To arbitrate or not to arbitrate *versus* Member States after *PL Holding?*

An EU law perspective on *intra*-EU investment arbitration in the post-BITs era

1. The judgement of the Court of Justice of the European Union (CJEU) in *PL Holding v. Poland*, delivered on 26 October 2021, is the latest in a series of decisions relating to the **incompatibility of intra-EU investment arbitration with the principle of autonomy of EU law**. It finds that art. 267 and 344 TFEU preclude a national legislation which allows a Member State to conclude an *ad hoc* arbitration agreement with a foreign investor, where such agreement has the effect to continue arbitration proceedings initiated on the basis of an arbitration clause contained in a bilateral investment treaty (BIT), considered invalid as a matter of EU law. As such, the finding of the Court comes as no surprise. Indeed, the ruling ensures *effet utile* to the principles stated in the precedents *Achmea* (relating to the incompatibility of *intra*-EU BITs arbitration clauses with the principle of mutual trust and autonomy of EU law) and *Komstroy* (where incompatibility was extended to *intra*-EU investment arbitration based on the Energy Charted Treaty). To the extent that an *ad hoc* arbitration agreement aims to remedy the invalidity of a BIT arbitration clause, it cannot survive the scrutiny of the Court. Yet, no doubts that the present judgement must be distinguished from the mentioned precedents, in that it tackles the validity of **an arbitration agreement contained in a contract concluded between the investor and the Member State, and not in a BIT** (i.e., as part of an international undertaking between Member States). More precisely, such contract was concluded, according to Swedish law, by virtue of the fact that Poland omitted to challenge the jurisdiction of the arbitral Tribunal within the time-limit prescribed by Polish law. This aspect of the case is particularly consequential, as it is capable to **blur the distinction between commercial and investment arbitration** elaborated in *Achmea* and the very exception for commercial arbitration based on the criterion of «freely expressed wishes of the parties», as ground for commercial arbitration (*Achmea*, para. 55). Purpose of this post is to analyze the rationale underpinning this decision, as a follow-up of *Achmea*, and try to identify its specific impact on intra-EU investment arbitration landscape.

2. The case originates from an investment dispute between PL Holding, a company incorporated under the law of Luxemburg, and the Republic of Poland. PL Holding holds shares in two Polish banks. Following the merger of these entities, in 2013 PL Holding becomes the 99.59% shareholder of the new bank resulting from the merger. Upon such an occurrence, Polish financial supervising authorities, prohibit PL Holding from exercising the voting rights attached to its shares and order to sell them. The Polish authorities' decision is based on considerations of sound and prudent management of banks as recognized also by relevant EU law (Directive 2013/36/EU, repealing Directive 2006/48/EC). PL Holding complies with the national authorities' measures, but decides to start arbitration proceedings against Poland before the Arbitration institute of the Stockholm Chamber of Commerce, under the BIT between Poland, on the one part, and Luxemburg and Belgium, on the other (hereinafter the "Luxemburg-Poland BIT"), claiming damages for expropriation. Poland objects to the jurisdiction of the Tribunal in different moments of the arbitration proceedings, also based on EU law arguments. Yet, in 2017 (before the CJEU delivers its judgement in *Achmea*), the Tribunal holds itself competent to decide the dispute under public international law and awards damages to PL Holding. Poland challenges the validity of the award before Swedish courts,

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contending *inter alia* the invalidity of the BIT arbitration clause, pursuant to the supervened *Achmea* judgement. The Svea Court of Appeal of Stockholm upholds the validity of the award, deeming that the jurisdiction of the Tribunal is based on a valid *ad hoc* arbitration agreement meanwhile concluded between the parties, and replacing the invalid BIT clause. Poland appeals the judgement of the lower court before the Swedish Supreme Court, which refers to the CJEU the preliminary question on whether EU law, as interpreted in *Achmea*, precludes national law to give effect to such *ad hoc* arbitration agreement, which allows the continuation of arbitration proceedings initiated on the ground of an invalid arbitration clause contained in a BIT.

3. Indeed, the premise of the CJEU's ruling is the finding by the referring court that the arbitration clause contained in art. 9 of the Luxemburg-Poland BIT is invalid, on ground of *Achmea*. The Court can hence avoid assessing the compatibility of such clause, assuming its invalidity as a matter of EU law. Actually, in *Achmea*, the Court declared a similar clause contained in a BIT between Member States incompatible not only with the principle of mutual trust, but also with the principle of autonomy of EU law stemming from artt. 267 and 344 TFEU. Such conclusion was based on the (well known) three pronged approach: 1) the potential application of EU law by the arbitral Tribunal; 2) the fact that the Tribunal does not belong to the judicial system of the European Union; 3) the insufficient degree of the *ex post* review of the award by national courts as regards its substantive compliance with EU law. Concerning this last issue, in principle, judicial review of the award by national courts could bring questions of EU law addressed by the Tribunal before the CJEU, through the preliminary ruling procedure *ex* art. 267 TFEU. This would insert them within the system of EU judicial protection and thus preserve the autonomous application of EU law by its own and Member States' courts (see, Lenaerts, pp. 6-7). It should also be recalled that the Court, in *Achmea,* drew a distinction between commercial and investment arbitration. Commercial arbitration is considered compatible with autonomy of EU law, as an expression of private parties' autonomy in shaping their contractual relationships. As per stated case law, the limited grounds of judicial review of commercial awards is legitimate, in the interest of efficient arbitration proceedings (*Eco Swiss*, para. 37; *Mostaza Claro*, para. 35). Conversely, for the Court, investment tribunals are established by Member States with the very purpose to allow private parties to escape the jurisdiction of national courts in disputes that may concern the application or interpretation of EU law. Such a circumstance, coupled with the limited (or absent, in case of ICSID arbitration) grounds of judicial review of the awards, runs counter the obligation of Member States under article 19(1) TEU (*Achmea*, para. 55) and breaches the duty of sincere cooperation in the fulfillment of EU law.

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4. In the light of the foregoing, the Court considers unacceptable under EU law a tacit *ad hoc* arbitration agreement between an investor and a Member State which establishes the jurisdiction of a Tribunal with a view to replacing a body referred to in a BIT arbitration clause, considered invalid for **having the same characteristics as the one considered in *Achmea***. Such an agreement would clearly constitute a **circumvention of the principles stated in that judgement** (*PL Holding*, para. 47). In other words, borrowing language from competition law, an *ad hoc* arbitration agreement such as the one at stake breaches EU law "by effect" (if not necessarily "by object"), in that it preserves the effects of an arbitration clause incompatible with EU law (*PL Holding*, para. 48). The Court reinforces its reasoning relying on the additional obligation of Member States to challenge the jurisdiction of a Tribunal established on the

grounds of an invalid BIT arbitration clause and set aside, annul or refrain from recognizing or enforcing its arbitral award (*PL Holding*, para. 52). Such obligation stems from the principle of sincere cooperation applied to *Achmea* and is today spelled out also in the Agreement for the termination of Bilateral Investment Treaties between Member States of the European Union singed between 23 Member States out of 27, in May 2020 (hereinafter, "Termination Agreement"). Any Member State that acknowledges the jurisdiction of such a Tribunal is running counter these obligations and is thus rendering the contractual legal basis unlawful, for infringement of fundamental principles of EU law. The reasoning of the Court in this respect is hardly questionable. No doubts that Member States failure to comply with such obligation may also determine the opening of infringement proceedings by the European Commission (see, recently, here).

5. What may be questioned is whether the reasoning extends to an arbitration agreement concluded between an intra-EU investor and a Member State (whether tacitly or within an investment contract), **in the absence of an invalid BIT arbitration clause which the parties (illegitimately) intend to replace**. *PL Holding* provides limited guidance, to the extent that the Court, as usual, circumscribes the scope of the ruling to the very situation under scrutiny. This is a typical way of reasoning of the Court, which thereby keeps the room of maneuver for future distinguishing in different situations. Indeed, not necessarily the holding cannot apply to different but comparable situations, such as purely *ad hoc* investment arbitration. In this case, however: (i) ***Achmea* may not apply entirely** and (ii) a problem clearly arises with the criterion elaborated by the Court for the **distinction between commercial and investment arbitration.**

6. As regards point (i), as already written elsewhere, our reading of *Achmea* is that the ruling was motivated not only by the need to preserve the particular nature of the law of the EU Treaties (*i.e.* autonomy of EU law), but also by another constitutional concern: mutual trust among Member States courts. It is submitted that, when a Member State concludes a BIT with another Member State, choosing to defer investment disputes to the jurisdiction of an international arbitral Tribunal, it is explicitly showing its distrust towards the jurisdiction of the other Member State, as not capable to solve properly such disputes, including their EU law aspects. This, for the Court, «calls into question [...] the principle of mutual trust among the Member States» (*Achmea*, para. 58). With this said, in case of purely *ad hoc* investment arbitration, it is doubtful that this mutual trust argument can apply. Indeed, the obligation of mutual trust on other Member States compliance with EU law binds Member States in their reciprocal relationship (*Opinion 1/17*, para. 128). However, by concluding an arbitration agreement with a private investor of another Member State, a **Member State does not violate the *obligation of trusting* other Member States systems**. With regard to this specific profile, therefore, such arbitration agreement may not be problematic. Instead, it remains to be assessed whether an investment arbitration Tribunal established through a contract between an investor and a Member States, in absence of any BIT between the Member States involved, is in itself compatible with the principle of autonomy of EU law, as expressed in artt. 344 and 267 TFEU. More precisely, it should be questioned whether the exercise of jurisdiction by such Tribunal would preserve the fundamental role of national courts in the application of EU law and their dialogue with the Court of Justice, through the preliminary ruling procedure (*supra*, § 3). Should the answer be negative,

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accordingly, the choice of a Member State to conclude such an agreement would be in breach of the duty of sincere cooperation in the fulfillment of EU law.

7. In this respect, coming to point (ii), to the extent that the arbitrated dispute would relate *inter alia* to the exercise of public powers *vis-à-vis* a foreign direct investment, in absence of a BIT, the Tribunal would be *a fortiori* required to interpret EU law, as part of national law. Such Tribunal would also certainly fall outside the EU judicial system, this being a well rooted position in the CJEU case law. As regards the legitimacy of the limited degree of judicial review of Tribunal's awards, the *Achmea* criterion justifying compatibility of commercial arbitration with EU law based on the «freely expressed wishes of the parties» (*supra*, § 3) would not allow to distinguish *ad hoc* investment arbitration from commercial arbitration (see also, in this blog, Zarra, qualifying *ad hoc* investment arbitration as "commercial", unless carried out under the ICSID framework). Indeed, this criterion was widely criticized in the literature, on the consideration that also private parties' choice of commercial arbitration relies on the legal orders of the Member States regulating commercial arbitration domestically. Hence, the same obligations should flow from the Treaties onto Member States as regards both commercial and investment arbitration (for example, Fumagalli, p. 903; Dimopoulos). Further weaknesses clearly arise in this case, where an investment arbitration Tribunal is likewise established through exercise of parties' autonomy. However, we agree with AG Kokott's opinion, stating that it is **only in relation to commercial arbitration *stricto sensu*** (intended as arbitration based on commercial contracts that do not govern a foreign direct investment), that **the Court seems willing to tolerate a limited ground of review of the award**, and, accordingly, a possible loophole in the effectiveness of EU law, based on the will of the parties (AG Kokott, para. 46 and 52). On the contrary, it seems unlikely that the Court will accept that a Member State removes intra-EU investment disputes, including their EU law aspects, from EU judicial system, through the conclusion of an (even isolated) arbitration agreement with the investor: if done repeatedly (*PL Holding*, para. 49), this would undermine autonomy of EU law as interpreted in *Achmea*, **running once again afoul Member State obligations under art. 19 TEU** (*Achmea*, para. 55). Following this reasoning, it could be questioned whether the same applies to arbitration clauses contained in other types of contracts concluded by Member States, such as commercial contracts with private parties (*e.g.*, a public procurement contract). Probably, however, the latter situation would fall under the commercial arbitration exception (*supra*, § 3). In this regard, it may be persuasive the idea that the difference, justifying the diverse treatment of the two types of agreements under EU law, relates to the **nature of the relationship subject to arbitration**, rather than on the nature of the parties (see, on the point, AG Kokott, cit., paras. 55 ff.). Yet, some clarification by the Court would be certainly welcome, if a different treatment is going to be maintained under EU law, for commercial and investment arbitration respectively.

8. After *PL Holding*, the gradual dismantling of *intra*-EU investment arbitration initiated some years ago seem to have come to one of its last battles. The CJEU is fully legitimizing the political agenda of EU institutions and of the vast majority of Member States to definitely outlaw traditional *intra*-EU investment arbitration from the European investment space. While intra-EU investment arbitration tribunals still show their reluctance— and sometimes blatant refusal—to apply CJEU case-law when assessing their jurisdiction under relevant BITs, Member States courts play a central role to set

aside—or resist enforcement in their territory of—the awards of investment arbitration tribunals constituted on the basis of *intra*-EU BITs, considered invalid as a matter of EU law. With the signature of mentioned Termination Agreement (*supra*, § 4), further debate in this respect seems destined to remain mainly academic. Following *PL Holding*, the same should apply, in the present author's view, to awards of investment arbitration tribunals constituted on the basis of *ad hoc* arbitration agreements between investors and Member States. It is possible that some investors will continue to initiate arbitration proceedings against Member States for some time, based on existing contracts, placing the seat of arbitration outside the EU or otherwise trying to elude the application of EU law. The effectiveness of these *escamotages* in avoiding legal hurdles, especially in the enforcement phase, also in third countries, is uncertain. However, as regards future intra-EU investment contracts, **Member States are probably precluded to agree to arbitration with single investors under *PL Holding***.

9. On the side of the EU institutions, the protection of intra-EU investments is being tackled by the European Commission, also in the context of the ongoing work for the Capital Market Union. It should be recalled that in 2018, the EU Commission tried to reassure intra-EU investors that their rights were widely protected under the far reaching nature of internal market rules, including a minimum (though not necessarily uniform) level of protection of the right to property against public expropriation, afforded by national constitutions, EU law and applicable human rights standards (similarly, in this Blog). Hence, after *Achmea*, failures in the protection of European investors rights «*would have to be filled within th[e judicial] system [of the Member States]*» (*PL Holding*, para. 68), including the action for damages under the *Francovich* doctrine, in case of Member States violation of EU law. However, the investment community continued to voice concerns relating to the deteriorating investment environment in the EU due to unforeseeable and sudden changes of legislation and, more importantly, to the uneven capacity of national judicial systems to provide impartial and efficient protection to the rights of EU citizens and enterprises. The Commission, **apparently squeezed between a stagnation of transnational investments flows (also linked to the pandemic), and the awareness of the rule of law issues affecting the judicial systems** of some Member States, did not turn a deaf ear: in 2020, it launched a public consultation on an intra-EU investment protection and facilitation initiative. The text of the consultation shows that the Commission is open to several options, in order to improve the intra-EU investment environment in the post-BITs era, which also overlaps with the COVID-19 recovery phase. Besides the implementation of tools of amicable resolution and prevention of investment disputes, the possibility is not excluded to establish, if deemed necessary, a binding intra-EU investment dispute settlement mechanism on the model of the Unified Patents Court (*i.e.* compatible with the principle of autonomy of EU law). Following the end of the public consultation in September 2020, a **legislative proposal was expected in December 2021**. The Commission seems to have taken some additional time for reflection, possibly awaiting also the judgement of the CJEU on the *Micula* case.

10. Whatever the proposal will contain, the need to ensure investors' confidence in the EU law system of investments protection needs to be balanced with the **need to ensure Member States and EU right to regulate in the public interest**. This is even more so in a moment, like the present one, where important (green and digital) transitions are being imposed on the economy, with the related need to innovate existing legal

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frameworks. Any possible substantive or procedural layer of additional investment protection should preserve such right to regulate, as matter of European constitutional concern (see, *Opinion 1/17* and this comment). In this regard, the idea of offering *intra*-EU investors a special forum *in lieu* of local courts may bear ambiguous implications: especially in case of smaller member States, the risk exists to increase the leverage of big multinational investors *vis-à-vis* the exercise of domestic public powers aimed at the protection of the general interest. Also in this perspective, the fundamental challenge remains **to strengthen the reliable, impartial and effective application of EU** (and national) **law by administrative and judicial authorities of all the Member States**. Failing this, the principle of mutual trust among Member States would lose its justification and, with it, the trust of business in the proper functioning of the internal market. The consequences would be extremely severe, for us all.