each party wants to and will submit a report in their own favour, which may make it necessary for the Tribunal to appoint a third expert to determine which one of the party appointed experts was actually right. This impacts the efficiency of the process immensely. Calling upon multiple experts in situations when one could suffice is undoubtedly costly and time-consuming.

This can be applied to our previous example concerning the construction dispute on the basis of FIDIC contract. The answers to crucial questions – do variations in works deviate from the initial employer’s instructions provided in the technical documentation and the contract and what is the cost of such deviations – would be given by the expert. Basically, the expert gives the answer whether the claim is well-founded or not. Party appointed experts may be considered unsought in situations like this. The most efficient way to solve this is for the Tribunal to appoint a single expert who would give the necessary answers.

However, from a party’s point of view, it is highly unlikely that any party would pass on the opportunity to secure its position with all evidence available, including a party appointed expert. Perhaps this is why the party appointed experts tend to be perceived as “hired guns” and are used for tailoring evidence in benefit of one party’s position, which brings up the question of their impartiality. There is a tendency that the experts are perceived, even by themselves, as being part of the team of the appointing party. The simple fact that the expert is appointed, instructed and paid by a particular party can, to some extent, create a feeling of loyalty towards that party, especially when the expert seeks to be appointed by that party in future disputes.

In order to reduce risks and complications with each party appointing their own experts, tribunals sometimes introduce a “hot tubbing” phase in the proceedings. Hot tubbing is also a common law concept.

Although the notion of hot tubbing differs from case to case, the basic approach is that both experts give evidence simultaneously and the Tribunal chairs a discussion between them. The experts compare their reports and make a list of issues they agree upon and issues they do not agree upon. They may sometimes even produce joint reports on issues they agree or disagree upon. Hot tubbing is extremely effective in highly technical arbitrations where complex factual and technical issues need to be resolved making both parties rely on evidence from a number of expert witnesses. This stage contributes to the efficiency of the proceedings and the reduction of costs. It is becoming progressively more common for the Tribunal not to appoint a tribunal appointed expert when conducting hot tubbing, since hot tubbing itself narrows down the number of issues that require an expert opinion. It shortens the trial and correspondingly enhances prospects of settlement. This possibility is also considered in Article 5 (4) of the IBA Rules:

“The Arbitral Tribunal in its discretion may order that any Party-Appointed Experts who will submit or who have submitted Expert Reports on the same or related issues meet and confer on such issues. At such meeting, the Party-Appointed Experts shall attempt to reach agreement on the issues within the scope of their Expert Reports, and they shall record in writing any such issues on which they reach
agreement, any remaining areas of disagreement and the reasons therefore.”

Even though it is the external counsel who usually ex- presses and justifies the need for the party appointed expert and elaborates the consequences such a process entails, the one who has the final say is the in-house counsel. It is the in-house counsels’ task not only to avoid unnecessary costs in the proceedings and be aware that party appointed experts may bring substantial costs, but also to make sure that, regardless of immensity of the costs, the case is well substantiated with all kinds of evidence. Balancing between making the case cost-effective yet strong is the task of the in-house counsel. This is why thorough communication on these issues between external and internal counsels is necessary.

Also, a very important role of the in-house counsel is his or her assistance in specifying instructions and questions for the expert. It is a crucial point because the answers given by the experts largely depend on how the questions are phrased. Furthermore, the central role of the in-house counsel is in setting the methodology that the party appointed expert will apply.

Finally, the review of the expert report, additional instructions and questions for the expert should also be done in communication between the in-house and external counsel. The in-house counsel is usually more familiar with the expert side of the dispute and can be crucial for this phase.

Tribunal appointed experts

Guidance on Tribunal appointed experts is given by Article 6 of the IBA Rules. As a result of all issues concerning party appointed experts, there is a tendency in international arbitration towards appointment of a single expert, either upon the parties’ agreement or at the tribunal’s directive. This may bring benefits in terms of efficiency and cost-effectiveness.

However, there are certain disadvantages in appointing a single expert. Firstly, appointing a single expert may actually increase accompanying costs, as the par- ties may appoint “shadow experts” if they do not agree with the official expert’s opinion. Also, when the tribunal appoints a single expert, it may be more inclined to accept the evidence of an expert it appointed, which is often an unforeseeable risk for the parties. For instance, there is always a possible alternative view that would be missed by the tribunal by appointing only one expert. Finally, there is a chance the expert will misinterpret its role and make determinations more suited for the tribunal.

In order to be able to make the right decisions when forming evidence strategy, the in-house counsel needs to understand the advantages and disadvantages of different types of expertise. At the end of the day, it is the in-house counsel who will be responsible for leading the arbitration case in the most efficient and cost-effective way.

In-house counsel could also have an important role in selecting the tribunal appointed experts, since the tribunal will usually suggest a few alternatives. The in-house counsel usually may give insightful comments in that respect, mainly in identifying the relevant experience of different experts, potential conflicts of interest or impartiality issues. Also, being involved in the selection process, the in-house counsel may well influence the costs for the appointing expert.

In my experience, the role of in-house counsel and external counsel is somewhat limited when it comes to specifying the tasks of the Tribunal appointed expert, because the Tribunal is usually the one to identify the questions and instructions for the expert. This can be done in two ways. The Tribunal may either order the parties to make their own proposals for the list of issues first and then determine the final instructions for the expert, or the Tribunal may completely exclude the parties from this stage and make a list of issues on its own. Whatever the case may be, in-house counsel and external counsel should work closely together on this, given that the outcome of a number of disputes will depend on the results of the expert opinion. The goal of both counsels should be to identify and narrow down the issues that require expert evidence and need to ensure the expert evidence is only heard on relevant issues.

Furthermore, the role of the in-house counsel is very important for the preparation of the expert report because it is the in-house counsel who is to collect the information and documentation requested by the expert and takes part in meetings with the expert alongside the external counsel.
Finally, the cooperation of the in-house counsel and the external counsel is crucial when objecting to the expert report and when questioning the tribunal appointed expert at the hearings. It goes without saying that both counsels should be present at the hearing and be given the opportunity to pose questions and raise objections.

**Conclusion**

Representing parties in arbitrations is a highly responsible task and may incite high risks for the business of the client. Therefore, close cooperation between the in-house counsel and the external counsel is of utmost importance. This is, first of all, an issue of quality – two heads are always better than one. Every event and action in the arbitration proceedings should be shared with the in-house colleague, because he or she can contribute with his or her understanding and knowledge of the business. Also, each and every important decision in the arbitration should be made in cooperation with the in-house counsel. The practice of our law firm is to send each and every written submission to the client for its review and comments. Time and again, the clients furnish interesting ideas and a different outlook that can improve the position in the dispute.

In-house counsel’s proactive role in the communication is vital at the very beginning of the proceedings, because the client is the first one to know the case and it is its task to transfer this knowledge to the external counsel. In so doing, the external counsel would send the right message to the tribunal and the opponent. Therefore, the role of in-house counsel is of high importance in developing the strategy of the case.

Going down the line, each and every stage in arbitration proceedings demands close cooperation, starting from the appointment of arbitrators (when the in-house in conjunction with its management will choose the arbitrator and may contribute with his own proposals), up to the later stages of the arbitration such as oral hearing (which should unquestionably be attended by the in-house counsel) and preparation of post-hearing submissions. It was shown in practice that this communication is crucial in the procedure of taking of evidence.

Transparency in arbitration proceedings between the in-house counsel and external counsel should be the guiding principle. The in-house counsel and the external counsel should cooperate in a friendly manner, get to know each other well and be open and transparent. Although the in-house counsel very often does not feel comfortable in arbitration proceedings, he or she should be an integral part of the team representing in arbitration proceedings – there is no room for vanity here and everyone can contribute with their own ideas. In this way, the responsibility and risks the arbitration proceedings bring are shared between the in-house counsel and external counsel. Raising the level of responsibility and sharing the responsibility will always lead to a better end result.

* This article was originally published in The Slovenian Arbitration Review, March 2014

* The Head of the Dispute Resolution Department at Karanović & Nikolić, a leading commercial law firm operating in Southeast Europe. He has represented clients in a number of major court cases as well as in a number of major international arbitration cases of high value and complexity before the ICSID, ICC and UNCITRAL arbitrations, and arbitrations before the local Foreign Trade Court of Arbitration before the Serbian Chamber of Commerce with a focus on complex corporate and commercial litigations and arbitrations. Milan is highly experienced in international and domestic corporate and commercial litigation, disputes and services and counsels large corporations and mid-sized businesses.
03

Things Too Good to Be True Don't Usually Last*

Vaclav Rovensky*
Partner at Kocián Šolc Balaštík (KSB)
vrovensky@ksb.cz
Jiri Hornik*
Partner at Kocián Šolc Balaštík (KSB)
jhornik@ksb.cz

Until two years ago, the Czech Republic was regarded a country with stable and favorable investment conditions. In this article I will briefly describe the situation which eventually harmed Czech Republic' reputation as regards international investment because Czech Republic's legal environment is no longer regarded as stable.

In the process of EU accession negotiations Czech Republic, among other, undertook to increase the share of renewable energy sources up to 8% by year 2010 and up to 13% by 2013. Willingness to meet EU targets related to renewable energy sources, continuously updated by various EU directives, forced Czech legislators to come up with a package of incentives which would create conditions for such an increase, in a landlocked country with very limited possibilities of power generation from renewable energy sources. As it turned out later on, this package was designed too generously as it led to uncontrolled proliferation of photovoltaic power plants ("PPPs"), the so called "solar boom"75, which eventually not only started to threaten the stability of the power grid, but the overall acceptability of the electricity price in the Czech Republic. Thus, Czech legislators had to come up with another set of laws, this time so controversial that it led to review of its constitutionality by Czech Constitutional Court and let to initiation of arbitration proceedings under which investors sought protection in accordance with international investment protection treaties.

1. How it started

In 2005 Czech Parliament adopted Act No. 180/2005 Coll., on the Support of Electricity Generation form Renewable Energy Sources, in which the Czech state implemented Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market. This act and related measures introduced very favorable conditions for investment to renewable energy sources projects as they guaranteed a long term stable support guaranteed by the state for this type of investment, consisting namely of the following measures:

i. guarantee of the recovery of investments into the renewable energy power plant for the period of 15 years from commissioning of the PPP (state support through regulated purchase prices or green bonuses-see below);

ii. right of the electricity producer for a priority con-nection of his PPP to the respective distribution or transport grid;

iii. right of the electricity producer for priority transfer of electricity generated by his PPP; this right being effective for all the operating life of the PPP;

iv. right of the electricity producer to demand that all electricity generated by his PPP is purchased by the operators of regional distribution grids;

v. right of the electricity producer to choose between two types of support programs-feed in tariffs (regulated purchase price) and the so called "green bonus"76

vi. guarantee of revenues per unit of electricity for 15 years and guarantee of continuous (although limited) increase of purchase prices annually set by the Energy Regulatory Office (between 2%-4% compared to purchase prices stipulated for the previous year);

vii. guarantee of limited decrease of purchase prices set by the Energy

---

75 The amount of installed capacity of PPPs in the CR increased almost 7 times between the beginning of the year 2009 and beginning of the year 2010 and almost 4 times during the year 2010.

76 This system is convenient for minor investors, who use the generated electricity especially for their own consumption. Amount of green bonus is set by Energy Regulatory Office.
Regulatory Office stipulated for new PPPs. The maximum admissible decrease for PPPs newly launched into operation was set at 5% compared to purchase prices for PPPs launched into operation during the previous year.

Apart from that the Czech legislators amended Act on Income Taxes and exempted the income tax from income received by operation of PPPs generating electricity in the calendar year in which they were commissioned and the following 5 years.

Unfortunately, the legislators have not foreseen several factors that led to the uncontrolled expansion of PPPs in the Czech Republic. Undoubtedly one of the strongest incentives of solar boom were high levels of state guaranteed purchase prices and green bonus set by the Energy Regulatory Office. For example, the purchase price and green bonuses for the electricity generated by the PPPs commissioned from 1 January 2006 till 31 December 2007 were twice as high compared to prices applicable to PPPs commissioned prior 1 January 2006. This, in connection with the annual limited permissible decrease of the purchase prices and green bonus applicable to PPPs newly launched into operation (and the necessity of annual, although limited, increase of regulated purchase prices), caused the inability of the Energy Regulatory Office to react flexibly on the increasing amount of PPPs and the increasing amount of provided state's support. To give some credit to the Energy Regulatory Office, the initial high purchase prices and green bonus were advocated by the high initial investments into PPPs in 2006. However, these dropped by 50% in the following four years, whereas guaranteeing the return on investment not in 15 years, but given the level of guaranteed state support, in the range of 6-8 years. Indeed, this would create an ideal situation for investment into a high profit venture moreover guaranteed by the state.

The initial investment into the PPPs dropped mainly due to the situation on photovoltaic panels market, as the price of the panels, representing approximately 80% of the overall costs of a PPP, dropped by more than 40% in 2009. Actually the decrease was even higher due to the fact that the panels were mostly imported during a period when the exchange rate of Czech currency to U.S. Dollar was very convenient.

The business at that time was also fueled by the availability of external finance, as the banks were (due the legislation described above) more than keen to provide loans for PPP projects, as they considered these to be safe, given the prices guaranteed by state, with practically certain investment recovery and loan payback.

2. The "Solar boom"

The reasons described above caused that Czech Republic, despite its small surface and below average sun- shine (compared to other parts of the world), became the fourth country in Europe and the sixth in the world as regards total installed solar capacity at the end of the year 2011. The photovoltaic capacity increased in three years from 66 MWe at the beginning of 2009 to 1959 MWe at the beginning of 2012, i.e. almost thirty times. That would sound impressive if it were not for several serious troubles inseparably connected with such extensive and sudden increase in the volume of solar powered electricity incoming to transfer and distribution scheme, such as threat of possible "blackouts" and drying up resources of the Czech Republic, used for subsidising of the PPPs (i.e. purchase prices and green bonus) and essentially adherent potential risk of substantial increase of electricity price for the end users-meaning the consumers and businesses. The worst case scenario mentioned even the increase of electricity price to final consumers by 20%.

As a result Czech government and legislators...
had to reconsider the position of the state towards support of the PPPs and decided to introduce a new package of measures that would allow for elimination of the potential threats and that would reflect and transmit into the state photovoltaic support the fact that due to the significant decrease of the initial investment costs of PPPs the conditions of this business substantially changed.

3. How it came to an end

In order to tame the solar boom, Czech legislators adopted all range of measures that actually denied the first set of measures. Namely acts No. 137/2010 Coll., 330/2010 Coll. and acts No. 402/2010 Coll. and 346/2010 Coll. and other regulations and price decision of the Energy Regulatory Office issued on the basis above. These regulations, effective mostly from 1 January 2011, after an extremely short implementation period, among others:

i. enabled the Energy Regulatory office to lower purchase prices significantly (as for the PPPs that were supposed to be commissioned in 2011 with recoverability of investment shorter than 11 years, the guarantee of maximum allowed 5% decrease of the purchase price between two consequent calendar years was totally canceled);

ii. cancelled any support for PPPs that were not connected to the distribution system by the end of February 2011, with exception of small PPPs with installed capacity up to 30 kWp on the roofs or enclosure walls of buildings listed in land registry;

iii. imposed an obligation to pay a levy on solar electricity generated in the period from 1 January 2011 to 31 December 2013 on those solar energy producers, whose PPPs were commissioned from 1 January 2009 to 31 December 2010 and provided that the installed capacity of their PPPs exceeded 30 KWe. The levy amounted to 26% in case of purchase price and 28% in case of green bonus;

iv. imposed a tax on CO2 emission allowances acquired free of charge among other to coal burning power plants by making these subject of a gift tax amounting to 32% (even though not connected in any way to the solar boom);

v. increased the fee for exemption of soil from agricultural soil fund, therefore making the construction of PPPs much more expensive (as most of PPPs were constructed on agricultural soil - pastures or fields);

vi. cancelled tax holidays (grace period of approximately 5 years after the commissioning of the respective PPP) that had been applicable on all electricity producers from renewable energy sources since year 1993 on and prolonged term for depreciating of tangible property used for generation of electricity from solar energy on 240 months; and

vii. limited the possibility to connect new PPPs to the grid.

The controversy of these measures is obvious, especially if compared with the initial declaration of the Czech government embodied in the first set of measures intended to support the solar energy sources in the Czech Republic. The measures above led to initiation of several arbitration proceedings by investors that claimed that the measures were unconstitutional and did not seek public

Republic was based on the principle of transfer of a major part of financing of the support to the final consumer and state's budget. To be more precise, the statement above regarding the "major part" is not correct in case of state aid for generation of electricity from renewable energy sources in form of "operational aid," as in the given segment 100% of the state aid was transferred to the final consumer till the end of the year 2010, or as the case may be 2011. See http://www.concourt.cz/ soubor I6378.

The two last ones were eventually subject of constitutional complaint filled by 20 Czech senators.

This caused a frantic race between the investors for connection of their PPPs before the end of the year 2010, because the purchase price for electricity generated by PPPs commissioned by 2010 (inclusive) was twice as high compared the purchase price of electricity generated by the PPPs commissioned in 2011.

---

82 Although the legislator called this measure "levy" it is in fact additional taxation.

83 This limitation lasted almost 2 years-until 1January 2012.
interest, as claimed by the legislators, but fiscal interests of the Czech Republic and as such should be considered as unacceptable; none of these cases have been decided so far and many others have been waiting for the decision of the Constitutional Court. In order to stop the legal uncertainty about the legal nature of these measures and to prevent the expected large number of arbitration cases, 20 senators filed a constitutional complaint with Czech Constitutional Court on 3 March 2011, seeking annulations of several provisions from the second set of state's photovoltaic measures.

On 16 May 2012 Czech Constitutional Court decided on the constitutional complaint mentioned above and generally approved the measures taken by the Czech State focused on limitation of solar boom and its consequences, concluding that the choice of statutory provisions aimed at limiting state support for the production of solar energy is in hands of the legislature, provided the guarantees of investment return are preserved. The principle of legal certainty cannot be considered to be a requirement for an absolute absence of change in the legislative framework; that is also subject to other social-economic changes and demands on the stability of the state budget. The Constitutional Court considered it legitimate, after an objectively determined change of situation in investment into PPPs, to regulate support for the production of energy from renewable sources so as to maintain the balance between inputs and revenues established by the original version of act No. 180/2005 Coll., which was expressed in the fifteen year period for return on investment and a fixed level of revenues. At the end of the court ruling the Constitutional Court summarized, that although the contested provisions reduced the support provided to PPP operators, for the foregoing reasons this was not such an interference as would violate the constitutionally guaranteed rights of the affected persons, whether property rights or the freedom to conclude business, or would fail to observe the essential requirements of a democratic rule of law state, as the petitioners believe. In view of the sample calculations submitted in the proceeding before the Constitutional Court, the Constitutional Court concluded that the expected fifteen year period for return on investment was not fundamentally jeopardized by the adoption of the contested provisions; this is the position of the government, and was not persuasively cast in doubt by the petitioners.

Notwithstanding the obvious political aspects of the said ruling of the Constitutional Court, it should be mentioned that all is not lost, as at the same time the Czech Constitutional Court held that the conclusions above are general and it is not excluded that the impacts of reviewed legislation might be different in individual cases. In other words, should the individual investors be able to prove that their investment return has, in their particular case, been substantially hindered by the legislative measures designed to limit the effects of the solar boom, they should have a chance of success. And possibly help to build the trust in the Czech investment environment, which almost vanished a few years ago.

* This article was originally published in the NYSBA Inside, Winter 2012, Vol.30 No.3

* Vaclav Rovensky is a Partner at Kocian Sole Balastik, a leading law firm based in Prague, the Czech Republic, where he concentrates his practice on energy law, project financing and arbitration in energy related matters.

* Jiri Hornik is a Partner at Kocian Sole Balastik and his practice focuses on, inter alia, real estate and project financing. Jiri is a member of the NYSBA's Corporate Counsel Section; They can be reached at vrovensky@ksb.cz and jhomik@ksb.cz.