NORD STREAM 2 V. THE EUROPEAN UNION – ATTRIBUTABILITY OF WRONGFUL CONDUCT IN INVESTMENT ARBITRATIONS

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ABSTRACT

In most instances of investment arbitration, the Treaty in question (a BIT/MIT/FTA) clearly outlines the liability of the host state and it is the host state against which arbitration is commenced by investors and all conduct is attributed to the state. However, in cases where countries are part of supranational organisations, such as the European Union, where they cede authority and sovereignty to an organisation, this question is not as straightforward. This is because in these instances, the organisation in question enacts laws and regulations that are binding on member states. The European Union is one such organisation. These situations also have the potential to impact the rights that accrue to investors under various international treaties such as the Energy Charter Treaty, to which many countries and the EU are members. In such situations, it becomes essential to determine the standard for attributing wrongful conduct and dividing the liabilities between countries and the organization. Such a question had never been presented before any tribunal. However, such a challenge has been made recently in the case of Nord Stream 2 v. European Union where the European Union has attempted to evade its responsibility by creating procedural challenges, stating that the Respondent selected by the Claimant is inappropriate and the dispute should have been raised against Germany. While the decision in the matter is not out yet, this case note is an attempt to reflect on the applicable law and to provide a possible solution to the situation.

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In September 2019, Nord Stream 2 initiated an investment arbitration claim against the European Union ("EU") under the Energy Charter Treaty ("ECT"). It alleged that the amendment to the EU Directive 2009/73/EC[1] ("Gas Directive") had adversely affected its investments. This is the first investment arbitration that has been formally initiated against the EU.[2] It raises pertinent questions as to the method of attribution of conduct between the EU and its Member in mixed treaties such as the ECT where both the EU and the EU Member States ("EU Members") are parties.

1. THE COMPLICATED RELATIONSHIP OF THE ARIO AND THE EU

The International Law Commission has drawn up Draft Articles on Attribution of Wrongful Conduct under International Law to International Organizations ("ARIO"). During the drafting of ARIO, it was considered that the rules provided therein may not be sufficient to govern the relationship between the EU and EU Members owing to the *sui generis* nature of EU.[3] Therefore, Article 64 was inserted in ARIO to provide for the rule of *lex specialis*.[4] Article 64 allows for attribution to be governed by special rules of international law. The EU has maintained that the rule of normative control is the *lex specialis* that governs the question of attribution of conduct between the EU and EU Members.[5]

The rule of normative control has two facets: transfer of competences to the EU and the obligation of EU Members to carry out binding decisions and policies adopted by the EU.[6] *First,* the Treaty on the Functioning of EU ("TFEU") provides for exclusive, shared and supporting

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[1] Directive 2009/73/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, *OJEU L 211* (13 July, 2009) *p. 94–136*

[2] Report on *Operation of Regulation (EU) No 912/2014 on the financial responsibility linked to investor-to-state dispute settlement under international agreements to which the European Union is party*, COM(2019) 597 Final: European Commission (19 November, 2019).

[3] Judge G. Gaja, 'Fifth Report on the Responsibility of International Organizations', United Nations Special Rapporteur (2 May 2007) A/CN.4/583, p.4, ¶7.

[4] Judge G. Gaja, 'Seventh Report on the Responsibility of International Organisations', United Nations Special Rapporteur (27 May 2009) A/CN.4/610, p. 39-40.

[5] ILC, Responsibility of International Organisations: Comments and Observations Received from International Organisations (ARIO Comments), Doc. A/CN.4/545, 25 July 2004, p. 29, ¶ 3.

[6] Hoffmeister, 'Litigating against the European Union and Its Member States: Who Responds under the ILC's Draft Articles on International Responsibility of International Organizations?', 21 EJIL (2010) 723, p. 742.

competences of the EU and lists certain subject matters.[7] When the EU frames any law on these subject matters, it binds all EU Members. The areas of energy and environment, which form the basis of the Gas Directive in question in *Nord Stream 2*, fall under Article 4 of the TFEU. Therefore, the EU and EU Members share competences in these areas.

Second, the TFEU provides for methods through which the EU carries out its acts.[8] Regulations, directives and decisions are the methods that have some degree of binding value. Under the TFEU, EU Members are obliged to adopt all measures of national law, necessary to implement legally binding acts of the EU.[9] Further, Article 7 of the Treaty on European Union provides for an enforcement mechanism for these measures and lays out consequences for non-compliance with binding EU law. EU Members, therefore, have no option but to apply and implement binding EU law.

The rule of normative control prescribes that when the EU enacts a law pursuant to its competence which is binding on its Members, it exercises normative control over such conduct, which should be attributed to the EU and not to the EU Members.

1.1 Attribution to EU in investment cases

In the investment context, for the EU to be held liable for actions against investors, the primary requirement is for the EU to be a party to the treaty that guarantees the protection of investors.[10] A majority of such treaties are 'mixed treaties' where EU Members and the EU are all party to the treaty. ECT is a prime example of this. Such treaties make it difficult to determine the question of attribution, especially when the they do not declare the competences of EU Members and the EU. There is also a possibility of joint liability being attributed to both EU Members and the EU.[11]

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[7] Treaty on the Functioning of the European Union ("TFEU"), art. 3, 4 and 6.

[8] TFEU, art. 288.

[9] TFEU, art. 291.

[10] Hoffmeister, 'Litigating against the European Union and Its Member States: Who Responds under the ILC's Draft Articles on International Responsibility of International Organizations?', 21 EJIL (2010) 723, p. 724.

[11] Kuijper, 'International Responsibility for EU Mixed Agreements', in P. Koutrakos and C. Hillion (eds), *Mixed Agreements Revisited (2010)*, 208, p. 210; Case C–239/03, *Commission v. France* [2004] ECR I–9325, ¶¶ 26–30.

The tribunal in *Electrabel v. Hungary* was the first to interpret the rule of normative control in the context of ECT. The alleged violations in this case related to breaches of the ECT owing to the cancellation of Power Purchase Agreements ("PPAs") pursuant to a decision by the EU. The tribunal drew an analogy from Article 6 of Articles on the Responsibility of States for International Wrongful Acts ("ARSIWA") where the conduct of an organ of a state, when placed at the disposal of another state and acting in exercise of elements of the authority of that other state is considered an act of the latter state, at whose disposal such organ is placed.[12] The tribunal found that as the EU is a contracting party to the ECT, Article 6 of ARSIWA, by analogy, can be applied in this case if Hungary was merely implementing the final decision adopted by the EU.[13] The tribunal went on to identify that it was essential to identify what Hungary was mandated to do pursuant to the EU decision.[14] The tribunal concluded that Hungary had no option but to cancel the PPAs and it was the EU that decided the compensation for the same.[15] Consequently, the act could not be attributed to Hungary (even though the tribunal had already dismissed this claim on merits and the parties did not seek to implead the EU as a respondent) since it exercised no discretion.

While in *Electrabel* it was fairly simple to conclude that Hungary did not exercise any discretion in respect of the impugned act, this analysis is not always as direct. There are many EU directives that provide some level of discretion to EU Members during the implementation process.[16] In such cases, it would be difficult for potential claimants to determine the appropriate respondent in investment arbitration proceedings. *Nord Stream 2* is an instance of this complicated scenario.

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[12] *Electrabel S.A. v Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, ¶ 6.74.

[13] *Ibid.*, ¶ 6.76.

[14] *Ibid.*

[15] *Ibid.*, ¶¶ 6.86-6.87.

[16] Directive 2011/83/EU of the European Parliament and of the Council on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, *OJEU L 304 (25 October 2011) p. 64–88*; Directive 95/46/EC of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data, *OJEU L 281 (24 October, 1995) p. 31–50*

2. THE ISSUES OF ATTRIBUTION IN QUESTION IN NORD STREAM 2

As stated above, *Nord Stream 2* involves questions pertaining to the modification of the Gas Directive by the EU. However, the EU has raised a jurisdictional challenge on the ground of lack of *ratione personae* jurisdiction of the tribunal based on two broad bases. *First*, it contends that the measure challenged by the Claimant did not impose any direct obligations on it and the measure was operationalized by Germany and not the EU.[17] *Second*, it contends that Germany had a broad margin of discretion while implementing the measure and therefore this allegedly wrongful conduct must be attributed to Germany.[18]

However, international law principles specifically provide that conduct can be attributed to an international organisation even if the impact of its measure is indirect. This is confirmed by the findings of the tribunal in *Electrabel*, with the relevant test being the presence of 'discretion' with a Member State while implementing an act.[19] The WTO practice also upholds this principle.[20] WTO Panels and the Appellate Body have found that even if certain WTO-inconsistent acts are undertaken by EU Members but pursuant to EU laws that have some binding value and in relation to the subject-matter for which the EU has assumed competence, those acts should be attributed to the EU.[21] This is because EU Members act as *de facto* organs/agents of the EU and therefore any internationally wrongful acts that they undertake are taken only pursuant to mandatory direction by the EU.[22] ARIO also recognizes this principle. It states that the conduct of any agent of an international organisation (which is very broadly defined in ARIO and includes any entity that is charged by an international organisation to carry out any of its functions and through which an international organisation acts) can be attributed to the international organisation. [23] The aggregate result of these authorities is the following: *since EU Members act as agents of the EU while implementing binding directions of the EU, their*

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[17] *Nord Stream 2 AG v. The European Union*, PCA Case No. 2020-07, European Union Submissions on Jurisdiction and Request for Bifurcation, 15 September 2020, ¶ 153.

[18] *Ibid.*, ¶ 156.

[19] *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, 25 November 2015, ¶ 6.76.

[20] The WTO practice is relevant in this context as the WTO Agreement, like the ECT, is a mixed agreement.

[21] European Communities Appellate Body Report, *Selected Customs Matters* (WT/DS315//AB/R), ¶¶ 218-227.

[22] European Communities Panel Report, *Geographic Indications* (WT/DS174/R), ¶ 7.725.

[23] ARIO, art. 6.

conduct can be attributed to the EU if they could exercise no discretion while implementing EU's directions.

Therefore, in relation to the EU's arguments in *Nord Stream 2*, there is no legal basis for insisting on a requirement of EU law having a "direct impact" on the investor for it to be attributable to the EU. As stated, it is sufficient that EU Members, while undertaking any wrongful act, are acting pursuant to mandatorily applicable EU law. The German government, while implementing the Gas Directive, adopted the language of Article 49a of the Gas Directive, verbatim. The Claimant's primary concerns pertain to the cut-off date in Article 49a which prevents it from benefitting from the derogations that are permissible under Article 49a. Since directives of the EU are binding on EU Members as to the result to be achieved through the directive,[24] it is reasonable to argue that the ultimate result sought to be achieved by Article 49a is to prevent projects that were not completed before the cut-off date from being eligible for derogations under Article 49a. Hence, Article 49a of the Gas Directive was binding on Germany and while implementing the same, it was acting as an agent of the EU. Therefore, the fact that the Amendment to the Gas Directive did not have any direct impact on the Claimant is irrelevant and wrongful conduct may still be attributed to the EU. The EU's first argument should, therefore, fail.

As for its second contention pertaining to the existence of discretion with Germany, it is clear that the EU Gas Directive in question is a directive as per Article 288 of the TFEU. Therefore, it is binding as to the result to be achieved and only leaves to the EU Members the discretion as to the choice and form of its implementation to achieve the given objective. Germany exercises no discretion while making a decision on whether the Claimant is eligible for derogations from the Gas Directive since the Claimant's project falls outside the permitted cut-off date. No other provision in Gas Directive makes the Claimant eligible for any such derogations on the basis of the discretion of the German Authorities. The EU's second argument should, therefore, also fail. However, even if the EU is able to prove that other provisions of the Gas Directive accorded some discretion to Germany to pass on certain benefits to the Claimant, the mandatory nature of the cut-off date under Article 49a would still deprive the Claimant of derogations available

[24] TFEU, art. 288.

thereunder, making the EU at least partially liable and, therefore, presenting a possibility of joint liability of Germany and the EU.

3. THE WAY FORWARD

The EU's challenge to the *ratione personae* jurisdiction of the tribunal in *Nord Stream 2* is the first such challenge to have been made on the grounds of attribution. To deal with the questions of attribution, the EU has implemented a regulation ("Financial Responsibility Regulation") to determine the allocation of financial liability in investment cases.[25] It also provides the method of determining the respondent in investment proceedings.[26] The EU can be made respondent in cases where it bears at least a part of the financial responsibility in relation to a dispute under Article 3 of the Regulation.[27] Article 3, *in turn*, provides that the EU bears financial responsibility arising from the treatment afforded by an EU Member where this treatment was required by EU Law.[28] However, it does not clarify what forms of EU Law "require" treatment to be mandatorily accorded by EU Members. Moreover, it does not recognize any possibility of joint liability attribution.

The Financial Responsibility Regulation should be amended to specifically outline what it considers to be EU Law Binding on EU Members. This can be done by specifically recognizing that EU Regulations, Directives and Decisions constitute EU law that is binding on EU Members in varying degrees. Furthermore, the regulation should also be appropriately amended to allow for the possibility of joint attribution to account for situations where the EU issues binding directions to EU Members while also granting certain discretion to them.

Once this Regulation is perfected by the EU, the EU should undertake the exercise of determination of the appropriate respondent in all proceedings once a claimant serves a notice to initiate investment arbitration proceedings. The EU has also issued a statement to this effect

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[25] Regulation establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party, Regulation (EU) No 912/2014 (23 July, 2014) ("Financial Responsibility Regulation").

[26] Financial Responsibility Regulation 2014, art. 9.

[27] Financial Responsibility Regulation 2014, art. 9(2)(a).

[28] Financial Responsibility Regulation 2014, art. 3(1)(c).

under Article 26(3)(b)(ii) of the ECT.[29] This process for the determination of the appropriate respondent by the EU should be regularised in order to minimise any procedural challenges that cause delays, such as the one made by the EU in *Nord Stream 2*.

In any case, it is currently incumbent upon the *Nord Stream 2* tribunal to clarify the principles of attribution of wrongful conduct to the EU which can act as the guiding force for EU lawmakers to amend the Financial Responsibility Regulation and bring it in conformity with the principles of international law. It is argued by the author that the tribunal should base its findings on principle of normative control as it applies to the relationship between the EU and EU Members. The tribunal should conclude that since the matter before it pertains to an EU Directive, which is binding on Germany as to the result to be achieved, and that the eventual impact on the investor in question stems from this end result which cannot be remedied in favour of the investor by Germany's discretion, this conduct should be attributed to the EU.

[29] Statement submitted to the Energy Charter Treaty (ECT) Secretariat pursuant to Article 26(3)(b)(ii) of the ECT replacing the statement made on 17 November 1997 on behalf of the European Communities ST/7830/2019/INIT, *OJEU L 115, (2 May, 2019), p. 1–2*