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The Contradictory Overlapping of National, EU, Bilateral, and the Multilateral Rules on Foreign Direct Investment: Who is Guilty of Such a Mess

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Abstract

This intends to be a very empirical Essay. It lets the facts (legal facts, but facts nevertheless) speak for themselves. Part I of this Essay first examines the not granting of national treatment by European Union ("EU")-and EU Member States'-law to companies controlled by third-country nationals or other companies. Part II shows that bilateral investment treaties ("BITs") concluded by EU Member States do grant such national treatment horizontally and without any sectorial exception (contrary to US BITs that do include a list of exceptions, as shown in Part III). Part IV explains why BITs (not only EU Member States' BITs, but all BITs) contradict Article II of the General Agreement on Trade in Services ("GATS"). Part V argues that EU Member States' BITs are contrary to the AETR-ERTA jurisprudence of the Court of Justice of the European Union ("CJ" or "Court") on the distribution of competences between the European Community ("EC" or "Community") and its Member States. Readers will have to assess whether the mess exists (and whether it matters); if they agree that there is a mess, then they can proceed to Part VI, which tries to identify who is to blame for it.

THE CONTRADICTION OVERLAPPING OF
NATIONAL, EU, BILATERAL, AND
MULTILATERAL RULES ON FOREIGN DIRECT
INVESTMENT: WHO IS GUILTY OF SUCH A MESS?

*Ramon Torrent **

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To Jean-Claude Piris, a lucid person

INTRODUCTION

This intends to be a very empirical Essay. It lets the facts (legal facts, but facts nevertheless) speak for themselves. Part I of this Essay first examines the *not granting* of national treatment by European Union (“EU”)—and EU Member States’—law to companies controlled by third-country¹ nationals or other companies. Part II shows that bilateral investment treaties (“BITs”) concluded by EU Member States *do grant* such national treatment horizontally and without any sectorial exception (contrary to US BITs that do include a list of exceptions, as shown in Part III). Part IV explains why BITs (not only EU Member States’ BITs, but all BITs) contradict Article II of the General Agreement on Trade in Services (“GATS”). Part V argues that EU Member States’ BITs are contrary to the *AETR-ERTA* jurisprudence of the Court of Justice of the European Union (“CJ” or “Court”) on the distribution of competences between the European Community (“EC” or “Community”) and its Member States.² Readers will have to assess whether the mess exists (and whether it matters); if they agree that there is a mess, then they can proceed to Part VI, which tries to identify who is to blame for it.

I. *THE EU AND ITS MEMBER STATES DO NOT GRANT HORIZONTAL NATIONAL TREATMENT TO FOREIGN DIRECT INVESTMENTS (“FDIS”) FROM THIRD COUNTRIES*

The laws of the European Union³ and its Member States frequently introduce differences of treatment between Member States’ companies (i.e., incorporated in accordance with the laws of a Member State) depending on whether or not they are controlled by third-country nationals or other companies. The nature of, and the justification for, these differences in treatment

1. In the context of this Essay, “third country” means “non-EU Member State.”

2. See *infra* notes 36–37.

3. The Treaty of Lisbon, which entered into force in December 2009, merged the European Community and the European Union into a single entity: the European Union. From a historical perspective, all references in this Essay should be to the European Community (“EC”).

vary according to the aims pursued by each specific set of legislation. Two paradigmatic examples follow.

Article 9 of the Decision of the European Parliament and Council Concerning the Implementation of a Programme of Support for the European Audiovisual Sector (known as the MEDIA Programme):

Legal and natural persons may be the beneficiaries of the programme. Without prejudice to the agreements and conventions to which the Community is a contracting party, *enterprises which benefit from the programme shall be owned and shall continue to be owned, whether directly or by majority participation, by Member States and/or Member State nationals.*⁴

Article 4 of the Council Regulation on Licensing of Air Carriers:

No undertaking shall be granted an operating licence by a Member State unless:

its principal place of business and, if any, its registered office are located in that Member State; and

its main occupation is air transport in isolation or combined with any other commercial operation of aircraft or repair and maintenance of aircraft.

Without prejudice to agreements and conventions to which the Community is a contracting party, *the undertaking shall be owned and continue to be owned directly or through majority ownership by Member States and/or nationals of Member States. It shall at all times be effectively controlled by such States or such nationals.*⁵

Therefore, a company established in a Member State, but owned, directly or by majority participation or ownership by third-country nationals or companies, receives radically less favorable treatment than companies owned by EU Member States nationals or companies. Other examples of less favorable treatment follow—and none of them are new.

Directive 94/22/EC of the European Parliament and of the Council of May 30, 1994 on the Conditions for Granting and

4. Parliament and Council Decision No. 1718/2006/EC Concerning the Implementation of a Programme of Support for the European Audiovisual Sector (*MEDIA Programme*), art. 9(1), 2006 O.J. L 327/12, at 17 (emphasis added).

5. Council Regulation 2407/92/EEC on Licensing of Air Carriers, art. 4, 1992 O.J. L 240/2, at 2–3 (emphasis added).

Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons: under Article 8(4) of that Directive, a Member State may refuse an authorization, in certain circumstances, "to an entity which is effectively controlled by the third country concerned [pursuant to the preceding paragraphs of the same Article] or by nationals of that third country;"⁶

Council Regulation (EC) 3283/94 of December 22, 1994 on Protection against Dumped Imports from Countries Not Members of the European Community and Council Regulation (EC) 3284/94 of December 22, 1994 on Protection against Subsidized Imports from Countries Not Members of the European Community: by virtue of, respectively, Articles 4 and 6 of those Regulations, in certain circumstances Community producers may be deemed not to be part of "Community industry" if they are controlled, directly or indirectly, by third-country undertakings;⁷

Council Regulation (EEC) 2343/90 of July 24, 1990 on Access of Air Carriers to Scheduled intra Community Air Service Routes and on the Sharing of Passenger Capacity between Air Carriers on Scheduled Air Services between Member States, and Council Regulation (EEC) 294/91 of February 4, 1991 on the Operation of Air Cargo Services between Member States: under Articles 2(e) and 2(b) respectively of those regulations, certain air carriers from Member States do not benefit or benefit in a limited way from the rights granted by these regulations if they do not meet the condition that "the majority of [their] shares [of capital] are and continue to be owned by Member States and/or nationals of Member States and which is and continues to be effectively controlled by such States or persons;"⁸

6. Parliament and Council Directive 94/22/EC on the Conditions for Granting and Using Authorizations for the Prospection, Exploration and Production of Hydrocarbons, art. 8(4), 1994 O.J. L 164/3, at 7.

7. Council Regulation 3283/94 on Protection against Dumped Imports from Countries Not Members of the European Community, art. 4, 1994 O.J. L 349/1, at 8-9; Council Regulation 3284/94 on Protection against Subsidized Imports from Countries Not Members of the European Community, art. 6, 1994 O.J. L 349/22, at 30.

8. Council Regulation 2343/90 on Access of Air Carriers to Scheduled Intra Community Air Service Routes and on the Sharing of Passenger Capacity between Air Carriers on Scheduled Air Services between Member States, art. 2(e), 1990 O.J. L 217/8, at 9; Council Regulation 294/91 on the Operation of Air Cargo Services between Member States, art. 2(e), 1991 O.J. L 36/1, at 2. This restriction applies only to certain air carriers not controlled by Member States or by nationals of Member States: those not

Council Directive 90/435/EEC of July 23, 1990 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States: the purpose of the Directive is to set up more favorable tax rules from which subsidiaries may benefit, provided at least twenty-five percent of their capital is held by a parent company of a Member State, but from which the subsidiaries of a parent company of a third country that do not fulfil that condition may not benefit;⁹

Council Regulation (EEC) 2919/85 of October 17, 1985 Laying Down the Conditions for Access to the Arrangements Under the Revised Convention for the Navigation of the Rhine Relating to Vessels Belonging to the Rhine Navigation: under the implementing regulation annexed thereto, less favorable treatment is granted, in the cases provided for in Article 3, to vessels whose owners are nationals of third countries that are not contracting parties to the Revised Convention for the Navigation of the Rhine.¹⁰

A detailed examination of the different EU Member States' legislation from this perspective exceeds the limits of this Essay, but it is worth highlighting a key detail that is often not addressed. Within the World Trade Organization ("WTO"), the Community and the Member States treat Member State companies differently depending on whether or not they are owned or controlled by third-country nationals or companies.

Indeed, Article XXVIII(k) to (n) of the GATS provides that companies of a Member State, which are owned or controlled by natural or juridical persons of a third country that is a WTO member, are deemed to be third-country companies and not companies of a Community Member State.¹¹ As a result, in the event of a dispute involving a subsidiary of a third-country services company in a Member State of the EU, that subsidiary

covered by the provisions of Articles 2(e)(ii) and 2(b)(ii) respectively of these two regulations.

9. Council Directive 90/435/EEC on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 1977 O.J. L 225/6.

10. Council Regulation 2919/85 Laying Down the Conditions for Access to the Arrangements under the Revised Convention for the Navigation of the Rhine Relating to Vessels Belonging to the Rhine Navigation, art. 3, 1985 O.J. L 280/4, at 4.

11. General Agreement on Trade in Services, Apr. 15, 1994, art. XXVIII(k)-(n), 1869 U.N.T.S. 183, 33 I.L.M. 1125[hereinafter GATS].

will be deemed to be a “foreign” company rather than a company of that Member State. The treatment under the GATS of Member State companies owned or controlled by natural or juridical persons of third countries is warranted and consistent with the general thrust of that agreement; yet, this example is a clear illustration of the basic difference in treatment between Member State companies depending on the sole criterion of ownership or control (by third country or by Member State nationals or companies).

The CJ has had occasion to examine the treatment of Member State companies depending on whether or not they are controlled by third-country nationals or companies for conformity with the Treaty Establishing the European Community, particularly in its binding Opinion 2/92, concerning the extent of and basis for the Community’s powers with respect to the Organisation for Economic Co-operation and Development (“OECD”) Council’s Third Revised Decision Concerning National Treatment.¹² The purpose of that OECD Council Decision is referenced in Opinion 2/92:

In the Revised Declaration, the OECD Member countries, and—in matters falling within its competence—the Community, express the intention to *accord to undertakings operating in their territories which are owned or controlled directly or indirectly by nationals of another Member country, treatment which is no less favourable than that accorded in like situations to domestic undertakings, subject to certain exceptions and derogations*. In the Third Decision, the contracting parties undertake, in particular, to comply with a procedure for notification and examination, within the framework of the OECD, of measures constituting exceptions to national treatment, and any other measures which have a bearing on national treatment.¹³

Neither the parties involved in the proceedings nor the CJ defended, or even mentioned, the argument that rules that

12. Organisation for Economic Co-operation and Development, *Third Revised Decision of the Council Concerning National Treatment*, OECD Doc. C(98)210 FINAL (Nov. 12, 1998), available at <http://acts.oecd.org/Instruments/PrintInstrumentView.aspx?InstrumentID=232&InstrumentPID=227&InstrumentHID=0&Lang=en> (last visited May 28, 2011).

13. Opinion on Competence of the Community or One of Its Institutions to Participate in the Third Revised Decision of the OECD on National Treatment, Opinion 2/92, [1995] E.C.R. I-521, ¶¶ 3–4 (emphasis added).

establish different treatment for Member State companies depending on whether or not they are controlled by third-country nationals or companies might be regarded as in breach of the provisions of the Treaty Establishing the European Economic Community ("EEC Treaty").¹⁴ At no time was the hypothesis that this question might be affected in one way or the other by Article 58 of the EEC Treaty (later Article 48 of the Treaty Establishing the European Community ("EC Treaty") and current Article 54 of the Treaty on the Functioning of the European Union ("TFEU")) either raised or defended.

In its opinion, the Court in no way calls into question the compatibility of such difference in treatment with the EEC Treaty. Quite the contrary: the "treatment to be accorded to foreign-controlled undertakings" or "the conditions for the participation of foreign controlled undertakings in the internal economic life of the Member States in which they operate" were regarded by the Court as open questions that can be and are in practice regulated by national or Community legislation.¹⁵

Thus, it goes without question that, at least in practice, companies constituted under the legislation of the Member States may be treated differently depending on whether or not they are owned or controlled directly or indirectly by third-country nationals or companies. The nature of and basis for any such differences in treatment will depend on the content and purpose the Community or Member States legislators intend to give to each specific piece of legislation.

14. *See id.* EEC Treaty Article 58 states:

Companies constituted in accordance with the law of a Member State and having their registered office, central management or main establishment within the Community shall, for the purpose of applying the provisions of this Chapter, be assimilated to natural persons being nationals of Member States. The term "companies" shall mean companies under civil or commercial law including co-operative companies and other legal persons under public or private law, with the exception of non-profit-making companies.

Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 58, 298 U.N.T.S. 11 [hereinafter EEC Treaty]; Consolidated Version of the Treaty Establishing the European Community art. 48, 2006 O.J. C 321 E/27 [hereinafter EC Treaty]; Consolidated Version of the Treaty on the Functioning of the European Union art. 54, 2010 O.J. C 83/47 [hereinafter TFEU].

15. *See Opinion* 2/92, [1995] E.C.R. I-521, ¶¶ 24, 33.

II. *BILATERAL INVESTMENT TREATIES SIGNED BY EU
MEMBER STATES GRANT HORIZONTAL NATIONAL
TREATMENT TO FDIS FROM THIRD COUNTRIES WITH NO
EXCEPTIONS*¹⁶

For example, Spain has been signing BITs¹⁷ since 1989 with a significant number of countries under the name of “Agreements on Reciprocal Investment Promotion and Protection” (“ARIPPs,” or “APPRI”s in Spanish).¹⁸ In principle, these agreements aim to foster and protect Spanish productive investments overseas. They are mainly concluded with non-OECD countries, with the declared purpose of providing greater legal security for investors, through the establishment of rights and guarantees additional to the ones already envisaged by the domestic legislation of the signatory country. Spanish APPRI”s are nearly identical to those of other EU Member States and completely identical in the point under discussion. As for their content, APPRI”s include rules related to their scope of application, admission and treatment of investments, expropriation, free transfer of payments, and other investment-related funds, as well as state-to-state and investor-to-state dispute settlement mechanisms.

The content of APPRI”s goes well beyond the mere protection and promotion of investment and creates broad

16. This issue, and the resulting incompatibility with EU law, have been raised in *Commission v. Finland*, Case C-118/07, [2009] E.C.R. I____ (delivered Nov. 19, 2009) (not yet reported). But the case addresses only a very minor aspect: the incompatibility with the EC Treaty arising from the incompatibility between the horizontal liberalization of movements of capitals, transfers, and payments granted in some BITs signed by Finland *before its accession to the EU* and *possible future* restrictive measures to be adopted by the Community/Union. *Id.* ¶¶ 2, 19, 25. The Court, nevertheless, does not hesitate to declare the incompatibility. *Id.* ¶ 50.

17. BITs are very interesting from a wider perspective: they accept as a principle that private investors can launch international legal actions against foreign states without even asking for permission from their own governments. What is highly contentious in areas as human rights, for example, seems to be completely innocuous when it is in the interest of investors. For background information on BITs, see generally KENNETH J. VANDEVELDE, *BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION* (2010).

18. The list of Spain’s completed BITs can be found on the website of Spain’s Secretary of State of Foreign Trade. *Acuerdos de Promoción y Protección Recíproca de Inversiones* [Reciprocal Investment Promotion and Protection Agreements], GOBIERNO DE ESPAÑA, <http://www.comercio.mityc.es/comercio/bienvenido/Inversiones+Exteriores/Acuerdos+Internacionales/APPRI/ListaAppris.htm> (last updated Aug. 19, 2010).

obligations regarding the treatment of investments. Not only do they include regulations on fair and equitable treatment and full protection and security, but they also introduce the principles of national treatment ("NT") and most-favored-nation ("MFN") status. Under these principles, foreign investors are to be granted, at least in general terms, the same treatment as the one granted to domestic investors, and the best treatment granted to any other nation. Only two exceptions to these principles are envisioned: privileges that any of the two contracting parties may offer to investors from a third country within the context of a customs union, a free trade area, a common market, or a regional agreement (the "regional integration exception"); or privileges resulting from an international taxation agreement.

The two agreements signed in October 1991 with Argentina and Chile, for instance, envisage the principles of NT and MFN in their Article IV, though with some differences in the language.¹⁹ The two first paragraphs of Article IV of the Spain-Chile agreement of 1991 read:

Each Party shall guarantee in its territory, in accordance with its domestic laws, fair and equitable treatment of the investments made by investors of the other Party, in conditions which are not less favourable than those enjoyed by its national investors.

This treatment shall not be less favourable than that which is extended by each Party to the investments made in its territory by investors of a third country.²⁰

In the agreement with Argentina, the recognition of the NT principle is not included in the first paragraph of Article IV, but in the fifth, in the following terms (the first and the second paragraphs refer, respectively, to fair and equitable treatment

19. Acuerdo Entre La Republica de Chile y El Reino de España Para la Protección y Fomento Recíprocos de Inversiones [Agreement between Chile and Spain on Reciprocal Protection of Investments], Chile-Spain, Oct. 2, 1991, *available at* <http://www.comercio.mityc.es/comercio/bienvenido/Inversiones+Exteriores/Acuerdos+Internacionales/APPRI/ListaAppris.htm> [hereinafter Spain-Chile Agreement of 1991]; Acuerdo Para la Promoción y la Protección Recíproca de Inversiones Entre El Reino de España y La Republica Argentina [Agreement on Reciprocal Protection of Investments between Spain and Argentina], Arg.-Spain, Oct. 3, 1991, *available at* <http://www.comercio.mityc.es/comercio/bienvenido/Inversiones+Exteriores/Acuerdos+Internacionales/APPRI/ListaAppris.htm> [hereinafter Spain-Argentina Agreement of 1991].

20. Spain-Chile Agreement of 1991, *supra* note 19, art. 4(1)-(2).

and to the MFN principle, in terms practically identical to the ones used in the agreement between Spain and Chile): "Notwithstanding the regulations on paragraph 2 of the present article, each party will apply, in accordance with its domestic regulations, to the investments of the investors of the other party, a treatment not less favorable than the one extended to its own investors."²¹

As already pointed out from a general perspective, the agreements with Chile or Argentina foresee only two exceptions to the NT and MFN principles: the regional economic integration exception and the taxation exception. Neither of the two agreements includes a list of exceptions aimed at excluding the application of the NT and MFN principles in certain industrial and economic activities and in that sense, both agreements respond to a standard model.

III. *COMPARISON WITH BILATERAL OR REGIONAL AGREEMENTS IN THE AMERICAS*

BITs concluded by the United States (and Canada) present two essential differences when compared to those concluded by EU Member States. The first is well known: they cover not only post-establishment but also access or first establishment, while those of EU Member States cover only the post-establishment phase. But the second remains surprisingly (or not?) unnoticed: US BITs include a list of sectors carved out from the agreement. This difference can be illustrated by comparing two bilateral investment agreements to which Chile and Argentina are also parties: the US-Argentina and the Canada-Chile BITs.

The US-Argentina BIT of November 14, 1991 devotes its Article II to treatment, establishing standards, exceptions, and other aspects.²² The first paragraph introduces the NT and MFN clauses, but qualifies their application by indicating that both principles are subject to the right of the parties to establish or maintain exceptions in certain sectors of activity, listed in the annexed Protocol. Parts 2 and 3 of the Protocol specify the US exceptions to the NT obligation, and Part 4 enumerates the

21. Spain-Argentina Agreement of 1991, *supra* note 19, art. 4(5).

22. Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., art. 2, Nov. 14, 1991, S. Treaty Doc. No. 103-2 (1993).

exceptions listed by the United States to both the NT and the MFN clauses. Argentina reserves the right to establish or maintain certain exceptions to the NT obligation (Part 5 of the Protocol) as well.

Likewise, the bilateral investment agreement signed by Canada and Chile on December 5, 1996 regulates the commitments on NT and MFN in Chapter G (Articles G-02 and G-03, respectively), but in a more detailed manner than the agreements concluded by Spain.²³ Article G-04 states that each party will grant investors from the counterpart the best treatment required by Articles G-02 and G-03. But what is particularly interesting to the present analysis is the existence of another article, G-08, which governs the reservations and exceptions to the obligations stemming from the above mentioned articles. Article G-08 refers to a series of lists attached as annexes to the agreement. The first three annexes encompass the reservations and exceptions to the NT and MFN clauses: Annex I: Reservations for Existing Measures and Liberalization Commitments; Annex II: Reservations with Respect to Future Measures; and Annex III: Exceptions to the Most-Favored-Nation Treatment.

The content and structure of the Canada-Chile Agreement and, in particular, its regulation of investments, resemble the North American Free Trade Agreement ("NAFTA").²⁴ Part 5 of NAFTA governs aspects related to investments, services and related matters, devoting Chapter XI to investments. This chapter is divided into two sections: Section A refers to investments and Section B refers to dispute settlement between a party and an investor of another party. The issues central to this study are thus governed by Section A; in particular, by Articles 1102 and 1103, which refer to NT and MFN, respectively, and by Article 1108, which refers to reservations and exceptions.

The first and second paragraphs of Article 1108 refer to reservations with respect to measures currently in force and to liberalization commitments. They stipulate that the NT and MFN

23. Canada-Chile Free Trade Agreement, arts. G-02, G-03, Dec. 5, 1996, 36 I.L.M. 1067; *see supra* notes 19–20 and accompanying text.

24. North American Free Trade Agreement, U.S.-Can.-Mex., §§ 101(a)(1)–101(b), Dec. 17, 1992, 107 Stat. 2057, 1992, 32 I.L.M. 289 [hereinafter NAFTA]; *see infra* notes 29–33.

obligations, the performance requirements governed by Article 1106, or the restrictions on senior management and boards of directors referred to in Article 1107, will not apply whenever different inconsistent measures are maintained by different levels of government (with some differences depending on whether the implementing jurisdiction is the federal or local government). As can be inferred from subparagraph (c), such measures cannot be amended to widen the exceptions. The detailed relation of the sectors and activities in which different treatment is feasible is envisaged in the schedules of Annex I (and III in the case of Mexico).

The third paragraph of Article 1108, in turn, enables contracting states to establish new reservations in the future, but only with respect to sectors, subsectors, or activities that were listed in Annex II, the underlying assumption being that the need for new exceptions may arise that were not foreseen at the time the agreement was signed. The limit to this possibility of adopting discriminatory measures for foreign investors in the future is established in the fourth paragraph: under no circumstances may one of the parties request an investor of the other party, by reason of its nationality, to sell or forego in any other way an investment in existence when the measure enters into force.

Besides reservations on current and future measures, the fifth and sixth paragraphs of Article 1108 envisage the exceptions that derive, respectively, from intellectual property rights and other rights established by the treaties or with respect to the sectors listed in Annex IV. Finally, NT and MFN apply neither to purchases made by one party or a state enterprise, nor to subsidies or other contributions (including credits, guarantees, and insurances guaranteed by the government) that they may grant.²⁵

IV. EU MEMBER STATE BITS NOT ONLY CONTRADICT EXISTING NATIONAL AND EU LEGISLATION IN FORCE, BUT ALSO, AS ALL BITS, CONTRADICT ARTICLE II OF THE GATS

As is well known, one of the main novelties of the 1994 WTO agreements is the adoption of the General Agreement on Trade

25. NAFTA, *supra* note 24, art. 1108(7).

in Services, as distinct from the General Agreement on Tariffs and Trade ("GATT") (even though, precisely to disguise this fact, a very similar English acronym, GATS, was given in order to give the impression that this was the GATT for services.) This is the way it was understood in 1994 and 1995, and it is still often understood now.

The scope of application of the GATS is determined by the "four modes of supply of services" defined in Article I:

For the purposes of this Agreement, trade in services is defined as the supply of a service:

- (a) From the territory of one Member into the territory of any other Member ("cross-border supply");
- (b) In the territory of one Member to the service consumer of any other Member ("consumption abroad");
- (c) By a service supplier of one Member, through commercial presence in the territory of any other Member ("commercial presence");
- (d) By a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member ("movement of physical persons").²⁶

These four modes of supply are completely heterogeneous. (1) The fourth mode, "movement of physical persons," is not a specific mode of supply, but rather a particular aspect of the other three modes.²⁷ As it was separated as a different mode, restrictive measures concerning this aspect can also be put together and separated without polluting liberalization in the remaining three modes. (2) The first and second modes refer to "international exchanges of services" as they have always been defined by the balance of payments: the demand comes from the importing country, the supply comes from the exporting country.²⁸ (3) The third mode, however, is only a fallacious way of re-baptizing FDIs in the services sector. The supply of the service is internal to the host country that receives the FDI and

26. GATS, *supra* note 11, art. 1.

27. The reader should try to construe an example of the fourth mode not involving one of the other three. He or she will not be able to do it.

28. See Ramon Torrent & Martin Molinuevo, *Keeping Multilateralism and Development in Mind: Proposals for a New Model of North-South Agreements*, in MULTILATERALISM AND REGIONALISM: THE NEW INTERFACE 79, 89 (Mina Mashayekhi & Taisuke Ito eds., 2005).

there is no need to face a foreign demand; it can be totally directed to the internal demand.

Therefore, the first and the second modes on the one hand, and the third mode on the other hand, originate problems completely different from the legal, economic, and political perspectives. From a legal perspective, the third mode raises very complicated questions that are not raised by the first and second modes: questions related to the post-establishment legal regime of national firms under foreign control. This is the reason why the GATS acquires some sort of universality in its scope: it covers absolutely all the aspects of national legislation insofar as they apply to firms under foreign control.

From a political perspective, the possible problem of foreign control over the national economy is much more acute for the third mode than for the first and second modes. In fact, this is the main problem (or problem perceived as such) that underlies the restrictions about access or national treatment relative to this mode.

The GATT and the GATS are agreements completely different with respect to their scope of application. This is a fundamental reality that is not sufficiently emphasized. The GATT looks at the product, whereas the GATS looks not only at the product, but also (and mainly) at the producer. As a consequence, as has already been noted in Part I, the GATS is compelled to define the nationality of a firm, not in terms of the place of establishment where its operations are made and whose legislation is applied, but in terms of the nationality of the physical or legal persons that control it. For example, for the GATS, Telefónica of Argentina is not an Argentinean legal/juridical person, but a Spanish legal/juridical person (due to the commercial presence in Argentina of Spain's Telefónica).²⁹ Even if it is surprising at first sight, this is effectively the result of the definitions of Article XXVIII of the agreement:

“[J]uridical person of another Member” means a juridical person which is either: (i) constituted or otherwise organized under the law of that other Member, and is engaged in substantive business operations in the territory of that

29. It is to be noted that, with this approach, the GATS departs from the well-known jurisprudence of the International Court of Justice in *Barcelona Traction, Light and Power Co.*, (Belg. v. Spain), Judgment, 1970 I.C.J. 3 (Feb. 5).

Member or any other Member; or (ii) *in the case of the supply of a service through commercial presence, owned or controlled by: 1. natural persons of that Member; or 2. juridical persons of that other Member identified under subparagraph (i).*³⁰

This is not the context to discuss in detail whether the introduction of the notion of “trade in services” made by the GATS has had poisonous effects over transparency and conceptual clarity of the international legal framework of the world economy. It suffices to point out, first, that it has created a multilateral legal framework for foreign direct investment that is different depending on whether the investments relate to the provision of services (covered by the GATS) or the production of goods (not covered by any multilateral agreement), an approach that does not make any economic sense (above all when goods-producing firms are increasingly diversifying toward the provision of services), and, second, that it has given an alibi for not developing an acceptable multilateral regime on FDI in all sectors.

What does matter here is that the GATS has added an additional element of contradiction to the multilateral and bilateral international agreements, mainly those on investment. Indeed, Article II of the GATS creates a horizontal obligation to grant MFN treatment to services and service providers from any other WTO member:

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.
2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions³¹

The horizontal obligation established by Article II.1 applies to FDI in the services sectors (re-baptized as “commercial presence” or “mode 3” by the GATS Article I). Therefore, it is clear that BITs, which also cover horizontal FDI in the service sectors, violate that provision, unless they are included in the

30. GATS, *supra* note 11, art. XXVIII (emphasis added).

31. *Id.* art. II.

corresponding list of exceptions envisaged by Article II.2, or unless they are considered an agreement of “Economic Integration” covered by the exception on economic integration of the GATS Article V, a consideration that makes absolutely no sense taking into account BITs’ very limited scope and goals.

It is sometimes argued that this interpretation of the GATS Article II is incorrect because it was agreed during the Uruguay Round of negotiations that BITs remained outside the scope of the GATS. This argument does not hold. First, no negotiating history is able to deprive a provision of what it clearly and unambiguously states. Second, the argument is factually wrong, and the best evidence for it lies in the fact that the BITs signed by some WTO members appear, in whole or part, in their respective lists of exceptions. This proves that they were very conscious that BITs were not kept outside the scope of the GATS.

To this author’s knowledge, this contradiction between the GATS and BITs was analyzed in writing for the first time in 2003 in a pioneering article by Marina Solé, published in the *Revista Brasileira de Comércio Exterior* [Brazilian Journal of International Trade].³² The argument was also developed in another pioneering work: the 2003–2006 International Relations Master’s thesis of Martin Molinuevo.³³ This Essay’s author also raised the issue in 2006 at the tenth World Trade Forum organized by the World Trade Institute in Bern. As a result of the discussion in Bern, the WTO Secretariat conducted research, the result of which can be found in Adlung and Molinuevo’s 2008 paper “Bilateralism in Services Trade: Is There Fire behind the (BIT-) Smoke?”³⁴ In the meantime, Pedro da Motta Veiga had also raised the issue in 2007.³⁵

32. Marina Solé, *Regulação no âmbito nacional, bilateral, regional e multilateral. Por que tanta confusão?* [Regulation at the National, Bilateral, Regional and Multilateral Levels. Why the Confusion?], *REVISTA BRASILEIRA DE COMÉRCIO EXTERIOR*, Jan.–Mar. 2003, at 28.

33. Martin Molinuevo, *WTO Disciplines on Foreign Investment, Wasn’t the GATS about Trade in Services?* (2002–2003) (unpublished MA thesis, University of Bologna) (available at <http://phase1.nccr-trade.org/images/stories/publications/Molinuevo.Tesis%20UniBo.Wasnt%20the%20GATS%20about%20trade.pdf>).

34. Rudolf Adlung & Martín Molinuevo, *Bilateralism in Services Trade: Is There Fire Behind the (BIT-)Smoke?*, 11 J. INT’L ECON. L. 2 (2008).

35. Pedro da Motta Veiga, *The International Regime on Investments: A Problematic Status Quo, an Uncertain Future*, International Seminar: The New Agenda for International Trade Relations as the DOHA Round Draws to an End, Barcelona,

As Adlung and Molinuevo's paper is written from the WTO perspective, the presentation is different: instead of concluding that BITs violate Article II of the GATS, it concludes that Article II of the GATS "dissolves" all BITs because they have to be "multilateralized" in application of it. Whatever the presentation, the facts are clear: BITs and the GATS overlap contradictorily.

V. THE BITS OF EU MEMBER STATES VIOLATE THE AETR-ERTA JURISPRUDENCE ON THE DISTRIBUTION OF COMPETENCES BETWEEN THE EU AND ITS MEMBER STATES

The CJ's well established *AETR-ERTA* jurisprudence³⁶ holds that the *internal* exercise of a *non-exclusive* Community competence gives birth to an *external exclusive* competence of the Community in order to undertake international obligations whose scope overlaps with that of the existing internal rules.³⁷ The series of *Open Skies* judgments of the Court of Justice make the meaning of the *AETR-ERTA* jurisprudence absolutely clear.³⁸ The scopes of internal Community and international rules (in the sense of legal relations covered by each of them) must be carefully compared. If they overlap (but only to the exact extent in which specific provisions of the international agreement and of internal pieces of legislation do overlap),³⁹ the Community has

Spain, Jan. 29–30, 2005, available at http://www.iadb.org/intal/aplicaciones/uploads/ponencias/Foro_AUSPINTAL_2007_01_01_MOTTA_VEIGA.pdf.

36. *Commission v. Council (AETR-ERTA)*, Case 22/70, [1971] E.C.R. 263.

37. The meaning of the *AETR-ERTA* jurisprudence is examined in RAMON TORRENT, *DERECHO Y PRÁCTICA DE LAS RELACIONES ECONÓMICAS EXTERIORES DE LA UNIÓN EUROPEA* [LAW AND PRACTICE OF EXTERNAL ECONOMIC RELATIONS IN THE EUROPEAN UNION] (1998). The arguments presented are those developed during the 1990s by the Legal Service of the Council of the European Union. They coincide exactly with those developed by the Court in the *Open Skies* jurisprudence.

38. See *Commission v. United Kingdom*, Case C-466/98, [2002] E.C.R. I-9427; *Commission v. Denmark*, Case C-467/98, [2002] E.C.R. I-9519; *Commission v. Sweden*, Case C-468/98, [2002] E.C.R. I-9575; *Commission v. Finland*, Case C-469/98, [2002] E.C.R. I-9627; *Commission v. Belgium*, Case C-471/98, [2002] E.C.R. I-9681; *Commission v. Luxembourg*, Case C-472/98, [2002] E.C.R. I-9741; *Commission v. Austria*, Case C-475/98, [2002] E.C.R. I-9797; *Commission v. Germany*, Case C-476/98, [2002] E.C.R. I-9855; see also Court of Justice Press Release, 89/02 (Nov. 5, 2002), available at <http://curia.europa.eu/en/actu/communiques/cp02/aff/cp0289en.htm>.

39. I.e., the *AETR-ERTA* effect must be analyzed "provision by provision" and not merely by considering whether the general subject matter of the international agreement and the internal piece of legislation overlap.

acquired an exclusive external competence and the Member States have lost theirs.

But there is no doubt that the Community has largely exercised (and for a very long time) its nonexclusive internal competence in areas of post-establishment covered by the horizontal provisions on fair and equitable treatment, national treatment, and most-favored-nation treatment included in the BITs of Member States. These internal Community rules are not carved out from the BITs. Therefore, only one conclusion is possible: in accordance with the *AETR-ERTA* jurisprudence, the EU Member States do not have, and have not had for a rather long time, the competence to sign horizontal agreements on post-establishment that, because of their horizontality, cover areas also internally covered by Community rules.

VI. *WHO IS GUILTY OF SUCH A MESS?*

A. *The First Culprit: Ideology*

In this author's opinion (and professional experience while working in the Legal Service of the Council), the first main culprit of such a mess, and in particular, the explanation of why no list of exceptions is included in EU Member States' BITs, is a purely ideological interpretation of Article 58 of the EEC Treaty (later Article 48 of the EC Treaty, and current Article 54 of the TFEU), became dogma. The article says:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.⁴⁰

This provision was construed as creating an absolute obligation of national treatment toward FDI in EU Member States. It is very easy to see, simply by reading the provision, that it says nothing of the sort. The provision is not easy to understand because treating companies "in the same way as natural persons" is senseless, precisely because companies and natural persons are of a completely different nature. But the

40. TFEU, *supra* note 14, art. 54, 2010 O.J. C 83, at 69.

provision makes sense when its historical context is taken into account. During the negotiations of the Treaty of Rome in 1956, one of the greatest achievements was the agreement to grant horizontal national treatment to natural persons from one Member State established in another Member State. Once this was achieved, the question arose as to whether this national-treatment obligation also applied when the natural persons operated through companies that they owned and controlled. And this was also achieved in Article 58 of the Treaty of Rome.

However, all the discussions concerned *nationals of Member States* and companies controlled by them! At no point did the idea come about to extend to *nationals from third-countries* (or companies controlled by them) this national-treatment obligation. One must remember in this respect that, as the Court has repeatedly recognized, the chapter on right of establishment, which contains the provision, is introverted and looks only to relations and operations *between Member States*, unless some rule applicable to operations with third countries is enacted *through secondary law*.

But that groundless interpretation served very well two ideological objectives: the first, that of transforming the EEC Treaty into a powerful instrument of external economic relations liberalization in favor of third-country capitals and companies; and the second, that of creating an additional restriction for Member States' policies, an objective that, for some defenders of European integration, constitutes an end in itself (more important, even, than that of developing EC policies).

In 1996, an opinion of the Legal Service of the Council on "Provisions of the EC Treaty applicable to investment from third countries" demolished the dogma, both on empirical and on analytical grounds.⁴¹ The opinion had an enormous diffusion and repercussion, not only in Brussels, but also in Washington, where it was immediately known, as well as in Paris, where the negotiations of the OECD Multilateral Agreement on Investment were going on, and in Geneva, where the negotiations on Basic Telecoms after the Uruguay Round were also well advanced.

The opinion prompted a profound discussion within the Legal Service of the European Commission. Led by its Director

41. Council, Opinion of the Legal Service on the Provisions of the EC Treaty Applicable to Investment from Third Countries, 6393/96 Ext. 1, JUR 106.

General, the Commission's Legal Service came about with a full reinterpretation of the dogma, which maintained its restrictive effects toward Member States' ability to maneuver when adopting economic policies, but liberated the Community from them. According to it, Article 48 EC Treaty created for Member States an obligation of granting national treatment to companies owned or controlled by third-country nationals or companies, but this obligation did not apply to the European Community when enacting secondary legislation.⁴² For years this interpretation remained quite hidden in the Commission's inner-most circles, but it finally came to the fore on September 22, 2003 in a so-called "Understanding Concerning Certain U.S. Bilateral Investment Treaties, signed by the U.S., the European Commission and acceding and candidate countries for accession to the European Union," negotiated in the framework of the OECD.⁴³ Its Annex G is an "Explanation Provided by the European Commission concerning the Scope and Operation of Article 48 of the EC Treaty," which, in rather cumbersome language, states the reinterpretation of the dogma. The only absolutely clear sentence is at the end:

Article 48 does not prevent the EC legislator *to provide for different treatment of third country companies and firms according to their ownership* in the pursuit of a common policy or when adopting measures under specific treaty provisions (e.g., Article 57.2 EC). The *provision would however not allow the EC legislator to authorise individual Member States to adopt measures which are not consistent with that Article.*⁴⁴

The reader should not waste much time trying to discover the legal basis for such an extraordinary interpretation of Article 48. There is none. The only possible analysis of the interpretation is the just-summarized historical one.⁴⁵

42. *Id.*

43. Understanding Concerning Certain U.S. Bilateral Investment Treaties, signed by the U.S., the European Commission, and Acceding and Candidate Countries for Accession to the European Union, Sept. 22, 2003, *available at* <http://www.state.gov/s/l/2003/44366.htm>.

44. *Id.* annex G (emphasis added).

45. See Ramon Torrent, *Derecho comunitario e Inversiones extranjeras directas: Libre circulación de capitales vs. Regulación no discriminatoria del establecimiento. De la golden share a los nuevos open skies* [European Community Law and Foreign Direct Investments: Free Circulation of Capitals vs. Non Discriminatory Regulation of Establishment: From the Golden

B. *The Second Culprit: Professional Practices*

Ideology is not the only culprit. All the facts analyzed in this Essay are very old and very easy to discover. Some of them have already been discussed in writing and, in any case, are undoubtedly important. How and why did—and do—they come as a surprise to even highly informed interlocutors? And why, after the surprise, did—and do—they fall into oblivion with such vertiginous rapidity? How is it possible that EU Member States have for years signed and implemented (and continue to do so) BITs that they systematically violate (in application of Community/EU law!)? How is it possible that officials, politicians, and experts in developing countries (and plenty of NGOs and institutes in developed countries), many of whom militate against BITs, have not raised the issues discussed in this Essay?

The answers to these questions fall much more within the realm of sociology and political science than within that of an essay in a law journal. However, there is a legal practice that underlies the answers to these questions: that of “copying and pasting” international agreements and parts of them. This practice, whose negative consequences do not need to be emphasized, has much more explanatory power than other well established explanations of the similarities in BITs, such as the collective action problems that developing countries would supposedly face as a result of their intense competition for the attraction of foreign investment. According to this view, developing countries would be trapped in a “prisoner’s dilemma” that would drag them into costly bidding wars in which they would progressively increase concession proposals offered to potential investors.⁴⁶ This author has discussed elsewhere⁴⁷ why

Share to the New Open Skies Agreements], 22 REVISTA ESPAÑOLA DE DERECHO EUROPEO 283 (2007) (Spain).

46. See, e.g., Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639, 669–74 (1997); CHARLES OMAN, OCED, DEVELOPMENT CENTRE STUDIES: POLICY COMPETITION FOR FOREIGN DIRECT INVESTMENT: A STUDY OF COMPETITION AMONG GOVERNMENTS TO ATTRACT FDI (1999), available at <http://www.oecd.org/dataoecd/25/28/35275189.pdf>.

47. See Ramon Torrent & Federico Lavopa, *Strengthening Enforcement of Core Labor Rights: Can a New Investment Agreement Model Help Multinational Corporations Be More Socially Responsible?*, in CORPORATE SOCIAL RESPONSIBILITY IN LATIN AMERICA: A COLLECTION OF RESEARCH PAPERS FROM THE UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT VIRTUAL INSTITUTE NETWORK (2010), available at

seemingly sophisticated collective-action explanations should possibly be abandoned in favor of much more realistic explanations based in the invisible inertial power exerted by the repetitive utilization of authentic templates or models of international investment agreements (and other agreements). These templates have appeared within a certain context, partly as the product of improvisation, and have remained in place long afterwards.

This resilience should not be surprising. Even leaving aside the well-known temptation of copying in order not to assume the risky and time- and effort-consuming responsibility of thinking, once the exhausting task of reaching an agreement on a text between the numerous national and subnational agencies involved in the design of one of these agreements has been accomplished, there are strong incentives to use this text as a model for subsequent negotiations. This is especially true in the case of investment treaties, which generally envisage a most-favored-nation clause. A country has little motivation to customize agreements containing such a clause, since it automatically extends to its counterpart a treatment equal to the one provided for in the most favorable clause of all the agreements it has signed.

CONCLUSION

National and, in particular, EU regional rules clearly violate bilateral international agreements concluded by EU Member States. Bilateral agreements concluded not only by EU Member States but also by other developed countries, beginning with the US and Canada, clearly violate the only multilateral agreement overlapping with them: the GATS. And all this in an area so important as foreign direct investment. The ones who behave like this internationally are not small developing countries but the big players with very powerful technocracies (in the public and the private sectors as well as in the academia).

This should not come as a surprise after having discovered that these very same actors were not aware that an enormous financial crisis was looming in the mid-2000s. But it should lead

everyone to a deep revision of existing approaches (in policy as well as in academia). If the revision does not take place, the world (and mankind) will continue to lack the necessary legal, institutional, and political means to govern economic globalization in a reasonable manner.