Case C-109/20: an *ad hoc* arbitration agreement cannot be used to circumvent an invalid arbitration clause in an intra-EU BIT

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On 26 October 2021, the Court of Justice of the European Union ("CJEU") decided, in its judgment in Case C-109/20 *Republic of Poland v PL Holdings*, that where an investor-State arbitration clause in an intra-EU bilateral investment treaty ("BIT") is invalid under European Union ("EU") law, investors cannot rely on a tacit *ad hoc* arbitration agreement with identical content to the arbitration clause. Importantly, the CJEU clarified that EU Member States must contest the jurisdiction of an arbitral tribunal in such a situation and national courts of the Member States must uphold an action to set aside an arbitration award made on the basis of an arbitration agreement that is contrary to EU law.

Factual background

PL Holdings Sàrl ("PL Holdings"), a Luxembourg company, initiated Stockholm Chamber of Commerce ("SCC") arbitration proceedings against Poland, alleging expropriation of its investment in a Polish bank. The Stockholm-seated arbitration was initiated pursuant to an intra-EU BIT, namely Article 9 of the 1987 BLEU (Belgium-Luxembourg Economic Union) - Poland BIT (the "BIT arbitration clause"). The arbitration clause in this BIT is similar to the clause at issue in the *Achmea* judgment.

In its partial award of 28 June 2017, the arbitral tribunal confirmed its jurisdiction. It issued its final award on 28 September 2017, ordering Poland to pay damages to PL Holdings. Poland applied to the Svea Court of Appeal in Sweden to set aside both awards. That court dismissed Poland's set aside action. It accepted that the BIT arbitration clause was invalid under EU law, as interpreted in the *Achmea* judgment. However, it found that this did not preclude Poland and PL Holdings from concluding a tacit *ad hoc* arbitration agreement (replacing the BIT arbitration clause) based on the common intention of the parties and concluded according to the same principles as applicable in commercial arbitration proceedings. On appeal, the Supreme Court of Sweden agreed that the BIT arbitration clause was incompatible with EU law but referred the following question to the CJEU for a preliminary ruling on the compatibility of the *ad hoc* arbitration agreement with EU law:

"*Do Articles 267 and 344 TFEU, as interpreted in* [*Achmea*], *mean that an arbitration agreement is invalid if it has been concluded between a Member State and an investor – where an investment agreement contains an arbitration clause that is invalid as a result of the fact that the contract was concluded between two Member States – by virtue of the fact that the Member State, after arbitration proceedings were commenced by the investor, refrains, by the free will of the State, from raising objections as to jurisdiction?*"

The reasoning of the CJEU

The CJEU reformulated the question of the Swedish Supreme Court as asking whether Articles 267 and 344 TFEU preclude national legislation allowing an EU Member State to conclude an *ad hoc* arbitration agreement with an investor from another EU Member State, which makes it possible to continue arbitration proceedings initiated pursuant to an arbitration clause in an intra-EU BIT, which is invalid under EU law and the content of which is identical to that agreement.

In essence, the question was based on two premises: whether an *ad hoc* agreement was concluded and whether the BIT arbitration clause was incompatible with EU law for the reasons stated in *Achmea* and confirmed in *Komstroy*.

First, the CJEU was doubtful about the first premise. Although the CJEU may not assess the facts at issue before the national court, it stressed the need for a careful enquiry into whether a tacit *ad hoc* arbitration agreement could be inferred from the factual circumstances.

Second, it was common ground that the BIT arbitration clause could lead to a situation where an arbitral tribunal may rule on a question concerning the application or interpretation of EU law, calling into question the principles of mutual trust and sincere cooperation, the preliminary ruling procedure, the preservation of the particular nature of EU law, and the autonomy of the EU legal order. The CJEU confirmed its judgments in *Achmea* and *Komstroy* without any detailed assessment of the BIT arbitration clause.

Against that background, the CJEU considered that allowing an EU Member State to conclude an *ad hoc* arbitration agreement with the same content as an invalid arbitration clause in an intra-EU BIT would circumvent the Member States' obligations under EU law, specifically Article 4(3) TEU and Articles 267 and 344 TFEU. It found that (i) the *ad hoc* arbitration agreement would have the same effect as the BIT arbitration clause and maintain the effects of an invalid commitment to accept the jurisdiction of the arbitral tribunal; (ii) this is not an isolated case and an *ad hoc* arbitration agreement could be used in many disputes; (iii) the validity of the legal basis of an arbitral tribunal's jurisdiction cannot depend on the conduct of the parties to the dispute; and (iv) the intention of a Member State agreeing to an *ad hoc* agreement is the same as its intention when signing an invalid BIT arbitration clause.

The CJEU thus concluded that Articles 267 and 344 TFEU preclude national legislation allowing an *ad hoc* arbitration agreement to be used to continue arbitration proceedings initiated pursuant to an invalid arbitration clause in an intra-EU BIT that has the same content.

The CJEU's reasoning was not, however, limited to the question of compatibility. The CJEU found that Member States have a positive obligation to challenge, before either the arbitral tribunal or the court with jurisdiction, the validity of an arbitration clause or *ad hoc* arbitration agreement. That positive obligation is based on EU law, especially the principles of the primacy of EU law and of sincere cooperation. According to the CJEU, the positive obligation also followed from its judgment in *Achmea*. The CJEU added that, in those circumstances, national courts must uphold an action to set aside an arbitration award made on the basis of an arbitration agreement that is contrary Articles 267 and 344 TFEU and the principles of mutual trust, sincere cooperation and the autonomy of EU law.

Comment

Positive obligations owed by Member States and their national courts

PL Holdings is the first judgment in which the CJEU addresses how to manage the consequences of *Achmea* and *Komstroy*. The CJEU found that EU law imposes positive obligations on Member States and their national courts:

- Member States must challenge the validity of any BIT arbitration clause or *ad hoc* arbitration agreement, before either the arbitral tribunal or any court with jurisdiction to consider the arbitration, where contrary to EU law;

- National courts must uphold actions to set aside an arbitration award made pursuant to an arbitration agreement that is contrary to EU law.

The CJEU found confirmation of those obligations in Article 7(b) of the Agreement for the Termination of Bilateral Investment Treaties between Member States of the European Union (the "Termination Agreement") which requires the parties to ask competent national courts to set aside, annul or refrain from recognising or enforcing a covered arbitration award. 23 Member States (but not Sweden) concluded the Termination Agreement to comply with *Achmea*. They chose to terminate all intra-EU BITs and sunset clauses listed in Annex A, by means of the Termination Agreement. The *PL Holdings* judgment therefore strongly signals the CJEU's support for the solutions developed in the Termination Agreement to manage the consequences of *Achmea*.

Uncertainty remains in relation to the validity of arbitration agreements in contracts between EU investors and EU Member States

There remains continuing uncertainty as to whether the CJEU's decision applies to all arbitration agreements in contracts between EU investors and Member States. In *Achmea*, the CJEU had distinguished commercial arbitration from investor-State arbitration under an intra-EU BIT because the former results from the freely expressed wishes of the parties whereas the latter is based on a treaty the purpose of which is to remove disputes from the jurisdiction of the Member States' courts (a distinction requiring further clarification). This had arguably suggested that contract-based arbitration (including ISDS) might be carved-out from the effects of the *Achmea* judgment.

In *PL Holdings*, the CJEU did not expressly address the analogy, suggested by the Svea Court of Appeal, between the *ad hoc* arbitration agreement at issue and a commercial arbitration agreement. It also made it clear that its judgment was limited to the type of *ad hoc* agreement at issue. In other words, it decided not to deal with contract-based arbitration in general or revisit its past caselaw supporting the use of that type of arbitration under certain conditions (see, for example, *Eco Swiss*). At the same time, the CJEU did make it clear that it will not tolerate any arrangement circumventing the incompatibility of a BIT arbitration clause with EU law.

In light of this uncertainty, it cannot automatically be assumed that an arbitration provision in a contract between an EU investor and a Member State would be upheld on challenge before a national court of an EU Member State. EU investors entering into investment contracts with EU Member States who wish to preserve the option of investor-State arbitration should require an option for ICSID arbitration or an arbitration seated outside of the EU with non-EU law governing the contract.

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Lawyers to contact

Nick Lawn, Partner (nlawn@vbb.com)

Isabelle Van Damme, Partner (ivandamme@vbb.com)

Quentin Declève, Senior Associate (qdecleve@vbb.com)

Rebecca Halbach, Associate (rhalbach@vbb.com)