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EU Court of Justice Decision on Bilateral Investment Treaties within the EU

Marek Wąsiński, Szymon Zaręba

In its judgment of 6 March, the Court of Justice of the European Union (CJEU) ruled that the arbitration dispute settlement model provided for in the investment agreement between Slovakia and the Netherlands is incompatible with EU law. The verdict may hinder the further application of similar solutions. The ruling, though, is conducive to Polish efforts to terminate investment protection agreements with other EU Member States.

Arbitration Clauses Incompatible with EU Law. The case decided by the CJEU concerned a dispute between Dutch insurance company Achmea BV and Slovakia. In 2012, the arbitration tribunal in Frankfurt am Main, established pursuant to the bilateral investment treaty (BIT) between the Slovak Republic and the Kingdom of the Netherlands, awarded compensation of €22 million to Achmea. Slovakia requested German courts (having jurisdiction since Frankfurt was chosen as the place of arbitration) set aside this ruling as contrary to EU law.

In the course of the proceedings, the German Federal Court of Justice asked the CJEU to assess the compatibility with EU law of the Investor-State Dispute Settlement (ISDS) clause contained in the Slovakia-Netherlands agreement. These clauses are used to protect companies investing abroad against nationalization of their property, discrimination, or expropriation. They allow, to the exclusion of the jurisdiction of national courts, the company to pursue claims directly against the state.

The CJEU ruled that the ISDS clauses are contrary to the Treaty on the Functioning of the European Union (TFEU). This is because arbitration courts are not parts of the judicial systems of the Member States, and since in their decisions they can interpret EU law in a way that is not subject to the scrutiny of the state court, their rulings violate the principle of the autonomy of law.

Effects on Agreements between EU Countries. From a formal point of view, the CJEU ruling in the Achmea case refers only to the agreement between the Netherlands and Slovakia. However, it has precedent value, meaning it will affect about 200 other BITs between EU countries that contain similar provisions. In light of the judgment, retaining these clauses threatens to violate obligations under EU law. This problem affects particularly the countries that joined the EU after 2004, since Art. 351 TFEU provides for the elimination of provisions of international agreements concluded before joining the Union if they are incompatible with EU treaties.

The Achmea judgment does not itself invalidate the ISDS clauses included in the BITs. It sends, however, a strong message to EU countries to terminate agreements that contain such clauses. This is consistent with the EC's previous recommendations to Member States to terminate intra-EU BITs precisely because ISDS is incompatible with EU law. However, in practice, most of these BITs also contain provisions ensuring the treaties will continue to apply to investments made before the agreement was terminated, depending on the agreed length, for the next 10-20 years. Investors are able then to initiate new proceedings against states based on these provisions during the relevant timeframe.

The effects of the ECJ judgment on arbitration proceedings are less obvious. Defendants certainly will invoke the Achmea judgment to challenge the jurisdiction of tribunals from the outset, aiming to end the proceedings at an early stage. This does not mean, however, that all tribunals will accept this argument and refuse to issue awards. If that occurs, the awards can be repealed by national courts in the EU countries where the arbitration took place, e.g., in Germany, based on non-compliance with the public policy clause. Moreover, courts in defendant countries will probably refuse to enforce some arbitration awards that are not directly applicable, relying on the principle of the primacy of EU law. In that case, these countries would then be exposed to the accusation they have violated international law by not applying binding bilateral agreements. The defendants then have to choose between adherence to either EU law or the BIT.

It is not clear from the CJEU ruling whether Member States will be able to re-claim payments of large awards for damage to investors, since the payments were made based on provisions found to be contrary to EU law, and what remedies the states would be entitled to if investors refuse to respond to such demands.

Impact on Extra-EU BITs. The CJEU judgment does not apply to agreements with third countries. Therefore, it is doubtful whether it would have a negative impact on the functioning of a BIT between, for example, Poland and the U.S. However, the judgement should be seen as a sign of a wider trend to question the rules for investor protection currently in force. In May 2017, the CJEU ruled, contrary to the position of the European Commission, that investment protection included in the EU-Singapore Free Trade Agreement is not the exclusive competence of the EU. This means that agreements that have investment arbitration clauses should be subject to the ratification procedure, not only at the EU level but also in all Member States.

The CJEU is also due to give an opinion on a trade agreement with Canada (CETA). The Belgian government submitted a request to verify compliance with EU law of a reformed ISDS clause—Investment Court System (ICS)—contained in the trade agreement. The Achmea judgment suggests the EU may conclude international agreements creating new judicial bodies whose decisions concern the interpretation and application of the agreements themselves, provided that the autonomy of EU law is respected. In this context, the most crucial part will be the CJEU’s interpretation of provision that give the ICS tribunal the possibility to consider the domestic law of a party as a “matter of fact”. Depending on whether the CJEU considers this a violation of the autonomy of EU law, it will be necessary to renegotiate the signed agreement or will make finalisation of the ratification process possible.

However, endeavours to change the ISDS clause go beyond the EU. Calls for reform appeared during the negotiation of the Comprehensive and Progressive Transpacific Partnership (CPTPP, after the U.S. withdrawal from what was then known as the TPP) and in the renegotiation of NAFTA between Canada, Mexico, and the U.S. Reform of arbitration rules adopted by the United Nations Commission on International Trade Law (UNCITRAL) that applied to some proceedings has been under consideration since 2017. The EU Council on 20 March mandated the European Council (EC) hold talks on this matter. The EC should try to dissolve the Investment Court System and turn it into a multilateral court system for investments. However, the chances of such a scenario are limited because of U.S. opposition and new agreements with ISDS clauses included. Even Vietnam and Canada, which agreed to the ICS proposal in bilateral agreements with the EU, at the same time signed CPTPP, which includes ISDS.

Conclusions. The Achmea judgment will significantly impede, if not completely block, the functioning of arbitration tribunals under ISDS clauses, disrupting the exercise of intra-EU BITs. With the risk that arbitration judgments may be repealed (due to non-compliance with EU law), investors will look for opportunities to use arbitration in non-EU countries, such as Switzerland. Accordingly, the investment attractiveness of countries such as the Netherlands or Luxembourg may decrease. They have been prime destinations for investments from the U.S. and others, not only because of their EU membership and good market conditions but also investor protection through numerous BITs with other EU countries.

The judgment is being positively received by NGOs that considered ISDS a threat to national regulations. This may increase pressure on EU Member States to withdraw from BITs and look for alternative forms of protection for their investors. However, ending a BIT and ISDS may be viewed by some investors, present and prospective, as a deterioration of market conditions. This is particularly the case when there is doubt about the efficiency and independence of certain countries’ domestic judicial system.

For Poland, which started to withdraw from BITs in 2016 (see annex), the CJEU judgment is favourable because it provides solid grounds for taking such actions. Nevertheless, the loss of credibility of ISDS in light of the CJEU judgement and Poland’s simultaneous termination of agreements may weaken the sense of security of investors from other Member States, which comprise a significant majority of foreign direct investment in Poland.

Annex:

Selected FDI in Poland, by stock (2016)

Country	FDI stock in Poland by the end of 2016 (million PLN)	Share of total FDI stock	Inflow of FDI to Poland in 2016 (million PLN)	Share of FDI inflow	BIT termination in progress?	Years ISDS remains in force after termination / end date
European Union	717,801.1	92.2%	50,441.0	91.9%	NA	NA
Netherlands	149,944.5	19.3%	20,189.6	36.8%	yes	15
Germany	129,356.7	16.6%	13,711.5	25.0%	yes	20
Belgium and Luxembourg	130,957.4	16.8%	10,711.4	19.5%	yes	10
France	78,729.3	10.1%	4,069.9	7.4%	yes	15
Spain	45,392.6	5.8%	-747.3	-1.4%	yes	10
United Kingdom	39,592.5	5.1%	2,092.1	3.8%	yes	15
Italy	32,454.4	4.2%	-1,649.5	-3.0%	terminated	9 January 2018
Austria	31,293.3	4.0%	4,029.9	7.3%	yes	10
Cyprus	25,987.2	3.3%	346.8	0.6%	yes	10
Sweden	15,590.7	2.0%	76.0	0.1%	yes	20
Denmark	13,406.8	1.7%	-313.4	-0.6%	mutual termination (awaiting signature)	10 (zero on mutual termination)
Finland	6,011.3	0.8%	-167.8	-0.3%	yes	20
Ireland	5,579.7	0.7%	-2,258.9	-4.1%	NA	NA
Portugal	4,516.6	0.6%	305.5	0.6%	terminated	3 August 2029

Czech Republic	2,307.0	0.3%	9.4	0.0%	ongoing negotiations	10
Malta	2,085.2	0.3%	107.4	0.2%	NA	NA
Hungary	1,876.1	0.2%	-366.3	-0.7%	yes	10
Lithuania	1,117.4	0.1%	59.6	0.1%	yes	10
Slovakia	623.7	0.1%	-162.0	-0.3%	no	10
Latvia	277.7	<0.1%	45.9	0.1%	mutual termination (in parliament)	10 (zero on mutual termination)
Slovenia	268.8	<0.1%	-25.7	0.0%	no	10
Bulgaria	205.8	<0.1%	249.3	0.5%	yes	10
Greece	196.4	<0.1%	34.0	0.1%	yes	20
Croatia	100.3	<0.1%	32.5	0.1%	yes	10
Estonia	94.0	<0.1%	15.6	0.0%	no	10
Romania	-164.2	<0.1%	45.6	0.1%	ongoing negotiations	10
U.S.	19,613.9	2.5%	125.9	0.2%	no	20

Source: own calculations based on National Bank of Poland