

EUROPEAN COURT OF JUSTICE RULES ON INVESTOR-STATE ARBITRATION UNDER AN INTRA-EU BIT

In a much-anticipated decision, the European Court of Justice (ECJ) holds that the arbitration agreement in the Slovakia – Netherlands bilateral investment treaty (BIT) is incompatible with EU law.

The landmark ruling was issued on 6 March 2018 in the *Slowakische Republik v Achmea BV* case (the ECJ's Ruling).¹ The ECJ found that the investor-State dispute settlement mechanism (ISDS) in a BIT between two EU Member States does not ensure full effectiveness of EU law, and thus is in conflict with the provisions of the Treaty on the Functioning of the European Union (the TFEU).

The ECJ's Ruling is in line with the position that has been consistently promoted by the European Commission and certain Member States in recent years (e.g. Czech Republic, Estonia, Greece, Spain, Italy, Cyprus, Latvia, Hungary, Poland and Romania).

But it diverts markedly from the position taken by the EU's Attorney-General, Advocate General Wathelet, who opined in September 2017 that arbitration clauses in intra-EU BITs are compatible with EU law. Similar views were also advocated by Germany, France, the Netherlands, Austria and Finland during the proceedings.

Although the ECJ's Ruling applies specifically to the ISDS mechanisms in the Slovakia – Netherlands BIT, it is likely to have grave implications for the enforcement and effectiveness of arbitration agreements in all intra-EU BITs.

THE AWARD AND THE REFERRAL TO THE ECJ

The ECJ's Ruling was issued in response to a request for a preliminary ruling filed by Germany's Federal Court of Justice, which was called on to decide on the challenge to an arbitral award issued in favour of Achmea BV (a Dutch insurance group) against Slovakia.

- Achmea won a EUR 22 million arbitration award in proceedings that arose out of the a BIT between the Netherlands and the Czech and Slovak Federative Republic which entered into force in 1992 (the Slovakia - Netherlands BIT).
- The German-seated tribunal found that Slovakia breached the Slovakia – Netherlands BIT by reversing the liberalisation of the private health

"The ECJ ruled that investor-State disputes involving the application of EU law necessarily need to ensure the involvement of the judicial system of the EU"

¹ Case ref. C-284/16.

insurance market and preventing the distribution of profits generated by sickness insurance activities to shareholders.

- The tribunal found that it had jurisdiction to hear the dispute on the following bases:
 - The arbitral tribunal's jurisdiction derives from the Slovakia – Netherlands BIT and German arbitration law (and not from EU law).
 - The ISDS mechanism is an "essential characteristic of an investor's rights under the BIT" and EU law does not replicate it.
 - There was no incompatibility between EU law and the BIT with regards to the arbitration agreement at Article 8 of the Slovakia – Netherlands BIT.
- Slovakia applied to the German courts to set aside the award, arguing that the agreement to refer disputes to arbitration in the Slovakia – Netherlands BIT was incompatible with EU law (and in particular Articles 18, 267 and 344 of the TFEU).
- The German court referred the question to the ECJ in accordance with Article 244 of the TFEU.

KEY PRINCIPLES OF EU LAW

The ECJ reiterated it was a fundamental feature of EU law to preserve and uphold fundamental principles of mutual trust and cooperation between Member States. The ECJ highlighted that the EU treaties establish a **judicial system designed to ensure consistency and uniformity** in the interpretation of EU law.

A central mechanism to implement these principles is the **preliminary ruling procedure** (Article 267 TFEU) under which "any court or tribunal of a Member State" may ask the ECJ to rule on a question of EU law. The ECJ noted that through this process, national courts and tribunals and the ECJ are tasked with ensuring the full application of EU law and the judicial protection of the rights and individuals under those laws (Article 19 of the TFEU).

Further, to support this approach, **EU Member States agree not to submit a dispute** concerning the application or interpretation of EU law **to any other method of settlement**, other than those provided for in the treaties (Article 344 TFEU).

THE ECJ's RULING

The ECJ ruled that the arbitration agreement in the Slovakia – Netherlands BIT is not compatible with EU law.

- The ECJ held that the arbitration clause agreed by the State parties to the Slovakia-Netherlands BIT **permitted the arbitral tribunal to apply EU law when hearing an investment dispute**. Article 8(6) of the Slovakia – Netherlands BIT specifically provides that the arbitral tribunal should take into account not only the provisions of the BIT, but also, inter alia, the laws of the host State and any other agreements concluded between the contracting States. Accordingly the ECJ noted, the tribunal may be called on to interpret or apply EU law in any dispute under the BIT.

- The ECJ then ruled that **investment arbitration tribunals are neither part of the EU judicial system, nor a court of any EU Member State**. It held that one of the key features of the arbitration agreement is to offer investors an alternative (and neutral) forum of dispute resolution from the national courts of the two countries signatory to the BIT.
- Given this, **the arbitral tribunal was not entitled to refer questions to the ECJ** under article 267 TFEU.
- As such, the ECJ concluded that **the arbitration agreement violates provisions of the TFEU**:
 - it has an adverse effect on the autonomy of EU law and endangers its full effectiveness; and
 - it is contrary to the Member States' obligations to refer disputes only to those mechanisms provided for in EU treaties.
- The ECJ further (at least implicitly) stated that investors cannot claim that an arbitration agreement in an intra-EU BIT remains valid by reference to the protection of the investors' legitimate interests in having access to ISDS.

IMMEDIATE IMPACT OF THE DECISION

The ECJ's Ruling only has direct application in the *Slovakia v Achmea* case. However, it is broadly accepted that ECJ judgments should also be followed by the courts of all EU Member States.

The ECJ's Ruling does not affect the validity of the substantive protections in the underlying BIT, but without the ability to directly enforce host State's treaty obligations, the protection that is afforded by the BIT is significantly weakened or completely nullified.

Further, while the rationale behind the ECJ's Ruling is limited to the specific wording of the Slovakia- Netherlands BIT, this wording is not unique among the intra-EU BITs. The far-reaching nature of its impact should not be underestimated.

It is immediately apparent that the decision will have a negative effect on the validity and effectiveness of similar ISDS provisions in other intra-EU BITs:

- First, **investment arbitration tribunals may follow the ECJ's Ruling and decline to hear claims brought by investors under intra-EU BITs**, as the arbitration clauses in the intra-EU BITs are contrary to EU law. In the past (before the ECJ's Ruling), investment arbitral tribunals have repeatedly rejected similar arguments brought by host States.
- Second, even if the arbitral tribunal issues an award in favour of the investor, **the courts of EU Member States may refuse to enforce such an award or even set it aside** (if the place of arbitration was in the EU), on the basis that the arbitration clause is inapplicable by virtue of EU law.
- Third, it also remains to be seen what impact the ECJ's Ruling will have on investment arbitrations in which **arbitral awards have already been issued in favour of the investor** and paid by the State.
- Fourth, in any event, the ECJ's Ruling may encourage EU Member States to **terminate their intra-EU BITs** – the process which has already been

“The ECJ's Ruling may affect all intra-EU BITs and render the awards issued thereunder unenforceable in EU Member States”

started by some Member States (e.g. Poland, Denmark, Italy and Romania).

QUESTIONS

The ECJ's Ruling raises a number of unanswered questions. A few are considered here.

1. What effect will the ECJ's Ruling have on multilateral agreements such as the Energy Charter Treaty (ECT)?

EU Member States (and the EU itself) are party to several multilateral treaties which provide for ISDS and have announced the intention to conclude several further agreements including ISDS (such as CETA, TTIP, etc.).

In recent cases founded on the ECT notably, against Spain, arbitral tribunals have consistently rejected arguments raised by the European Commission (by way of *amicus curiae* interventions), that the arbitration provisions in the ECT are contrary to EU law. The two most recent examples are the decision in *Eiser Infrastructure v Spain*, ICSID Case No. ARB/13/36 (4 May 2017) and the decision in *Novenergia v Spain*, SCC Arbitration 2015/063 (15 February 2018). In each case, the tribunals held that the arbitration agreement in each of the BITs underlying the arbitration were not incompatible with EU law.

Tribunals faced with disputes between an EU Member State and an investor of another EU Member State arising out of the ECT may be similarly concerned about the effect of the ECJ Ruling on the effectiveness of the arbitration agreement in the ECT in respect of those parties.

2. Does the ECJ's Ruling affect commercial arbitration?

The ECJ in its ruling sought to distinguish between investment treaty arbitration and commercial arbitration. In its brief reasoning, it argued that in the case of commercial arbitration, the parties (who are often not EU Member States) consent to excluding the jurisdiction of the EU courts (and it is lawful for them to do so) and referred to existing rulings by the ECJ which accepted commercial arbitration as co-existing with the EU judicial system.

In this context, EU Member States retain the ability to review such decisions for their compatibility with EU law and, if necessary, can refer a matter to the ECJ for a preliminary ruling.

By contrast, where BITs are concerned, EU Member States (as signatory parties to the treaty) agreed to remove disputes concerning EU law from their judicial systems in breach of their obligations under EU law, albeit that any award may be challenged or enforced on grounds of public policy (unless the award is rendered under the ICSID Convention), similar to a commercial arbitral award.

On this logic, it appears that commercial arbitration is not affected by the ECJ Ruling, but the distinction is not very clear.

3. What is the impact of the decision in relation to extra-EU BITs?

It will be interesting to see what impact the ECJ's Ruling might have on the jurisdiction of tribunals or enforcement of awards rendered under BITs which involve claims by non-EU investors and EU Member States (extra-EU BITs). If investors seek to enforce awards under extra-EU BITs in a Member State, its courts may be required, if the ECJ Ruling applies, to refuse enforcement of the

award on the basis that the arbitration agreement underpinning the award is incompatible with EU law (and therefore contrary EU public policy).

4. What impact, if any will the ECJ's Ruling have on disputes under UK BITs after Brexit?

In a similar vein, when the UK leaves the EU, further consideration will need to be given to the impact of the ECJ's Ruling on the effectiveness of the BITs that the UK has in place with EU Member State countries. At first sight, many of the reasons regarding the consistency of EU law which formed the basis of the ECJ's Ruling, will no longer be relevant, given that the UK will most probably no longer be bound by principles such as the autonomy of EU law. However, as highlighted above, if enforcement of an award under UK's BITs with an EU Member State is sought in an EU Member State, the ECJ Ruling may still prove to be a reason to challenge or refuse enforcement (for the reasons set out above). This would affect the effectiveness of UK's BITs with EU Member States for UK investors even after the UK has left the EU.

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