ALERT MEMORANDUM

The BGH's *Achmea* Decision: Arbitration Clauses In "Intra-EU BITs" Are Invalid

November 30, 2018

On October 31, 2018,[1] the German Federal Court of Justice (the *Bundesgerichtshof*, "**BGH**") rendered an eagerly awaited decision, finding in accordance with the *Achmea* judgment of the Court of Justice of the European Union ("**CJEU**")[2] that arbitration clauses in bilateral investment treaties between EU Member States ("**intra-EU BITs**")[3] are incompatible with EU law and arbitral awards issued under intra-EU BITs must be set aside.

The BGH set aside the arbitral award against the Slovak Republic in favor of the Dutch insurance company Achmea[4] based on the lack of a valid arbitration agreement, and reversed the lower court's decision upholding the award.[5] The BGH's decision reignites the momentum of the debate triggered by the CJEU's *Achmea* judgment.

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The *Achmea* Arbitration

In 1991, then-Czechoslovakia and the Netherlands entered into a treaty on the promotion and reciprocal protection of investments (the "**Treaty**" or "**BIT**"). Pursuant to Article 8(2) of the Treaty, each contracting party agreed to resolve investment disputes with investors of the other contracting party through arbitration. The arbitration agreement is perfected once an investor accepts this "offer" to arbitrate.

Achmea, a Dutch insurance company, began operating on the Slovak health insurance market in 2004. In 2006, regulatory measures partially reversed the liberalization of the Slovak health insurance market, restricting Achmea's operations in Slovakia.

In October 2008, Achmea initiated an UNCITRAL arbitration against the Slovak Republic for breaches of the BIT's substantive protections. The arbitral tribunal seated in Frankfurt issued a final award on December 7, 2012, ordering Slovakia to pay damages to Achmea.[6]

Set Aside Proceedings And Referral To The CJEU

The Slovak Republic ("**Applicant**") brought an action to set aside the award before the Higher Regional Court of Frankfurt ("**Higher Regional Court**"). The Applicant claimed that the investor-State arbitration provision in Article 8(2) of the BIT was incompatible with EU law and thus the arbitral tribunal lacked jurisdiction. The Higher Regional Court dismissed the challenge and upheld the award.[7]

Subsequently, the Applicant lodged an appeal to the BGH, which in turn requested in March 2016 a preliminary ruling from the CJEU as to whether Articles 344 and 267 of the Treaty on the Functioning of the European Union ("**TFEU**") preclude the application of an investor-State arbitration clause in an intra-EU BIT.

In its judgment of March 6, 2018, the CJEU ruled that an investor-State arbitration clause in an intra-EU BIT, such as Article 8(2) of the Treaty, adversely affects the autonomy of EU law and is incompatible with the duty of sincere cooperation as it jeopardizes the effective and uniform application of EU law.[8]

The BGH's *Achmea* Decision

Following the CJEU's *Achmea* judgment, the BGH ruled on October 31, 2018 on the Slovak Republic's application to set aside the *Achmea* award.

The BGH overruled the Higher Regional Court's decision and set aside the *Achmea* award due to the absence of a valid arbitration agreement.

*Ground For Setting Aside Pursuant To The German Code Of Civil Procedure ("**CCP**")*

The BGH based its decision to set aside the *Achmea* award on Section 1059(2) No. 1 a) CCP. Pursuant to this provision, German courts may set aside an award rendered under an invalid arbitration agreement.

Because Article 8(2) of the BIT was incompatible with EU law and therefore invalid, there was no valid arbitration agreement.

Article 8(2) Of The BIT: Inapplicable As Incompatible With EU Law

The BGH fully accepted the CJEU's reasoning in the *Achmea* decision.

The CJEU held that Achmea's possibility to initiate arbitration against the Slovak Republic under Article 8(2) of the BIT was incompatible with the EU's judicial system.

It follows from Article 344 TFEU that international treaties between EU Member States must not impair the autonomy of the EU legal system. To safeguard this autonomy, the EU established a judicial system with the preliminary ruling procedure under Article 267 TFEU as its "*keystone*", ensuring the consistency and uniformity of the interpretation of EU law.

As with domestic courts, investment treaty tribunals may be called upon to interpret and apply EU law. However, unlike EU Member State courts, investment treaty tribunals may not request preliminary rulings under Article 267 TFEU. The limited judicial review to which an award may be subject in set aside proceedings before the domestic courts of an EU Member State does not ensure sufficient "control" of the award by the domestic courts.

Arbitration clauses, such as Article 8(2) of the BIT, therefore threaten the autonomy of EU law ensured by Article 267 TFEU, which is incompatible with the EU Member States' duty of sincere cooperation. It is irrelevant whether an investment treaty tribunal is actually called upon to interpret and apply EU law as it suffices that arbitral proceedings on the basis of an intra-EU BIT may, in principle, raise questions of EU law.

No Violation Of Good Faith

The BGH examined in detail whether the principles of good faith pursuant to Section 242 of the German Civil Code ("**CC**") might preclude the setting aside of the award in the present case.

The BGH, recalling its previous case law, held that the principle of good faith may bar a party from invoking a ground for setting aside an award if that party expressly and unconditionally invoked an arbitration agreement prior to the proceedings to induce the other party to initiate arbitration, only to argue in the arbitration and subsequent enforcement proceedings that the arbitration agreement was invalid. Likewise, contradictory conduct could prevent a party to the proceedings from invoking the invalidity of an arbitration agreement if, through its specific conduct, that party had created a special element of trust as a result of which the other party appears worthy of protection.

Since, according to these standards, the BGH found no violation of Section 242 CC in the present case, it expressly left the question open whether a good faith objection pursuant to Section 242 CC would be compatible with the Member States' duty to ensure the effective application of EU law. Consequently, it remains to be seen whether in a case where a party could successfully demonstrate that the standards set by the BGH in respect of bad faith are met, the other party would be barred from invoking the invalidity of an arbitration agreement based on a violation of Section 242 CC.

No Referral Of CJEU's Achmea *Judgment To German Federal Constitutional Court*

Contrary to the Applicant's suggestion, the BGH declined to refer the CJEU's *Achmea* judgment to the German Federal Constitutional Court (*Bundesverfassungsgericht*) for review.

The Applicant contended, *inter alia*, that in issuing the *Achmea* judgment, the CJEU exceeded its competence. Referring to the standards established in the Federal Constitutional Court's *Honeywell* decision,[9] the BGH held that such *ultra vires* review is called for only in cases of "serious breaches." Such "serious breach" can exist only where a CJEU judgment interpreting primary EU law exceeds the threshold of arbitrariness. However, the BGH did not consider the CJEU's interpretation of Articles 344 and 267 TFEU arbitrary.

Closing Remarks And Outlook

The BGH's *Achmea* decision marks the first instance where the CJEU's *Achmea* judgment led to the setting aside of an arbitral award rendered under an intra-EU BIT. Pursuant to the *Achmea* judgment, the BGH concluded that the incompatibility of investment arbitration clauses in intra-EU BITs with EU law invalidates the arbitration agreement. Consequently, the BGH set aside the arbitral award.

The BGH's decision sends a strong signal to domestic courts of other EU Member States, which could equally uphold requests for the setting aside of arbitral awards rendered by tribunals under intra-EU BITs.

However, the scope of the BGH's decision remains uncertain, particularly with regard to arbitral awards issued under different circumstances. The CJEU's *Achmea* judgment, on which the decision of the BGH is based, concerned arbitral proceedings under an intra-EU BIT. Therefore, it remains to be seen what impact the BGH's *Achmea* decision will have on arbitration proceedings under the Energy Charter Treaty ("**ECT**"), a multilateral treaty in the energy sector that contains an investor-State arbitration clause and whose contracting parties are all the EU Member States other than Italy, as well as the EU itself.

It also remains unclear to what extent the BGH's findings in the *Achmea* decision apply to the recognition and enforcement of ICSID awards rendered under intra-EU BITs.

Finally, since the BGH declined to refer the CJEU's *Achmea* judgment to the Federal Constitutional Court,

it remains to be seen whether Achmea will lodge a constitutional complaint before the Federal Constitutional Court to determine the compatibility of the CJEU's *Achmea* judgment with the German Basic Law.

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CLEARY GOTTLIEB

1 German Federal Court of Justice, Decision, Case I ZB 2/15 (Oct. 31, 2018).

2 *Slowakische Republik (Slovak Republic) v. Achmea BV*, Case C-284/16, CJEU, Judgment (Mar. 6, 2018). For greater detail on this CJEU judgment, please see: Cleary Gottlieb Alert Memorandum of March 9, 2018.

3 The abbreviation "BIT" stands for Bilateral Investment Treaty.

4 *Achmea B.V. (formerly known as "Eureko B.V.") v. The Slovak Republic*, PCA Case No. 2008-13, Final Award (Dec. 7, 2012).

5 Frankfurt Higher Regional Court, Decision, Case 26 Sch 3/13, (Dec. 18, 2014).

6 *Achmea B.V. (formerly known as "Eureko B.V.") v. The Slovak Republic*, PCA Case No. 2008-13, Final Award (Dec. 7, 2012).

7 Frankfurt Higher Regional Court, Decision, Case 26 Sch 3/13, (Dec. 18, 2014).

8 Cleary Gottlieb Alert Memorandum of March 9, 2018 discusses this decision in detail.

9 German Federal Constitutional Court, Decision, BVerfGE 126, 286 (July 6, 2010).