JUDGMENT OF THE COURT (Second Chamber)

19 November 2009*

In Case C-118/07,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 20 February 2007,

Commission of the European Communities, represented by M. Huttunen, H. Støvlbæk and B. Martenczuk, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Republic of Finland, represented by J. Heliskoski, acting as Agent, with an address for service in Luxembourg,

defendant,

* Language of the case: Finnish.

supported by:

Federal Republic of Germany, represented by M. Lumma and C. Blaschke, acting as Agents, with an address for service in Luxembourg,

Republic of Hungary, represented by J. Fazekas, acting as Agent,

Republic of Lithuania, represented by D. Kriaučiūnas, acting as Agent,

Republic of Austria, represented by C. Pesendorfer, acting as Agent, with an address for service in Luxembourg,

interveners,

THE COURT (Second Chamber),

composed of J.-C. Bonichot (Rapporteur), President of the Fourth Chamber, acting as President of the Second Chamber, C. Toader, C.W.A. Timmermans, K. Schiemann and L. Bay Larsen, Judges,

Advocate General: E. Sharpston,
Registrar: R. Grass,

having regard to the written procedure,

after hearing the Opinion of the Advocate General at the sitting on 10 September 2009,

gives the following

Judgment

1 By its application, the Commission of the European Communities seeks a declaration that, by not having taken appropriate steps to eliminate incompatibilities with the provisions of the EC Treaty concerning the provisions on transfer of capital contained in the bilateral investment agreements entered into by the Republic of Finland with the former Union of Soviet Socialist Republics of which the Russian Federation is the successor (agreement signed on 8 February 1989, SopS 58/1991), the Republic of Belarus (agreement signed on 28 October 1992, SopS 89/1994), the People's Republic of China (agreement signed on 4 September 1984, SopS 4/1986), Malaysia (agreement signed on 15 April 1985, SopS 79/1987), the Democratic Socialist Republic of Sri Lanka (agreement signed on 27 April 1985, SopS 54/1987) and the Republic of Uzbekistan (agreement signed on 1 October 1992, SopS 74/1993) ('the bilateral agreements'), the Republic of Finland has failed to fulfil its obligations under the second paragraph of Article 307 EC.

Legal context

2 The Republic of Finland concluded the bilateral agreements at issue before its accession to the European Union.

3 The agreements entered into force with regard to the Russian Federation on 15 August 1991, the Republic of Belarus on 11 December 1994, the People's Republic of China on 26 January 1986, Malaysia on 3 January 1988, the Democratic Socialist Republic of Sri Lanka on 25 October 1987 and, finally, the Republic of Uzbekistan on 22 October 1993.

4 Those agreements guarantee to the investors of each Contracting Party the free transfer, in freely convertible currency, of payments relating to an investment.

5 All of those agreements, apart from the agreement concluded with the Russian Federation, contain a clause which guarantees the protection of investments within the limits authorised by the laws of the Contracting Party. By way of example, the agreement concluded with the Democratic Socialist Republic of Sri Lanka contains the following clause: 'Every contracting party guarantees under all circumstances, within the limits authorised by its own laws and decrees and in conformity with international law, a reasonable and appropriate treatment of investments made by citizens or companies of the other Contracting Party.'

Pre-litigation procedure

6 As it took the view that the bilateral agreements were capable of impeding the application of restrictions on movements of capital and on payments which the Council of the European Union might adopt under Articles 57(2) EC, 59 EC and 60(1) EC, the Commission sent a letter of formal notice to the Republic of Finland on 7 May 2004.

7 By letter of 7 July 2004, the Republic of Finland submitted its observations to the Commission on that letter of formal notice. It maintained that the disputed provisions

of the investment agreements at issue did not prevent it from complying with its obligations under Articles 57(2) EC, 59 EC and 60(1) EC.

8 Taking the view that the arguments put forward by the Republic of Finland were inadequate, the Commission sent it a reasoned opinion on 16 March 2005.

9 By letter of 19 May 2005, the Republic of Finland submitted to the Commission its observations on that reasoned opinion. It maintained its earlier arguments.

10 As it took the view that those arguments were not capable of rebutting the complaints made in the reasoned opinion, the Commission decided to bring the present action.

11 By order of the President of the Court of 9 July 2007, the Federal Republic of Germany, the Republic of Lithuania, the Republic of Hungary and the Republic of Austria were granted leave to intervene in support of the form of order sought by the Republic of Finland.

The action

12 As a preliminary point, it must be observed that one of the bilateral agreements does not contain a special provision of the kind referred to in paragraph 5 of this judgment which, according to the Republic of Finland, enable it to fulfil its Community obligations in any event.

13 In those circumstances, it is appropriate to examine the Commission's action by analysing, first of all, the agreement which does not contain such a provision, and then, secondly, those which do.

14 Third, it is appropriate to examine the general arguments of the parties relating to the principle of non-discrimination and the scope of the second paragraph of Article 307 EC.

The agreement concluded with the Russian Federation

Arguments of the parties

15 According to the Commission the absence, in particular in the agreement concerned, of any provision enabling the Republic of Finland to apply restrictions on movements of capital and payments which may, as the case may be, be decided by the Council on the basis of Articles 57(2) EC, 59 EC and 60(1) EC might lead that Member State to fail to comply with its Community obligations. The Commission also takes the view that, by failing to take the appropriate steps to eliminate incompatibilities with the Treaty, the Republic of Finland has failed to fulfil its obligations under the second paragraph of Article 307 EC.

16 The Republic of Finland and the Member States intervening in support of the form of order sought by it submit that, in the absence of any restrictive measure adopted by the Council vis-à-vis third countries with which it concluded investment agreements, the issue of the compatibility of the agreement at issue with a provision of the Treaty which has not been the subject of any application does not arise since no 'incompatibilities [have been] established' within the meaning of the second paragraph of Article 307 EC. Accordingly, the infringement alleged by the Commission is purely hypothetical. In those circumstances, the Member States' obligation to take all the

appropriate steps to eliminate the 'incompatibilities established' exists only from the time when the Court has previously held that such incompatibilities exist.

17 Furthermore, the States intervening submit that the safeguard measures referred to in Articles 57(2) EC, 59 EC and 60(1) EC may be implemented only in exceptional cases which could not have been foreseen when the agreement at issue was concluded. It follows that the Republic of Finland may rely on the principle *rebus sic stantibus* and provisionally suspend the contested provisions relating to the freedom to transfer if the Community adopts safeguard measures.

Findings of the Court

18 The bilateral investment agreement at issue, concluded by the Republic of Finland, contains provisions which ensure freedom of transfer, without undue delay, of payments with respect to an investment in freely convertible currency.

19 In particular, the freedom to transfer funds in order to make an investment, the management and growth of that investment, the freedom to repatriate the income from that investment, and the freedom to transfer the funds necessary to repay loans and the funds arising from the realisation or assignment of that investment are thereby guaranteed.

20 That agreement thus complies with the wording of Article 56(1) EC, according to which '… all restrictions on the movement of capital between Member States and between

Member States and third countries shall be prohibited', and the wording of Article 56(2) EC which provides that '… all restrictions on payments between Member States and between Member States and third countries shall be prohibited'.

21 It is true that the provisions of the Treaty to which this action brought by the Commission relate give the Council the power to restrict, in certain circumstances, movements of capital and payments between Member States and third countries, which include the movements covered by the transfer clauses at issue.

22 The relevant provisions, which appear in Articles 57(2) EC, 59 EC and 60(1) EC introduce exceptions to the principle of free movement of capital and payments between Member States and third countries, with a view to protecting the general Community interest and enabling the Community to comply, as appropriate, with its international obligations and with those of the Member States.

23 Article 57(2) EC allows the Council, acting by qualified majority on a proposal from the Commission, to adopt certain measures restricting the movement of capital to or from third countries involving, inter alia, direct investment. Where those measures constitute a 'step back' in Community law as regards the liberalisation of the movement of capital to or from third countries, unanimity is required.

24 Article 59 EC authorises the Council, on a proposal from the Commission and after consulting the European Central Bank, to adopt safeguard measures where movements of capital to or from third countries 'cause, or threaten to cause, serious difficulties for the operation of economic and monetary union', provided that those measures are strictly necessary and that they relate to a period 'not exceeding six months'.

25 Article 60(1) EC allows the Council, on a proposal from the Commission, in order to implement a common position or a joint action in the area of the common foreign and security policy, to take the 'necessary urgent measures' on the movement of capital and on payments. Such action could, for example, be required in order to give effect to a resolution of the Security Council of the United Nations Organisation.

26 It is common ground that the bilateral agreement at issue does not contain any provision enabling the Community to restrict movements of funds connected with investments. It is therefore necessary to examine whether the Republic of Finland was, for that reason, under an obligation to take the appropriate steps to which the second paragraph of Article 307 EC refers.

27 Under the first paragraph of Article 307 EC, the rights and obligations arising from an agreement concluded before the date of accession of a Member State between it and a third country are not affected by the provisions of the Treaty. The purpose of that provision is to make it clear, in accordance with the principles of international law, that application of the Treaty is not to affect the duty of the Member State concerned to respect the rights of third countries under a prior agreement and to perform its obligations (see, Case 812/79 *Burgoa* [1980] ECR 2787, paragraph 8; Case C-84/98 *Commission* v *Portugal* [2000] ECR I-5215, paragraph 53; and Case C-216/01 *Budějovický Budvar* [2003] ECR I-13617, paragraphs 144 and 145).

28 However, the second paragraph of Article 307 EC obliges the Member States to take all appropriate steps to eliminate incompatibilities with Community law which have been established in agreements concluded prior to their accession. Under that provision, the Member States are required, where appropriate, to assist each other to that end and, where appropriate, to adopt a common attitude.

29 The provisions of Articles 57(2) EC, 59 EC and 60(1) EC confer on the Council the power to restrict, in certain specific circumstances, movements of capital and payments between the Member States and third countries.

30 In order to ensure the effectiveness of those provisions, measures restricting the free movement of capital must be capable, where adopted by the Council, of being applied immediately with regard to the States to which they relate.

31 Accordingly, as the Court held in Case C-205/06 *Commission* v *Austria* [2009] ECR I-1301, paragraph 37, and Case C-249/06 *Commission* v *Sweden* [2009] ECR I-1335, paragraph 38, those powers of the Council, which consist in the unilateral adoption of restrictive measures with regard to third countries on a matter which is identical to or connected with that covered by an earlier agreement concluded between a Member State and a third country, reveal an incompatibility with that agreement where, first, the agreement does not contain a provision allowing the Member State concerned to exercise its rights and to fulfil its obligations as a member of the Community and, second, there is also no international-law mechanism which makes that possible.

32 As regards the abovementioned agreement, the Republic of Finland, does not put forward any mechanism which would enable it to fulfil its Community obligations. Furthermore, in any event, the possibility, relied on by the States intervening, of taking other steps made available under international law such as the suspension or the denunciation of the agreement at issue or of certain provisions of that agreement is too uncertain in its effects to guarantee that the measures adopted by the Council could be effectively applied within the prescribed period.

33 It is common ground that, in the case referred to, the Republic of Finland has not taken any steps, within the period prescribed by that institution in its reasoned opinion, with respect to the third country concerned to eliminate the risk of conflict to which the application of the agreement concerned may give rise with measures liable to be adopted by the Council pursuant to Articles 57(2) EC, 59 EC and 60(1) EC.

34 It should be added that, as the Court held in the cases which gave rise to the judgments in *Commission* v *Austria* and *Commission* v *Sweden*, the incompatibilities with the Treaty which the investment agreements with the third countries give rise to and which preclude the application of restrictions to the movement of capital and to payments which the Council may adopt pursuant to Articles 57(2) EC, 59 EC and 60(1) EC are not limited to the defendant Member State in this case.

35 It should therefore be stated that, in accordance with the second paragraph of Article 307 EC, the Member States are required, where necessary, to assist each other to eliminate the incompatibilities established between the agreements concluded by the Member States prior to their accession and Community law and, where appropriate, to adopt a common attitude. In the context of its duty under Article 211 EC to ensure that the provisions of the Treaty are applied, it is for the Commission to take any steps which might facilitate mutual assistance between the Member States concerned and their adoption of a common attitude.

The agreements concluded with the Republic of Belarus, the People's Republic of China, Malaysia, the Democratic Socialist Republic of Sri Lanka and the Republic of Uzbekistan

Arguments of the parties

36 The Commission submits that the specific provisions of the kind set out in paragraph 5 of this judgment, and on which the Republic of Finland relies as regard the abovementioned agreements, refer to the laws and administrative provisions of the States parties to those agreements as they were in force at the time when the agreements were concluded, that is, in this case, prior to the accession of the Republic of Finland to the Union. Therefore, the Commission takes the view that those provisions do not, by

themselves, offer that Member State the option to implement without delay restrictive measures that the Community may be led to adopt.

37 The Republic of Finland and the Republic of Lithuania argue, to the contrary, that those provisions may be applied because the restrictive measures adopted by the Council, by virtue of the direct effect of Community law, form part of Finnish law, within the meaning of those provisions. Therefore, there is no incompatibility with the Treaty for the purposes of the second paragraph of Article 307 EC.

Findings of the Court

38 It must be observed, as the Republic of Finland rightly submitted, that restrictive measures, which may be adopted by the Council on the basis of Articles 57(2) EC, 59 EC and 60 EC, form part of the Finnish legal order. However, it is not clear whether such measures, in the light of the bilateral investment agreements at issue, may be regarded as part of Finnish law.

39 According to well-established case-law, an international treaty must be interpreted not solely by reference to the terms in which it is worded but also in the light of its objectives. Article 31 of the Vienna Conventions of 23 May 1969 on the Law of Treaties and of 21 March 1986 on the Law of Treaties between States and International Organisations or between International Organisations, which express, to this effect, general customary international law, stipulate in that respect that a treaty must be interpreted in good faith, in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose (Case C-268/99 *Jany and Others* [2001] ECR I-8615, paragraph 35, and Case C-344/04 *IATA and ELFAA* [2006] ECR I-403, paragraph 40).

40 From that perspective, it must be observed that the aim of the provisions of the bilateral agreements at issue, challenged by the Commission in its action for failure to fulfil obligations, is to ensure freedom of payments in respect of investments, and that as quickly possible.

41 In that context, it is, to say the least, debatable whether the provision which guarantees the protection of investments within the limits authorised by the laws of the Contracting Party contained in the bilateral agreements concerned would allow either party to limit payment entitlement pursuant to decisions — whether national or otherwise — taken after the entry into force of the agreements, especially as in some agreements it is also stated that each Contracting Party is required to act 'in accordance with international law'.

42 Therefore, the provisions of the bilateral agreements at issue, relied on by the Republic of Finland in support of its argument that, contrary to the Commission's submissions, it would be in a position, if necessary, to satisfy in full Community obligations which may arise from the adoption by the Council of measures restricting the free movement of capital do not appear to guarantee that that would be the case, since the interpretation of those provisions is too uncertain and, therefore, the same is true as regards their scope and their effects.

43 It follows that the provisions of the bilateral agreements at issue relied on by the Republic of Finland are not sufficient to ensure the compatibility of the agreements challenged by the Commission with Article 307 EC.

The principle of non-discrimination and the scope of the second paragraph of Article 307 EC

Arguments of the parties

44 The Federal Republic of Germany and the Republic of Hungary submit that a finding that the contested bilateral agreements are incompatible with the Treaty, for the purposes of the second paragraph of Article 307 EC, would be contrary to 'the principle of competition on the internal market and the principle of non-discrimination', since the Republic of Finland and the citizens and undertakings of the Union which are covered by the agreements concluded by that Member State would be at a disadvantage in comparison with other member States and the citizens and undertakings covered by investment agreements which are not criticised by the Commission.

45 The Commission submits that the comparison made with investment agreements concluded by other Member States is irrelevant, since the Court has consistently held that a Member State may not rely on the fact that other Member States have also failed to perform their obligations in order to justify its own failure to fulfil its obligations under the Treaty.

46 Lastly, the Republic of Finland, supported by the Republic of Hungary, dwells on the serious consequences liable to result from the position of the Commission, which would make it possible to establish a failure to fulfil obligations on the basis of the second paragraph of Article 307 EC in any case in which an agreement, entered into with a third country either before the entry into force of the Treaty or prior to accession of the Member State concerned, applies in an area in which the Community has not yet exercised the powers available to it under the Treaty. Such an interpretation would confer on the second paragraph of Article 307 EC an unlimited scope which would be open to challenge from the perspective both of legal certainty and of the distribution of powers between the Community and the Member States, and would upset the balance created by the first and second paragraphs of Article 307 EC.

47 The Commission submits that it has never claimed that the Member States are required to have recourse to measures under Article 307 in all the fields in which the Community may adopt legislative measures in the future. It accepts that such a requirement on its part is also impossible since the content of legislative acts likely to be adopted in the various fields cannot, by definition, be foreseen. It submits however that that is not the case with respect to Articles 57(2) EC, 59 EC and 60(1) EC, which confer on the Council very precisely defined powers as regards restrictions on movements of capital and payments with respect to third countries which require the Member States, when such measures are adopted, to implement them immediately.

Findings of the Court

48 In the first place, it must be observed that a Member State may not rely on the fact that other Member States have also failed to perform their obligations in order to justify its own failure to fulfil its obligations under the Treaty. In the Community legal order established by the Treaty, the implementation of Community law by the Member States cannot be made subject to a condition of reciprocity. Articles 226 EC and 227 EC provide the appropriate remedies in cases where Member States fail to fulfil their obligations under the Treaty (see Case C-38/89 *Blanguernon* [1990] ECR I-83, paragraph 7, and Case C-163/99 *Portugal* v *Commission* [2001] ECR I-2613, paragraph 22).

49 In the second place, as regards the argument that the consequence of granting the Commission's application would be to confer on the second paragraph of Article 307 EC a scope which is unduly wide, it is sufficient to hold that this judgment in no way prejudges the obligations of the Member States in other circumstances and merely holds, as stated earlier, that the exercise of the powers conferred on the Council in relation to the movement of capital might be hindered by the very existence of the bilateral agreements at issue and by the terms in which they are drafted.

50 Having regard to the foregoing considerations it must be held that, by not having taken appropriate steps to eliminate incompatibilities with the Treaty concerning the provisions on the transfer of capital contained in the bilateral agreements at issue, the Republic of Finland has failed to fulfil its obligations under the second paragraph of Article 307 EC.

Costs

51 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs to be awarded against the Republic of Finland, and the latter has been unsuccessful, the Republic of Finland must be ordered to pay the costs.

52 In accordance with Article 69(4) of those Rules, the Federal Republic of Germany, the Republic of Lithuania, the Republic of Hungary and the Republic of Austria, which have intervened in the proceedings, are to bear their own costs.

On those grounds, the Court (Second Chamber) hereby

1. **By not having taken appropriate steps to eliminate incompatibilities with the Treaty concerning the provisions on transfer of capital contained in the investment agreements on the mutual promotion and protection of investments entered into by the Republic of Finland with the former Union of Soviet Socialist Republics of which the Russian Federation is the successor (agreement signed on 8 February 1989), the Republic of Belarus (agreement signed on 28 October 1992), the People's Republic of China (agreement signed on 4 September 1984), Malaysia (agreement signed on 15 April 1985), the Democratic Socialist Republic of Sri Lanka (agreement signed on 27 April 1985) and the Republic of Uzbekistan (agreement signed on 1 October 1992),**

the Republic of Finland has failed to fulfil its obligations under the second paragraph of Article 307 EC.

2. Orders the Republic of Finland to pay the costs.

3. Orders the Federal Republic of Germany, the Republic of Lithuania, the Republic of Hungary and the Republic of Austria to bear their own costs.

[Signatures]