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Structuring for Brexit: The *Achmea* Decision

By Robert Blackett

Any business which is planning to invest either in Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia or Slovenia, or in the energy sector anywhere the UK or EU, should consider whether its investment might have to be structured differently, because of the combined effect of the UK's planned withdrawal from the EU and a surprise ECJ decision from March 2018.

BITs

Some EU Member States are party to "*bilateral investment treaties*" ("BITs") with other EU Member States.

States which are party to BITs agree to treat investments by one another's investors to a certain standard. Typically each state agrees:

(a) To accord investments by the other state's nationals or companies:

   (i) The most favourable treatment that it accords to investments by its own, or any third country's, nationals or companies

   (ii) "F*air and equitable treatment*"

   (iii) "*Full protection and security*"

(b) To pay compensation in the event that it expropriates investments belonging to the other state's nationals or companies

(c) That the investors may bring claims against the host state for breach of the treaty by way of binding international arbitration, instead of through the host state's domestic courts

The UK is party to bilateral investment treaties ("**BIT**") with twelve EU Member States (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia). Those same countries are also party to BITs with a number of other EU Member States.

BITs give investors some protection against political risk. In the past, investors from the EU who invested in those Eastern European countries have enjoyed protection under their respective BITs. For example:

(a) In 2006 Cypriot investors who funded a new terminal at a state-owned airport in Hungary in exchange for the right to operate that terminal were awarded $84 million in a claim against **Hungary** under the Cyprus-Hungary BIT. Hungary had unlawfully expropriated the investment (*ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16).

(b) In 2007 two Finnish banks and a German bank which had loaned an Estonian company money to build a fish processing factory were awarded $6 million and €10 million in a claim against **Estonia** under Finland-Estonia and Germany-Estonia BITs. Estonia breached its obligation to act "*fairly and equitably*" when it failed to honour representations made to the banks, persuading the banks to restructure the loans to the detriment of the banks (*Oko Pankki Oyj, VTB Bank (Deutschland) AG and Sampo Bank Plc v. The Republic of Estonia*, ICSID Case No. ARB/04/6).

(c) In 2017 a Lithuanian investor was awarded $4.5 million in respect of claims against **Latvia** under the Lithuani-Latvia BIT. The claims arose out of the early termination of a lease agreement, and alleged nationalisation of a heating and hot water supply system in which the claimant had invested.

(d) In 2017 an Italian investor was awarded an undisclosed sum in respect of claims against **Romania** under the Italy-Romania BIT. The claims arose out of alleged breaches of a privatisation agreement concerning a steel manufacturer in which the claimant had invested, which had led to its liquidation.

Energy Charter Treaty

The Energy Charter Treaty ("**ECT**") is a multilateral treaty which creates a framework between the Contracting Parties for trade, transit and investment in the energy sector. All EU Member States, including the UK, are Contracting Parties to the ECT. The EU itself is also a Contracting Party. Article 10(1) of the ECT sets out investment protections similar to those found in BITs which are to apply as between a Contracting Party and an Investor from another Contracting Party.

Structuring Investments to Obtain Treaty Protection

An investor may wish to invest in a country which is not party to an investment treaty with the investor's home state. In such a case a question arises as to whether the investor can make its investment via an entity in a state which is party to a relevant treaty and thereby obtain treaty protection.

Whether such a strategy is successful depends upon the wording of the particular investment treaty.

Saluka v Czech Republic (Partial Award, 17 March 2006) concerned a claim by Saluka, a Netherlands company, against the Czech Republic under a BIT between those countries. The Czech Republic complained that the Netherlands company was just a shell, and that the "real" investor was a Japanese company, which was not entitled to protection under the BIT. The Tribunal should recognise that reality, "pierce the corporate veil" and deny Saluka, which was really a Japanese company, the protections of the treaty. The Tribunal said of this argument:

> "[the terms of the Treaty] *expressly give a legal person constituted under the laws of The Netherlands – such as, in this case, Saluka – the right to invoke the protection of the Treaty. To depart from that conclusion requires clear language in the Treaty, but there is none. The parties to the Treaty could have included in their agreed definition of "investor" some words which would have served, for example, to exclude wholly-owned subsidiaries of companies constituted under the laws of third States, but they did not do so. The parties having agreed that any legal person constituted under their laws is entitled to invoke the protection of the Treaty, and having so agreed without reference to any question of their relationship to some other third State corporation, it is beyond the powers of this Tribunal to import into the definition of "investor" some requirement relating to such a relationship having the effect of excluding from the Treaty's protection a company which the language agreed by the parties included within it.*
>
> *While it might in some circumstances be permissible for a tribunal to look behind the corporate structures of companies involved in proceedings before it, the Tribunal is of the view that the*

circumstances of the present case are not such as to allow it to act in that way."

Denial of Benefits in the ECT and the UK's Intra-EU BITs

Some treaties do contain express provisions which are addressed to this issue (known as "*denial of benefits clauses*"). The ECT provides:

> ***"Article 17: Non-Application of Part III in Certain Circumstances***
>
> *Each Contracting Party reserves the right to deny the advantages of this Part to:*
>
> *(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organised; …"*

This provision was considered in *Plama Consortium Ltd v Bulgaria* (ICSID Case No. ARB/03/24, Award). The tribunal in that case accepted that, in Article 17, the Contracting Party did not deny protections to such investors, but only reserved its right to do so. And that, if a Contracting Party exercised that right, it would not have retrospective effect (i.e. the investor would still be entitled to the protections of the treaty in respect of the period preceding the denial).

None of the UK's intra-EU BITs contain denial of benefits clauses (i.e. the UK's BITS with Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia).

Sunset Clauses in the UK's Intra-EU BITs

The UK's intra-EU BITs are generally terminable on either one year or six months notice. They all, however, contain 'sunset' clauses. The effect of these clauses is that the treaty remains effective, and investments will continue to be protected, for a further 'sunset' period (15 or 20 years) following termination.

Arbitration Procedure Under BITs

BITs provide for different arbitral procedures, and may give the investor a choice as to what procedure is to be followed.

Many BITs provide for arbitration under the UNCITRAL rules. Arbitrations under those rules do not enjoy any special status. Arbitrations under the UNCITRAL awards have a jurisdical seat, and will be subject to the supervisory jurisdiction of the courts of that seat. The award which results from such an arbitration is just like any arbitral award, and can be challenged in the courts of the seat according to the rules of the seat. If the arbitration were seated in England, sections 67 and 68 of the Arbitration Act 1996 would govern any challenge. One ground on which awards can be challenged under section 68 is if they are contrary to public policy. When recognition or enforcement is sought in a country other than the seat the award will be treated like any other foreign award. Enforcement of the award in England would be governed by sections 100 to 103 of the Arbitration Act 1996 (which give effect to the New York Convention in England). One ground on which enforcement of an award can be declined is if it is contrary to public policy (section 103(2) of the Arbitration Act 1996).

In many BITs, however, the state parties consent to submit disputes to a different system of arbitration, which is governed by different rules. The Convention on the Settlement of Investment Disputes between States and

Nationals of Other States (“**ICSID Convention**”) established the International Centre for Settlement of Investment Disputes (“**ICSID**” or the “**Centre**”). All EU Member States (but not the EU itself) are Contracting States to the ICSID Convention.

Article 25 of the ICSID Convention provides:

> *“The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State … and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally …”*

Article 54(1) of the ICSID Convention provides:

> *“Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State …”*

The ICSID Convention sets out limited grounds allows Contracting States to decline to recognise and enforce awards. In particular, it does not make any provision for enforcement to be refused on the grounds that any award is contrary to public policy.

In the UK the ICSID Convention is given effect by the Arbitration (International Investment Disputes) Act 1966. It allows awards rendered pursuant to the ICSID Convention to be registered in the High Court (Court of Session in Scotland), whereupon the pecuniary obligations imposed by the award are of the same force and effect as if the award had been a judgment of that court.

The UK’s intra-EU BITs variously provide for UNICTRAL and/or ICSID arbitration. In the ECT the Contracting Parties consent to submit disputes to ICSID, to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law or to the Arbitration Institute of the Stockholm Chamber of Commerce, at the investor’s option.

TFEU, TEU

The EU is founded on two treaties, the Treaty on European Union (“**TEU**”) and the Treaty on the Functioning of the European Union (“**TFEU**”). Each of the EU’s Member States, including the UK, is a party to those two treaties.

The TEU, TFEU and the law adopted by the EU pursuant to those treaties have ‘primacy’ over the laws of Member States. This has long been recognised in the case law of the ECJ, and of the Member States and is also set out in a declaration annexed to the TFEU.

BITs Between EU Member States and Non-Member States

The EU intends to replace BITs between Member States and non-Member States with new agreements negotiated by the EU.

On 12 December 2012, the EU adopted Regulation 1219/2012 establishing transitional arrangements with respect to the thousands of BITs already concluded between Member States and non-Member States.

Under that regulation all existing BITs with non-Member States remain in force. Member States must notify the Commission of those BITs. If the Commission considers that a provision of such a BIT is a "serious obstacle" to the negotiation of BITs between the EU and other countries, the Commission must enter into consultation with the Member State to identify appropriate actions. When a Member State intends to negotiate a new BIT, or an amendment to an existing BIT, with a non-Member State, it must seek authorisation from the Commission. The Commission will authorise negotiations unless they would be inconsistent with EU investment policy or EU law, superfluous, or constitute a "*serious obstacle*" to negotiation or conclusion of agreements with third countries by the EU. Member States must also seek the Commission's agreement before activating dispute settlement mechanisms against a third country and shall, where requested by the Commission, activate such mechanisms.

Achmea - Background

The Netherlands and the Slovak Republic (both EU Member States) are party to a BIT (this is the same BIT which was invoked in the *Saluka* case discussed above). Article 8 of that BIT provides for "*all disputes between one Contracting Party and an investor of another Contracting Party concerning an investment of the latter*" to be referred to arbitration, under the UNCITRAL Rules.

In 2004, as part of a reform of its health system, the Slovak Republic opened the Slovak market in 2004 to those offering private health insurance services. Achmea, an undertaking belonging to a Netherlands insurance group, set up a subsidiary in Slovakia to which it contributed capital and through which it offered private sickness insurance services on the Slovak market.

In 2006 the Slovak Republic partly reversed the liberalisation of the private sickness insurance market. In particular, by a law of 25 October 2007, it prohibited the distribution of profits generated by private sickness insurance activities.

In October 2008 Achmea brought arbitration proceedings against the Slovak Republic under the BIT. The seat of the arbitration was Germany.

On 26 January 2011, the Constitutional Court of the Slovak Republic held that the prohibition was contrary to the Slovak constitution, and the Slovak Republic once more allowed the distribution of such profits.

By an arbitral award of 7 December 2012, the arbitral tribunal ordered the Slovak Republic to pay Achmea damages in the principal amount of €22.1 million.

Under Paragraph 1059(2) of Germany's *Zivilprozessordnung* (Code of Civil Procedure), an arbitral award can be set aside only if one of the grounds in that provision is present. The grounds include the arbitration agreement being invalid under the law to which the parties have subjected it, and the recognition or enforcement of the arbitral award being contrary to public policy.

The Slovak Republic brought court proceedings in Germany, seeking to set aside the award on the grounds that the arbitration agreement was invalid or that recognition of the award was contrary to public policy. The Slovak Republic argued that the arbitration provision in the BIT was incompatible with Articles 267 and 344 of the TFEU. The German court referred the issue to the ECJ for a preliminary ruling.

EU Treaty Provisions Considered in _Achmea_

The EU treaty provisions which the Slovak Republic relied upon were as follows.

Article 19(1) of the TEU provides: "*the Court of Justice of the European Union … shall ensure that in the interpretation and application of the Treaties the law is observed. Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law*".

The TFEU provides:

> ***"Article 267***
>
> *The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:*
>
> *(a) the interpretation of the Treaties;*
>
> *(b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;*
>
> *Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.*
>
> *Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.*
>
> *…"*
>
> ***"Article 344***
>
> *Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein."*

Slovakia pointed to the fact that Article 8(6) of the BIT required the tribunal to "*decide on the basis of the law, taking into account in particular though not exclusively: … the law in force of the Contracting Party concerned;* [and] *the provisions of … other relevant Agreements between the Contracting Parties*", which would include EU legislation and the EU Treaties.

Hence there was a theoretical possibility that a tribunal appointed under the BIT might be called upon to decide a dispute concerning the interpretation of EU legislation or of the EU Treaties (note that there was no suggestion that the dispute between Achmea and Slovakia had actually involved any issue of EU law whatsoever).

TFEU requires that Member States not submit disputes concerning the interpretation of the EU Treaties to any method of settlement other than that provided for in the Treaties. The only method for settling such questions which is referred to in the treaties is raising them before a "*court or tribunal of a member state*". Once the question comes before a court or tribunal "*against whose decisions there is no judicial remedy under national law*" that court is required to refer the mater to the ECJ.

Slovakia argued that an arbitral tribunal constituted under Article 8 of the BIT would not be a "*court or tribunal of a Member State*" and there would be no "*judicial remedy*" against (the substance/merits of) its decisions. An arbitral tribunal, not being a court or tribunal of a Member State, could not refer an issue to the ECJ.

The Advocate General delivered an opinion on 19 September 2017 that the arbitration provision in the BIT was compatible with TFEU.

The ECJ's Ruling in *Achmea*

On 6 March 2018 the ECJ issued a judgment in *Slovak Republic v Achmea BV* (6 March 2018 C-284/16). In a surprise decision, the ECJ took the unusual step of departing from the Advocate General's opinion. The operative part of the judgment states:

> *"Articles 267 and 344 TFEU must be interpreted as precluding a provision in an international agreement concluded between Member States, such as Article 8 of the Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federative Republic, under which an investor from one of those Member States may, in the event of a dispute concerning investments in the other Member State, bring proceedings against the latter Member State before an arbitral tribunal whose jurisdiction that Member State has undertaken to accept."*

Does *Achmea* Affect Other Arbitration Agreements With EU Member States?

The ECJ's ruling is directed to "*a provision in an international agreement concluded between Member States*". Quite apart from such state-to-state agreements, however, states regularly enter into commercial contracts which contain arbitration agreements. One might have thought that such agreements would be equally objectionable, since there is equally a theoretical possibility that a tribunal appointed under such a commercial arbitration agreement might be called upon to decide a dispute concerning the interpretation of EU legislation or of the EU Treaties.

In *Achmea*, the ECJ says that commercial arbitration agreements are nonetheless not affected by its ruling:

> *"… in relation to commercial arbitration, the Court has held that the requirements of efficient arbitration proceedings justify the review of arbitral awards by the courts of the Member States being limited in scope, provided that the fundamental provisions of EU law can be examined in the course of that review and, if necessary, be the subject of a reference to the Court for a preliminary ruling ..."*
>
> "*However, arbitration proceedings such as those referred to in Article 8 of the BIT are different from commercial arbitration proceedings. While the latter originate in the freely expressed wishes of the parties, the former derive from a treaty by which Member States agree to remove from the jurisdiction of their own courts, and hence from the system of judicial remedies which the second subparagraph of Article 19(1) TEU requires them to establish in the fields covered by EU law … disputes which may concern the application or interpretation of EU law. In those circumstances, the considerations set out in the preceding paragraph relating to commercial arbitration cannot be applied to arbitration proceedings such as those referred to in Article 8 of the BIT."*

This does not really seem to explain why commercial arbitration is permissible where treaty arbitration is not.

A commercial arbitration award can always be challenged in the courts of the seat, or enforcement resisted, on the ground that the award is contrary to public policy. If a commercial arbitration tribunal were to decide a point of EU law incorrectly, a party could bring a challenge or resist enforcement, asserting that the award was based upon an incorrect interpretation of EU law and so contrary to public policy. This, the ECJ suggests, is sufficient to make commercial arbitration compatible with Articles 267 and 344 TFEU.

The problem is that the same is equally true of awards made under the arbitration provisions of investment treaties. Admittedly, if the treaty provides for ICSID arbitration, that excludes the possibility of a challenge on public policy grounds, and so one can see why ICSID arbitration agreements might be considered to be incompatible with TFEU. But many investment treaties do not provide for ICSID arbitration – the award in the *Achmea* case was made pursuant to the UNCITRAL Rules. The juridical seat was Germany. And the award was open to challenge on grounds of public policy. It is hard to see why that kind of award is any different from a commercial award.

The ECJ attempts to justify treating treaty arbitration and commercial arbitration differently on the ground that: "*While the latter originate[s] in the freely expressed wishes of the parties, the former derive[s] from a treaty*". That makes no sense at all. The arbitration provision in an investment treaty is a "freely expressed wish" by the state concerned to arbitrate disputes under the treaty.

This criticism is, however, academic – that fact is that, however unsatisfactory or incoherent the ECJ's reasoning, Achmea prohibits agreements like Article 8 of the BIT considered in that case, and does not affect commercial arbitration agreements which EU Member States may enter into, even if they concern the same subject matter.

Does *Achmea* Affect the ECT?

Unlike the BIT which was considered in the Achmea case, the ECT is a treaty which the EU is itself a party to.

The issue of whether the ECT is compatible with EU law has yet to be tested before the ECJ. The European Commission, however evidently considers that arbitration under the ECT is equally objectionable, despite the EU having itself signed up to it.

In the mid-2000s Spain encouraged investment in solar power projects by way of a series of incentives. These were modified in 2013/14 to impose a much less generous regime. A number of investors from other EU Member States brought claims against Spain under the ECT.

The European Commission submitted a series of *amicus curiae* briefs in those arbitrations, asserting that the tribunals lacked jurisdiction. The Commission raised the same arguments as in Achmea, and also argued that the investors were not from an "*Area*" of "*another Contracting Party*". Spain and the investors were all from the same "*Contracting Party*" – the EU. The arbitral tribunals rejected the Commission's arguments.

On 10 November 2017, in Decision 2017/C 442, the Commission stated: "*any provision that provides for investor-State arbitration between two Member States is contrary to Union law … Union law provides for a complete set of rules on investment protection … Member States are hence not competent to conclude bilateral or multilateral agreements between themselves*" and the "*ECT does not apply to investors from other Member States initiating disputes against another Member State*".

On 19 July 2018 the Commission issued Communication COM(2018) 547/2 which includes that "*EU investors … cannot have recourse … to arbitration tribunals established under the Energy Charter Treaty*".

Investors from EU Member States who are considering energy investments in other EU Member States should probably assume that the courts of EU Member States will not enforce any awards which might be made in their favour under the ECT.

UK's Notification of Withdrawal From TFEU and TEU

TEU Article 50 provides:

> *"1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.*
>
> *2. A Member State which decides to withdraw shall notify the European Council of its intention. … the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal …*
>
> *3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period."*

In Article 50 "*the Treaties*" means TEU and TFEU. Article 50 of TEU applies *mutatis mutandis* to the Euratom Treaty (Article 106a of the Euratom Treaty).

On 29 March 2017 the UK gave notice in accordance with Article 50(2) of the TEU of its withdrawal from the EU and from Euratom. Therefore TEU, TFEU and the Euratom Treaty shall cease to apply to the UK on 29 March 2019.

Awards in Favour of UK Investors Against EU Member States Will Become Enforceable

For the moment the UK is an EU Member State. The UK's BITs with Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia are intra-EU BITs. Pursuant to *Achmea*, an award which a UK investor obtained against one of those countries would be contrary to EU law and unenforceable in the UK or any other EU Member State as contrary to public policy.

Once the UK ceases to be party to TFEU, those treaties are no longer intra-EU treaties, and the reasoning in *Achmea* ceases to apply. There would be nothing to prevent an award made pursuant to those treaties in favour of a UK investor being enforced in the UK or in any EU Member State.

Awards Under Intra-EU BITs / Intra-EU ECT Award May Become Enforceable in the UK

A UK court would probably not presently enforce an award which had been made under an intra-EU BIT (say an award against Slovakia in favour of a German investor). Such awards are contrary to public policy for so long as the UK remains bound by TFEU. Once TFEU ceases to apply, such awards would no longer be contrary to (UK) public policy. There is, therefore, a possibility that such awards, though they would not be enforceable in EU Member States, would be enforceable in the UK.

Implications for Prospective Investors in EU Member States

Investors from EU Member States who are considering investing in Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia should consider whether to make their investment via a UK shell company, in order to obtain the protection of the UK's BITs with those countries.

Investors from EU Member States who are considering making energy sector investments in other Member States should consider whether to make their investments via a UK shell company, in order to obtain the protection of the ECT. The position is somewhat less clear cut in respect of the ECT because the ECT contains a denial of benefits provision, but there is a good chance that such provisions only have prospective effect. So, provided the host state does not disavow the protections of the ECT before the shell company makes the investment, the ECT may still provide a valuable protection.