ECJ: Clarification on competences regarding Free Trade Agreements

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The failure of the Doha Round and other multilateral efforts to liberalise trade has led to international trade policy occurring mainly on a bilateral level. The EU in particular has followed an active commercial policy in recent years. The aim of the resulting so-called "new generation" Free Trade Agreements is not only to facilitate cross-border trade of products, but also to develop international supply chains, to create mechanisms for the implementation and the enforcement of the law and to open the market as a whole. Hence, Free Trade Agreements include a wide range of regulations, which go beyond classic regulations to reduce tariff and non-tariff trade barriers.

The comprehensive regulatory content of bilateral trade agreements raises the question: does the EU have the competence to conclude such trade agreements? This question was the subject of the request for an opinion by the European Commission before the Court of Justice of the European Union (CJEU). The proceeding concerned the Free Trade Agreement with Singapore. The court published its highly anticipated opinion on 16 May 2017 (C-2/15 – *the Opinion*).

Content of the opinion

In the Opinion of 16 May 2017, the CJEU found that, pursuant to a general principle and on a first step, Member States have the competence to conclude international treaties and to legislate. Exceptions exist, on a second step, where the treaties give competences to the EU. Thus, the EU needs either an exclusive or a shared competence in order to be able to conclude the Free Trade Agreement with Singapore. If the competence is shared with the Member States, each Member State will also have to consent to the agreement.

On that basis, the CJEU elaborated that, according to the Treaty on the Functioning of the European Union (TFEU), the competence for the common commercial policy exclusively lies with the EU (Art. 3 sec. 1 lit. e TFEU). However, against the background of the extended content of "new generation" Free Trade Agreements, this cannot include every provision that has an effect on trade. Rather, trade has to be promoted, facilitated, or regulated, by having an immediate and direct effect upon it (Opinion, para. 36). Whether the agreement promotes, facilitates, or regulates trade has to be reviewed for every regulation separately.

According to the CJEU, most provisions – even of a comprehensive Free Trade Agreement – meet these conditions. This specifically includes the trade of goods, trade and investments concerning renewable energy, trade-specific aspects of intellectual property as well as questions related to competition law, trade in services and public procurement.

There are, however, exceptions for two areas of the Free Trade Agreement:

Portfolio investments

Art. 207 sec. 1 TFEU, which substantiates Art. 3 sec. 1 lit. e TFEU and the meaning of commercial policy, only mentions “foreign direct investments” as being part of the EU’s commercial policy. The CJEU concluded that Art. 207 sec. 1 TFEU does not apply to all investments that are not foreign direct investments. In particular, this includes portfolio investments. The main difference between portfolio investments and direct investments is that direct investments entail the possibility to participate in the management or to exercise control over the invested company (Opinion, para. 84). Participating in the management or exercising control over a company influences trade. Thus, there is a link between direct investments and the EU’s common commercial policy. According to the CJEU, this is not the case with portfolio investments, which is why the EU does not possess exclusive competence to conclude Free Trade Agreements that regulate portfolio investments. However, portfolio investments facilitate the free movement of capital, which is a goal of the EU. As a result, the EU and the Member States share a competence for portfolio investments (Opinion, para. 239 et seq.).

Dispute Resolution

The competence of the EU to enter into international commitments includes the competence to couple those commitments with institutional provisions regarding the implementation and enforcement of the Free Trade Agreement. Those provisions are of an ancillary nature and therefore fall within the same competence as the substantive provisions which they accompany (Opinion, para. 276).

Pursuant to the dispute resolution clause in the EU-Singapore Free Trade Agreement, investors could not only bring legal action against the EU but also initiate arbitration proceedings against its Member States. Therefore, the Member States agreed to the future submission of claims to arbitration (Opinion, para. 275).

The CJEU thus concluded that provisions on dispute resolution are not merely of an ancillary nature. This is because, pursuant to the Free Trade Agreement, Member States would stand to lose jurisdiction if the EU consented to the initiation of arbitration proceedings. According to the CJEU, such interference into the place of jurisdiction is not of an ancillary nature (Opinion, para. 292). Due to the lack of an express regulation concerning the competences, the EU does not have exclusive competence but shared competence.

As far as there is a dispute between the parties of the agreement i.e. between the EU and Singapore, such problems do not arise. There is no interference into the place of jurisdiction, which is why one can talk of the provisions concerning dispute resolution being of an ancillary nature (Opinion, para. 303).

Impact of the Opinion

Although the controversial provisions concerning the dispute resolution between Member States and investors require the Member States' unanimous consent, the Opinion clarifies that Member States do not have a "veto" power concerning the most important provisions.

The consequence for the EU is therefore that it has to assess whether current Free Trade Agreements include provisions that, according to the Opinion, require consent by the Member States' parliaments. The EU will most likely observe the Opinion in current negotiations, especially with Japan, Vietnam, Mexico and the Mercosur-States. Those Free Trade Agreements will therefore probably only include provisions that fall within the exclusive competence of the EU. It is also possible that these agreements will be divided into two parts. The part that includes regulations for which the EU only has a shared competence would then require consent by the Member States.

BLOMSTEIN lawyers Roland M. Stein and Florian Wolf have discussed the impact of the Opinion on the EU's common commercial strategy in an article published in, *Journal for Tariffs and Excise Taxes* (Stein/Wolf, *Zeitschrift für Zölle und Verbrauchsteuern* 2017, p. 135). They point out that the EU's trade partners could be reluctant to negotiate Free Trade Agreements, which need to be divided into two parts, due to EU-internal competences. They argue, furthermore, that a coherent common commercial policy would not be possible if the consent of each national parliament to trade agreements was always required. They therefore conclude that the CJEU has struck the right balance between national sovereignty and the effectiveness of the common commercial policy.

BLOMSTEIN will follow up on the development in the area of the common commercial policy of the EU and will report on the main developments regarding Free Trade Agreements and other issues related to trade. If you have questions regarding the potential impacts on your company or sector, Roland M. Stein and Florian Wolf will be happy to answer your questions at any time.