Back to the Future: Ferenc Mádl, The Law of the European Economic Community (1974)

Investment Protection Then and Now

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Abstract

The first part of the article (Sections 1-2) reviews Prof. Ferenc Mádl's magnum opus, published in 1974, emphasizing the importance of the monograph's publication in the communist era. It discusses the unique structure of the volume, which, from the perspective of undertakings and companies, examined the fundamental economic freedoms and EEC competition law in parallel. The second part (Sections 3-5) highlights the issue of investment protection, noting that Mádl's early academic theorem has been vindicated decades later by the case-law of the CJEU, in particular in its SEGRO and Horváth judgment: Provisions ensuring free movement of capital serve to protect foreign investments as well.

Keywords: Ferenc Mádl, investment protection, SEGRO and Horváth, Achmea, BIT.

1. A Monograph on EEC Law – Why and to What End?

In 1974, a major monograph was published on the law of the European Economic Community (EEC).[1] This wouldn't have been all that surprising, had it not been for the book to have been published in Hungary under the Soviet bloc. At that time there were no official ties between the EEC and the Eastern European communist countries, which were trying to build and develop a completely different economic organization in the Soviet hemisphere, known as Comecon.[2]

According to its subtitle, Prof. Mádl's book was devoted to undertakings, economic competition and the role of the state in the process of economic integration. This reflects the unique structure of the monograph (spanning the major aspects of regulating enterprise): on the one hand, the cross-border

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1 Ferenc Mádl, *Az Európai Gazdasági Közösség joga*, Akadémiai, Budapest, 1974. The revised English translation of the book was published a few years later: Ferenc Mádl, *The Law of the European Community*, Akadémiai, Budapest, 1978. All the notes refer to the original, Hungarian edition published in 1974, if not indicated otherwise.

2 Council for Mutual Economic Assistance (CMEA), established in January 1949 to facilitate and coordinate the economic development of the eastern European countries belonging to the Soviet bloc.

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activities of companies under the umbrella of the right to establishment, free movement of capital and protection of foreign investments; and measures having the aim of supporting effective competition within European integration, on the other. Actually, these twin pillars represent two sides of the same coin: the aspects of facilitation and control in the economic law.[3]

Mádl's work offers us a real journey into the past and into the future in many aspects. It is a dig into the past, because it takes us back to an early stage of the EEC, where we can still witness the ongoing formation of the institutions, the legal system and the basic principles of integration. Just like when the Sun begins to radiate in a nascent solar system, the orbits of the planets take shape, and the nebula disappears. The founding fathers of the Communities, Jean Monnet and Walter Hallstein, were still alive or had just passed away, but their thoughts and legacy had a strong impact, which often appear in the book.

"Fabula de te narrator", the tale is also about us, the author wished to write in the introduction to the volume, but censorship struck out this eloquent phrase. Some years later, in the revised English translation of the volume, Ferenc Mádl had the chance to explain his enthusiasm for the subject.

> "Socialist jurisprudence cannot ignore the fact that in one half of Europe – of absolutely vital interest to us – a new system of norms has come into being, a legal system that calls itself European Law or Community law. We cannot ignore the fact that this system has begun to function; that its organizational, legal and procedural institutions have begun to operate […]."[4]

When the volume was published, a professor from West Germany asked why the author had dealt with such a "completely irrelevant topic" in a communist country. Yet history has proved that the subject was far from being irrelevant or uninteresting. Fifteen years after the monograph was first published, the Soviet systems collapsed in Central and Eastern Europe. By then, a new generation of Hungarian lawyers had the opportunity to learn about the law of the EEC by studying the volume. *The monograph actually sketched the possible future*. Twenty years later, Hungary submitted its application to join the EU. Thirty years later, in 2004, Hungary became a part of integration. By that time, *Ferenc Mádl, as the President of the Republic of Hungary, had authorized the Act of Accession*.

3 The monograph included the following chapters: I. Introduction; II. Forces of production, economic situation […]; III. Enterprises and economic competition in the pragmatic economic policy of the EEC (premises in principles); IV. General features of the EEC legal system as a structure of economic integration: European Community law and its sources; V. Enterprise in the integration – harmonization of company law; VI. The movement of capital and investments in the integration through the channels of general and EEC Regulation; VII. Economic competition in the integration by an integrated legal structure; VIII. International cartels and monopolies; IX. The state in the economy – public enterprises and economic competition; X. The state in the economy *versus* state immunity; XI. General critical synthesis on the function and institutions of Community Law.

4 Mádl 1978 (English edition), pp. 9-10.

There is a great temptation for the reader to continue this mental time travel. Examine the state of the legal institutions presented in the early 1970s, compared to the present situation. This is all the easier because the author chose the most sensitive issues of European economic law with a very sharp eye. The right to establishment and the recognition of foreign companies, the European Company (*Societas Europae*) in *statu nascendi* and its future, the free flow of capital and protection of foreign investments in the EEC, competition law, its instruments and the growing role of the CJEU. Of course, if we wanted to show for each legal institution what had happened in the nearly five decades since the book's publication, we would have to write another major monograph.

2. Free Movement of Capital and the Protection of Foreign Investments

That is why we are now tackling only one issue, the free movement of capital and the protection of foreign investment. Ferenc Mádl rightly referred to the "tact of the legal system" of the Common Market,[5] *i.e.* the fact that the Treaty of Rome (EEC Treaty) did not address the substantive legal protection of foreign investments against expropriation and nationalization of property. This silence is particularly evident when compared with the comprehensive system of protection offered by bilateral investment protection treaties (BITs).[6] Referring to developments that had taken place since, we can add that this difference still exists today, not only with regard to BITs, but also with regard to the founding treaties of the North American Free Trade Area, the NAFTA and the USMCA, which is currently in force.

However, already in 1974, Mádl's monograph noted that although the EEC had not adopted an instrument specifically protecting the investments of natural and legal persons of a Member State against expropriation in another Member State, the very essence of legislation governing undertakings was that freedom of investment must be protected from all discriminatory practices. These include the relevant parts of the Treaty of Rome as main legal bases, *i.e.* Articles 52 to 58 on the establishment of undertakings, Articles 67 to 73 on the free movement of capital (investments), and Articles 132 and 220 on the conditions for non-discriminatory market access for undertakings. In Mádl's view, these provisions, read together, essentially ensured investment protection in a positive sense. This assumption was bold. At the time, the liberalization of capital movements took place step by step and proceeded only very slowly. Any attempt at investment protection presupposed, at the very least, a broad interpretation of the very cautiously worded provisions of the Treaty of Rome.

5 Mádl 1974, pp. 176-178.
6 Id. pp. 171-175.

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3. The Proof of the Pudding – the SEGRO and Horváth Case

The practical test of this proposition took place several decades later, in a preliminary ruling procedure launched in a Hungarian case, *SEGRO and Horváth*.[7] According to the key provision Article 63 TFEU, all restrictions on the movement of capital between Member States, and between Member States and third countries is prohibited. In Hungary, *the protection of domestic ownership of arable land was a strong priority*. After accession, restrictions were upheld for seven years,[8] which was later extended for another three-year period. Following the expiry of this derogation, the Hungarian Parliament adopted Act CCXII of 2013 on transactions in agricultural and forestry land, laying down various provisions and transitional measures. Section 108(1) of the Act on transitional measures repealing Section 91(1) of the former, 1994 Act, stated that

> "Any right of usufruct or right of use existing on 30 April 2014 and created, for an indefinite period or for a fixed term expiring after 30 April 2014, by a contract between persons who are not close members of the same family shall be extinguished by operation of law on 1 May 2014."

As a result of this provision, *the legally established usufruct rights* of many, including foreigners, who had provided for this in their long-term business plans, *simply evaporated*. Even if it wasn't expropriation proper, it was meant a disenfranchisement of a package of rights *in rem* without compensation. Usufruct is a kind of beneficial ownership. According to Section 5:147 of the Hungarian Civil Code, a person may possess, use, exploit, and collect the proceeds of a property owned by another person by virtue of beneficial ownership. It is no coincidence that an international dispute arose before the ICSID over this provision, with a claim based on the British-Hungarian BIT for the protection of English investors.[9]

The requests for a preliminary ruling were made in proceedings brought, first, by *SEGRO Kft.*, and second, by *Günther Horváth*, against decisions deleting rights of usufruct over agricultural land that were held by SEGRO Kft. and Mr Horváth, respectively, from the property register.

According to the judgment of the CJEU in these joined preliminary ruling cases, the national provisions at issue in the main proceedings essentially have the purpose of extinguishing by operation of law previously acquired rights of

7 Judgment of 6 March 2018, *Joined Cases C-52/16 and C-113/16, SEGRO and Horváth*, ECLI:EU:C:2018:157.

8 *See* the Treaty of Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic, in particular, its Article 24, providing authorization for transitional measures.

9 *Magyar Farming Company Ltd. Kintyre Kft. and Inícia Zrt. v Hungary*, ICSID Case No. ARB/17/27, Award, 13 November 2019. *See e.g.* János Ede Szilágyi & Tamás Andréka, 'A New Aspect of Cross-Border Acquisition of Agricultural Lands. The Inícia Case Before the ICSID', *Hungarian Yearbook of International Law and European Law*, Vol. 8, 2020, pp. 92-105.

usufruct over agricultural land, where the holders of those rights did not satisfy the conditions to which the acquisition of rights of usufruct over agricultural land are henceforth subject under national legislation, and of arranging, consequently, for the deletion of such previously acquired rights from the property registers.[10]

The CJEU declared that, by virtue of its very subject matter, legislation such as that at issue in the main proceedings, which provides for the extinction of rights of usufruct acquired by contract over agricultural land, including those held as a result of exercise of the right to free movement of capital, restricts that freedom on account of that fact alone.[11] Such restrictive measures *may only be permissible if they are justified, on the basis of objective considerations independent of the origin of the capital concerned, by overriding reasons in the public interest and if they observe the principle of proportionality*, a condition which requires them to be appropriate for ensuring the attainment of the objective legitimately pursued and do not to go beyond what is necessary in order for it to be attained.[12]

The Hungarian Government submitted as justification that, inasmuch as the legislation at issue in the main proceedings makes the future acquisition of rights of usufruct over productive land and the preservation of such rights that already exist subject to compliance with the condition that the usufructuary has the status of close family member of the owner of the property concerned, it pursues public interest objectives. Thus, that legislation seeks to limit the ownership of productive land to those persons who work it and to prevent its acquisition for purely speculative purposes. It is also meant to enable it to be farmed by new undertakings, to facilitate the creation of properties of a size that enables viable and competitive agricultural production, and to prevent a fragmentation of agricultural land as well as migration from rural areas and depopulation of the countryside.[13]

However, the CJEU was not persuaded. According to its verdict, the fact that the required family tie exist does not guarantee that the usufructuary farms the land himself and that he has not acquired the right of usufruct at issue for purely speculative purposes. Similarly, it cannot be assumed that a person outside the owner's family who has purchased a usufruct over such land would not be in a position to farm that land himself and that the purchase would necessarily have been made for purely speculative purposes, without any intention to cultivate the land.[14] Other measures with less far-reaching effects than extinguishing the rights *in rem* concerned could have been adopted in order to penalize, from the outset, including any infringements of the applicable exchange control legislation, such as administrative fines.[15]

In sum, according to the CJEU, Article 63 TFEU must be interpreted as precluding national legislation, such as that at issue in the main proceedings, under which rights of usufruct that have previously been created over agricultural

10 *Joined Cases C-52/16 and C-113/16, SEGRO and Horváth*, para. 50.
11 Id. para. 62.
12 Id. para. 76.
13 Id. para. 81.
14 Id. para. 87.
15 Id. para. 106.

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land and the holders of which do not have the status of close relation of the owner of that land are extinguished by operation of law and are, consequently, deleted from the property registers. In its ruling, the CJEU made it clear that *the provisions on the free movement of capital also ensure the ownership/usufruct of citizens of another Member State and the protection of their foreign investments*. The theory outlined four decades earlier was validated at the highest level, with the restriction that, in its judgment, the CJEU referred only to the free movement of capital and did not invoke the provisions on freedom of establishment.

4. The EU Charter of Fundamental Rights and the Protection of Property

This line of interpretation was confirmed in the judgment *European Commission v Hungary*.[16] This case was not a reference for a preliminary ruling, but an infringement procedure initiated by the European Commission against Hungary, with strong emphasis on Article 17 of the Charter of Fundamental Rights, in addition to the free movement of capital. According to EU Article 17 of the Charter on the right to property

> "Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest."

On those grounds, the Grand Chamber of the CJEU declared that, by adopting Section 108(1) of Act CCXII of 2013 laying down various provisions and transitional measures concerning transactions in agricultural and forestry land and thereby extinguishing, by operation of law, the rights of usufruct over agricultural and forestry land located in Hungary that are held, directly or indirectly, by nationals of other Member States, *Hungary failed to fulfil its obligations under Article 63 TFEU* (on free movement of capital) *in conjunction with Article 17 of the Charter of Fundamental Rights*.[17]

It should be noted, however, that at the time of writing this paper, in April 2021, Section 108 of Act CCXII of 2013 is still in force in Hungary, despite the judgment of the CJEU. More precisely, it still contains the very same provision, which was at the heart of the dispute and according to which

> "[a]ny right of usufruct or right of use existing on 30 April 2014 and created, for an indefinite period or for a fixed term expiring after 30 April 2014, by a contract between persons who are not close members of the same family shall be extinguished by operation of law on 1 May 2014."

16 Judgment of 21 May 2019, *Case C-235/17, Commission v Hungary*, ECLI:EU:C:2019:432.
17 Id. para. 131.

This situation may indicate the limits of effective protection of investments under EU law, although some new, fairly complex provisions were added to the paragraph under scrutiny.[18]

5. *Achmea* and the Fall of Bilateral Investment Protection Agreements

It is however worth examining the judgments of the CJEU cited above in a broader context. This, in turn, leads us to the BITs previously concluded between Eastern and Western European countries,[19] which suddenly qualified as international agreements between Member States following the enlargement of the EU in 2004. This new situation has inevitably raised the problematic relationship between investment protection based on bilateral treaties and EU law.[20] Following several relevant cases, the problem culminated in *Achmea*,[21] resulting in a landmark decision.[22]

The CJEU's judgment was based on a dispute between Dutch insurer Achmea B.V. (formerly known as Eureko B.V.) and Slovakia. In 2006, Slovakia partly reversed the earlier liberalization of its health insurance market, thereby prohibiting the distribution of profits generated by Achmea's Slovak insurance activities. In 2008, Achmea brought arbitration proceedings against Slovakia under a BIT[23] for violation of substantive treaty standards. In its final 2012 award, the ad-hoc arbitral tribunal, constituted under the UNCITRAL Rules and seated in Frankfurt, found that Slovakia had violated the BIT and ordered it to pay approximately EUR 22.1 million in damages to Achmea.[24]

In the setting-aside proceedings subsequently initiated by Slovakia before the German courts, Slovakia challenged the arbitral award on jurisdiction. It argued that the arbitral tribunal lacked jurisdiction to hear the claims because the arbitration clause included in Article 8 of the BIT was incompatible with EU law, more specifically Article 18 (non-discrimination and citizenship), Article 267

18 Section 108(4) and (5).

19 The predecessors of these BITs (including the General Economic Treaties and treaties on the payment of compensations due to nationalizations in Central and Eastern European countries) are thoroughly analyzed by Ferenc Mádl in his monographs. *See* Mádl 1974, pp. 171-175. Naturally, the specific consequences of the accession of new Member States to the EU were not foreseeable at that time. The importance of BITs was revisited by Mádl and the author of this article, *see* Ferenc Mádl & Miklós Király, *Külföldi beruházások jogi védelme*, ELTE, Budapest, 1989, pp. 86 and 53-67.

20 Ursula Kriebaum, 'The Fate of Intra-EU BITs from an Investment Law and Public International Law Perspective', *ELTE Law Journal*, 2015/1, pp. 27-35.

21 Judgment of 6 March 2018, *Case C-284/16, Achmea*, ECLI:EU:C:2018:158

22 *See e.g.* Tamás Szabados, 'Az Európai Unió Bíróságának Achmea-döntése. A tagállamok közötti beruházásvédelmi egyezmények választottbírósági kikötéseinek összeegyeztethetetlensége az uniós joggal', *Jogesetek Magyarázata*, Vol. 10, Issue 1, 2019, pp. 29-36; János Martonyi, 'Investor-State Dispute and the Autonomy of EU Law; Battle of Tribunals?' *in* János Martonyi, *Nemzet és Európa, Emlékirat helyett*, Ludovika Egyetemi Kiadó, Budapest, 2021, pp. 105-108.

23 Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federative Republic ('the BIT'), concluded in 1991.

24 *Case C-284/16, Achmea*, paras. 9-11.

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(preliminary ruling procedure) and Article 344 (dispute settlement) of the TFEU.[25] In these proceedings, the Higher Regional Court of Frankfurt rejected Slovakia's arguments, finding that the BIT was not incompatible with the aforementioned provisions of the TFEU. However, the German Federal Court of Justice, hearing the case on appeal, referred questions on the compatibility with EU law of the BIT's arbitration clause to the CJEU for a preliminary ruling, at the same time, presenting its view that the arbitration clause was not contrary to the provisions of the TFEU. It is worth recalling the relevant paragraph of Article 8 of the BIT:

> "Each Contracting Party hereby consents to submit a dispute referred to an arbitral tribunal, if the dispute has not been settled amicably within a period of six months from the date either party to the dispute requested amicable settlement."[26]

The CJEU emphasized that, in *Achmea*, apart from the fact that the disputes falling within the jurisdiction of the arbitral tribunal referred to in Article 8 of the BIT may relate to the interpretation of both that agreement and of EU law, the possibility of submitting those disputes to a body that is not part of the judicial system of the EU is provided for by an agreement that was concluded not by the EU but by Member States.[27]

Therefore, Article 8 of the BIT was considered as *calling into question not only the principle of mutual trust between Member States but also the preservation of the particular nature of the law established by the Treaties*, based on the preliminary ruling procedure provided for in Article 267 TFEU, and is therefore not compatible with the principle of sincere cooperation.[28] The other key provision from the point of view of the legal dispute was Article 344 TFEU, according to which 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.

According to the preliminary ruling delivered by the CJEU, Articles 267 and 344 TFEU must be interpreted as precluding a provision in an international agreement concluded between Member States, such as Article 8 of the Treaty on the encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federative Republic, under which an investor from one of those Member States may, in the event of a dispute concerning investments in the other Member State, bring proceedings against the latter Member State before an arbitral tribunal whose jurisdiction that Member State has undertaken to accept.[29] A decision with this content was, in fact, to be expected. The European Commission has long taken the view that

25 Id. paras. 11 and 31.
26 Article 8(2) of the BIT.
27 *Case C-284/16, Achmea*, paras. 45, and 58.
28 Id. paras. 34, and 58.
29 Id. paras. 31, and 60.

bilateral investment protection agreements between Member States (intra-EU BITs) are incompatible with EU law and has expressed this view in a number of investment protection disputes.[30]

The judgment created a whole new situation. The net of protection provided by bilateral conventions began to unravel. This was complemented by the fact that most EU Member States have concluded an agreement on the formal denunciation of BITs in 2020.[31] The abolition of BITs will also deprive the Washington Convention[32] of all of its practical significance for investment disputes within the EU. After all, following the CJEU's decision, Member States will hardly submit themselves to the jurisdiction of the ICSID if the investor comes from the EU. Henceforth, investment protection rests with the CJEU and the courts of the Member States; more specifically with the protection offered by EU law and the domestic law of the Member States. And, of course, the main question is whether the Member States' forums will follow the CJEU's previous decisions properly and, where necessary, seek a new preliminary ruling from the CJEU.

The arbitration dispute settlement mechanism guaranteed by the BITs, which provided individuals with the capacity to sue sovereign states before neutral international *fora*, has thus been abolished within the EU. Time will tell how this will affect future investments in the new EU Member States in the long run. Will investors be satisfied with a broad interpretation of the provisions on free movement of capital and the protection afforded by the EU Charter of Fundamental Rights and domestic laws, or will they invest elsewhere?[33] Somewhat surprisingly, investors from third countries have been put in a better position than their counterparts in the EU, because they can still start a procedure offered by ICSID or commercial arbitration, if they feel that their rights have been violated, at least as long as they are not replaced by treaties concluded by the EU under the aegis of the common commercial policy.

Achmea may be justified by the strict application of the provisions of the TFEU and the preservation of the CJEU's monopoly on the interpretation of EU law. It can also be argued that, when it comes to investing within the single

30 *Eureko B.V. v the Slovak Republic*, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrability and Suspension, 26 October 2010; *EURAM v. the Slovak Republic*, PCA Case No. 2010-17, European Commission Observations, 13 October 2011; *Micula v Romania*, ICSID Case No. ARB/05/20, Award, 11 December 2013. *See e.g.* Marcel Szabó, 'Editorial Comments: The Relevance of Foreign Investment Protection in International and EU Law, Foreword to Vol. 8 (2020) of the Hungarian Yearbook of International Law and European Law', *Hungarian Yearbook of International Law and European Law*, Vol. 8, 2020, p. 12.

31 Agreement for the Termination of Bilateral Investment Treaties between the Member States of the European Union, 2020.

32 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington, 1965. It has established International Centre for Settlement of Investment Disputes (ICSID).

33 Szabó 2020, pp. 13-14, referring to the article by Veronika Korom in the Hungarian Yearbook 2020: Veronika Korom, 'The Impact of the Achmea Ruling on Intra-EU BIT Investment Arbitration. A Hungarian Perspective', *Hungarian Yearbook of International Law and European Law*, Vol. 8, 2020, pp. 53-74. *See also* Szabados 2019, p. 36; Martonyi 2021, p. 108.

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internal market, because both the investor and the place of investment are tied to it, it is unnecessary to use an external forum to settle investment disputes. At the same time, the denunciation of BITs is a rip in the fabric of a relatively well-functioning global dispute settlement mechanism in the region.