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Insight

Shrinking investment protection in the EU: can Swiss and other BITS act as a safety net for intra-EU investments?

Authors

Matthias Scherer
Partner
Zurich

Lorette Giacometti
Associate
Zurich

As the EU dismantles its network of investment protection treaties among Member States, we investigate alternative avenues open to investors.

The European Union (EU) is in the process of dismantling the elaborate network of investment protection treaties among EU Member States, and companies and private investors domiciled within the EU engaged in investments across EU Member States (intra-EU investors) will pick up the tab.

Such treaties offered protection against expropriations and other interference by EU Member States, and access to international arbitration. Bilateral investment treaties (BITs) were under the radar but have in recent years allowed EU investors to hold EU states accountable where there is perceived interference with intra-EU investments (e.g., solar energy subsidies in Spain and Italy, and the exit from nuclear energy in Germany).

In this blog, we will take a closer look at developments in the EU and explain how intra-EU investors can ensure they still have access to international justice to protect investments within the EU.

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1. Shrinking protection for intra-EU investors

The EU began dismantling the elaborate network of BITs among EU Member States following a string of rulings from the European Court of Justice (notably *Slovak Republic v Achmea*[1]). It declared intra-EU Investor-State Dispute Settlement (ISDS) proceedings incompatible with the EU's common rights and obligations and also announced its intention to withdraw from the Energy Charter Treaty (ECT). The latter is a plurilateral investment treaty with 53 members, and withdrawal from it would further limit ISDS access for intra-EU investors.[2]

The elimination of the intra-EU BIT framework has a number of serious consequences for EU investors. New arbitration proceedings against EU states are no longer possible and EU courts will set aside arbitral awards if the seat of the arbitration is within their jurisdiction.

The EU Commission has not as yet presented intra-EU investors with a substantial alternative to international arbitration and, in its Communication to the European Parliament, it expressed the view that EU investors do not require additional mechanisms beyond those offered by national and EU law.[3]

EU investors may consider that proceedings in the host State's courts lack the assurance of a level playing field, compared with independent arbitration. Intra-

EU investors concerned by such diminishing protection typically resort to rethinking the channels through which they invest in EU States; rather than investing through an EU Member State in another Member State, they will consider investing through a third State that has concluded an investment protection agreement with the EU host State. Although there are indeed opportunities for restructuring investments, there are also hurdles.

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2. Claims of EU investors against the EU host State

Can EU investors assert claims against the EU host State of the investment via a non-EU third State's BIT?

For example, a German investor that has invested in the Czech Republic could restructure its investment via Switzerland to gain access to the Czech Republic–Switzerland BIT.

But how can the German investor become a "Swiss investor" within the meaning of the treaty and thus enjoy the benefits of the Swiss BIT?

Each BIT defines the term "investor." According to most BITs, qualified investors include:

- nationals of the third State;
- companies of the third State (such companies are often required to have substantial business activities in the third State, i.e., no letterbox companies) [4]; and
- companies in the host State controlled by either a national or company of the third State.

The general principle is therefore that EU investors, as foreign nationals, cannot directly invoke the BIT of a third State for their claims. However, companies of the third State owned by foreign nationals can pursue such claims. The same applies to any company of the host State that is "effectively controlled" by a company of the third State.

This means that a German investor could set up a company in Switzerland and transfer its investments made in the Czech Republic (the invested assets) to this company.[5] In the event of a dispute with the Czech authorities, the German investor could invoke the Czech Republic–Switzerland BIT through its company in Switzerland, which is considered an investor under the Czech Republic–Switzerland BIT, and thus gain access to independent arbitration – despite the lack of a BIT between Germany and the Czech Republic.

There may be several ways to access a BIT; for instance, if an EU company has invested in Croatia, Slovenia, Romania, Estonia, Latvia, Lithuania, Bulgaria, the Czech Republic, Slovakia, Poland or Hungary, it can restructure its investment through Switzerland, as Switzerland has BITs with each of these countries. However, each investment must be analysed on a case-by-case basis to determine which third State (if any) is the most suitable for the restructuring.

Any restructuring must also be timely – concluded before a dispute arises – since many BITs and arbitral tribunals consider that a restructuring done merely a result of a pending dispute is an abuse of law.

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3. Claims of EU investors against their home State

Can EU-investors also have recourse to the third State's treaty for claims against their home State?

For example, a Czech investor that has invested in the Czech Republic could restructure its investment via Switzerland to gain access to the Czech Republic–Switzerland BIT.

But could such a Czech investor really become a “Swiss investor” within the meaning of the treaty by simply restructuring its investment and thus enjoy the benefits of the Czech Republic–Switzerland BIT?

BITs are intended to protect international investors and, as outlined above, the treaties themselves define who is considered an international investor under the treaty.

On this basis, it might seem that the Czech investor could not simply set up a company in Switzerland and thus gain access to the Czech Republic–Switzerland BIT. However, arbitration tribunals do not look at the ultimate beneficiary or the nationality of the management of a company, but rather the “nationality” of the company itself.

The classic case confirming this approach is the *Tokios Tokelés v. Ukraine* case:[6]

- Claimant Tokios Tokelés, a Lithuanian business entity, asserted that Ukrainian governmental authorities violated the obligations of the Ukraine-Lithuania BIT through actions taken against its Ukrainian subsidiary, Taki spravy.
- Ukraine challenged the applicability of the BIT by questioning the foreign status of the investment. They contended that Tokios Tokelés was not a “genuine entity” of Lithuania as it was predominantly owned and controlled by Ukrainian nationals. With ninety-nine per cent ownership and two-thirds of management comprising Ukrainian nationals, Ukraine argued that Tokios Tokelés, in economic substance, was a Ukrainian investor in Lithuania, not a Lithuanian investor in Ukraine.
- Ukraine contended that permitting this claim would essentially enable nationals to initiate international arbitration against their own government. They urged the tribunal to “pierce the corporate veil,” disregarding the company’s state of incorporation and determining its nationality based on the predominant nationality of its shareholders and managers.
- The tribunal, interpreting the BIT provisions based on their ordinary meaning, context and the treaty’s object and purpose, determined that the “only relevant consideration” was whether the company was established under the law of the third State.

Therefore, while investors should take into account the specific wording of the treaty, it can be held that, in principle, the decisive factor for the use of third State BITs is *solely the incorporation of the company* and not the origin of the capital or the nationality of the owners.

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4. Conclusion

The EU’s dismantling of intra-EU BITs and its proposed exit from the Energy Charter Treaty means that intra-EU investors will no longer have access to international arbitration under intra-EU investment protection treaties. While the EU Commission’s believes they will be able to rely on national courts, investors have concerns that these do not offer a level playing field in disputes with the State.

- EU investors with investments in other EU Member States may consider restructuring their investments through a legal entity in a third State.

- In certain circumstances, restructuring is an available option for an intra-EU investor bringing claims against its own EU home State.
- Some intra-EU investors may be able to secure their investments through non-EU States' BITs, such as Switzerland.
- Any restructuring must be done in a timely manner.[7] Most BITs require that the investment has acquired nationality under the BIT before the dispute arises.

A decision to structure and restructure investments will never depend on available investment treaties alone. Such a decision involves a holistic analysis, including tax and corporate law considerations. Focusing exclusively on possible treaty remedies against state interference will rarely be an advisable approach. However, disregarding the possibility of a future dispute with the host State is also inadvisable; given the shrinking levels of protection within the EU and limited access to arbitration, intra-EU investors would be wise to take precautions.

We can scrutinise investment portfolios and provide advice on possible remedies in the event of state interference with investments.

References

[1] *Slovak Republic v. Achmea B.V.*, Case No. C-284/16, Judgment, 6 March 2018, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62016CJ0284>; see also *Republic Poland v. PL Holdings Sàrl*, Case C-109/20, Judgment, 26 October 2021, available at: < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62020CJ0109 >; *Republic of Moldavia v. Komstroy LLC.*, Case No. C-741/19, Judgment, 2 September 2021, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62019CJ0741>.

[2] The Energy Charter Treaty (1994), text available at: < https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2427/download>.

[3] Communication from the Commission to the European Parliament and the Council, Protection of intra-EU investment, 19 July 2018, available at: < https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A52018DC0547 >.

[4] An investor holding shares in a company of a third State may also benefit from the protection of the BIT for its indirect investment in the asset that qualifies as an investment in the host State. This is because most current BITs also protect indirectly-held investments.

[5] But beware: restructuring must take place before disputes are foreseeable.

[6] *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004, available at: < https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/78/tokios-tokel-s-v-ukraine>.

[7] It goes without saying that it must first be assessed whether/what kind of treaty protection exists in respect of the host State of the investment.
