Implications of the CJEU's Achmea decision (C-284/16) on tax treaty arbitration

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On 6 March 2018 the Grand Chamber of the CJEU ruled in the *Achmea* decision (C-284/16) that the bilateral investment treaty (BIT) between The Netherlands and the Slovak Republic violated EU law because it allowed an arbitral tribunal to interpret provisions of EU law in a dispute between investors and (Member) States, while such interpretation could not be effectively challenged via the domestic court process.[1] That meant that the CJEU would be left offside as final arbiter of EU law.
Although the case concerned intra-EU dispute resolution, the level of abstraction in the CJEU's judgment suggests that agreements between Member States and third countries could be at risk too, as Prof. Thym convincingly argues.[2] But does the *Achmea* decision also imply that arbitration procedures in other treaties than investment treaties, such as tax treaties, are now a no-go?

The decision

In 2004, the Slovak Republic opened its market to private parties offering sickness insurance services. Achmea, a Dutch insurer, entered the Slovak market and started offering those services. In 2006 the liberalization of the private sickness insurance market was already partly reversed, and several legislative measures were taken that caused Achmea damages. It brought arbitration pursuant to Article

8 of the BIT and Frankfurt am Main (in Germany) was chosen as the place of arbitration.

The Slovak Republic saw an escape to paying damages in its accession to the EU in 2004 (13 years after the signing of the BIT between the Netherlands and the Czech and Slovak Federative Republic, to which the Slovak Republic succeeded) and submitted that the recourse to an arbitral tribunal pursuant to Article 8 of the BIT was in breach of EU law. The arbitral tribunal dismissed that objection and ordered the Slovak Republic to pay Achmea damages. The Slovak Republic brought an action to set aside that arbitral award before the Frankfurt Higher Regional Court and, after appeal on a point of law, the case came before the German Federal Court of Justice (*Bundesgerichtshof)*.

The *Bundesgerichtshof* referred three questions to the CJEU, of which the first and second essentially read whether Articles 267 TFEU (governing the jurisdiction of the CJEU) and 344 TFEU (reminding Member States to cooperate with the CJEU when disputes arise concerning the interpretation or application of the Treaties) preclude a provision such as Article 8 of the BIT.

The CJEU starts off its decision proper with six paragraphs of EU law doctrine (par. 32-37): on the autonomy of the EU legal system, the essential characteristics of EU law, the primacy of EU law and the role of the national courts and the CJEU in ensuring the full application.

The CJEU then ascertains whether the disputes which the arbitral tribunal is called on to resolve "are liable to relate to the interpretation of EU law" (par. 39). As the arbitral tribunal, when called on to rule on possible infringements of the BIT, must "take account in particular of the law in force of the contracting party concerned and other relevant agreements between the contracting parties" (pursuant to Art. 8(2) of the BIT) it necessarily may be called upon to interpret or indeed to apply EU law ("particularly the provisions concerning the fundamental freedoms" (par. 42)), according to the CJEU. The CJEU notes that "given the nature and characteristics of EU law, that law "must be regarded both as forming part of the law in force in every Member State and as deriving from an agreement between the Member States" (par. 41).

The CJEU furthermore analyses whether the arbitral tribunal can be considered to be "situated within the EU judicial system", as in that case "its decisions are

subject to mechanisms capable of ensuring the full effectiveness of the rules of the EU" (par. 43). Here, the CJEU refers to its *Beiras Litoral* decision, in which it derived the status of "court or tribunal of a Member State" of the tribunal in that case "from the fact that the tribunal as a whole was part of the system of judicial resolution of tax disputes provided for by the Portuguese constitution itself" (par. 41).[3] But in the *Achmea* case, the CJEU notes, "the arbitral tribunal is not part of the judicial system of the Netherlands or Slovakia. Indeed, it is precisely the exceptional nature of the tribunal's jurisdiction compared with that of the courts of those two Member States that is one of the principal reasons for the existence of Article 8 of the BIT (par. 45)" The consequence is that the arbitral tribunal is not a court or tribunal "of a Member State" within the meaning of Article 267 TFEU.

The CJEU subsequently distinguishes the arbitral tribunal from "a court common to a number of Member States, such as the Benelux Court of Justice", in whose case it has held that "there is no good reason" why such a court should not be able to submit preliminary questions to the CJEU in the same way as courts or tribunals of the Member States (par. 47).[4] It holds (par. 48):[5]

"whereas the Benelux Court has the task of ensuring that the legal rules common to the three Benelux States are applied uniformly, and the procedure before it is a step in the proceedings before the national courts leading to definitive interpretations of common Benelux legal rules, the arbitral tribunal at issue in the main proceedings does not have any such links with the judicial systems of the Member States."

As a result, the arbitral tribunal cannot be regarded as a "court or tribunal of a Member State" within the meaning of Article 267 TFEU, which is entitled to refer preliminary questions to the CJEU.

If the arbitral tribunal is not itself entitled to refer questions directly to the CJEU, the only remaining escape would be that its awards are at least "subject to review" by a court of a Member State, who would be able to submit the relevant questions of EU law to Luxembourg. In five paragraphs (paras. 51-55) the CJEU concludes that the only limited review of the award by German courts is not the "full review" [my term, GFB] that it had in mind. As the arbitral tribunal made German law applicable to the procedure governing judicial review of the validity of the arbitral award, such review could only be allowed to the extent German law permits, and German law (Paragraph 1059(2) of the Code of Civil Procedure) provides only for

limited review (par. 53).

In two crucial paragraphs, the CJEU distinguishes the investor-to-state-dispute arbitration under the Dutch-Slovak BIT from "commercial arbitration", since for the latter category of arbitration it had accepted in previous decisions that judicial review of arbitral awards by the courts of the Member States would only be limited in scope. Given their importance, I quote them entirely:

"54 It is true that, 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 (see, to that effect, judgments of 1 June 1999, Eco Swiss, C-126/97, EU:C:1999:269, paragraphs 35, 36 and 40, and of 26 October 2006, Mostaza Claro, C-168/05, EU:C:2006:675, paragraphs 34 to 39).

55 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 (see, to that effect, judgment of 27 February 2018, Associação Sindical dos Juízes Portugueses, C-64/16, EU:C:2018:117, paragraph 34), 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."

The CJEU ultimately concludes that: "Article 8 of the BIT has an adverse effect on the autonomy of EU law" (par. 59) and that Articles 267 TFEU and 344 TFEU preclude this provision.

Implications on tax treaty arbitration

To assess the implications of the *Achmea* decision for tax treaty arbitration, consider the arbitration clause in Article 25(5) of the tax treaty between The Netherlands and Germany (signed in 2012). This clause is largely similar to Article

25(5) of the OECD Model.

On the same day as the tax treaty itself (12 April 2012), also a mutual agreement was signed between The Netherlands and Germany with the mode of application of the arbitration procedure in the tax treaty. Although most of the provisions in this mutual agreement are of a procedural nature, in assessing the implication of the *Achmea* decision, of relevance are paras. 14 (applicable legal principles) and 18 (definitive award). The first sentence of par. 14 reads (unofficially translated): "[t]he arbiters decide on the matters submitted for arbitration in accordance with the applicable provision of the treaty and, without prejudice to these provisions, with the domestic law of the contracting states." The other sentences, amongst others, confirm that the interpretation rules in articles 31-33 of the VCLT will be applied, that a dynamic interpretation of the Commentary to the OECD Model will be followed, and that the OECD Transfer Pricing Guidelines will be taken into account for interpretation of the arm's length principle. Par. 18, in pertinent part, stipulates that the arbitral award is definitive, unless judges of one of the contracting states do not consider the arbitral award executable due to a violation of Article 25(5) (of the treaty) or of a procedural rule.

Given the broad notion applied by the CJEU in *Achmea*, the disputes concerning the (alleged) "taxation not in accordance with the provisions of this Convention" (Article 25(1) of the treaty) that the arbitral panel should resolve can likely be considered to be "liable to relate to the interpretation of EU law". Transfer pricing disputes, for instance, concern the interpretation of the arm's length principle and that principle has been embraced as justifying restrictions of free movement when "erosion of the tax base through the shifting of profits out of the jurisdiction" should be prevented.[6] Arguably, although conceptually perhaps a stretch, the CJEU could consider the arm's length principle a notion of EU law that it would like to interpret (as well).[7] Also, under circumstances, tax treaty arbitration on the interpretation of a "beneficial ownership" clause in the dividend article of a tax treaty could be considered to be "liable to relate to the interpretation of EU law" given the explicit link with such an anti-abuse measure in Article 1(4) of the Parent-Subsidiary Directive.

The arbitral panel that should be formed should be considered to be outside the EU judicial system, given the definitive nature of the award. This conclusion should not be altered by the fact that Article 25(5) of the Dutch-German tax treaty does not contain the exception that "[t]hese unresolved issues shall not, however, be

submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State", that does occur in Article 25(5) of the OECD Model (this exception makes it even clearer that the tax treaty arbitration procedure takes place outside the ordinary legal system). The arbitral tribunal should not be regarded as a tribunal that should be entitled to refer preliminary questions to the CJEU, such as the Benelux Court, given the absence of links with the judicial systems of the Member States. The grounds for revoking the arbitral award by national judges that are listed in par. 18 of the mutual agreement are unlikely to satisfy the CJEU's requirement of a "full review" by a court of a Member State. Finally, the key considerations in paras. 54-55 of the *Achmea* decision, where the CJEU distinguishes investor-to-state-dispute arbitration from commercial arbitration, would apply equally to the arbitration procedure under the Dutch-German tax treaty.

In conclusion, each of the considerations in the *Achmea* decision that led the CJEU to conclude that the arbitration clause in the BIT violates EU law seem to apply equally to the arbitration clause in the Dutch-German tax treaty, and no doubt, to arbitration clauses in many other tax treaties concluded by Member States. Par. I(1) of the protocol to the treaty, by the way, explicitly codifies that "the law of the European Union has primacy over the provisions in the convention."

Considerations

The *Achmea* decision has far-reaching consequences for bilateral investment treaties, but the CJEU's extensive argumentation in the decision suggests that also arbitration clauses in tax treaties concluded by Member States may violate EU law. Clarity on this point will likely not come until a national court, asked to review a tax treaty arbitral award, refers questions on this point to Luxembourg, or until the European Commission would launch an infringement procedure. It would have to be analysed in further detail what the consequences would be for cases actually decided through tax treaty arbitration, should the CJEU conclude a breach of EU law of the arbitration clause. There seem to be various cures (if necessary), such as appointing the CJEU as arbiter (as Germany and Austria did in their tax treaty[8]) or granting national courts a "full review" role. As long as not all 28 Member States have signed up for mandatory MAP binding arbitration under the MLI,[9] tax treaty arbitral tribunals will remain outside the EU judicial system (the case that they fall within the EU system might be stronger when all 28 Member States sign up). Finally, considering the CJEU's argumentation in *Achmea*, it even

seems doubtful whether an "Advisory Commission" (Article 8) or an "Alternative Dispute Resolution Commission" (Article 10) should be regarded as tribunals being "situated within the EU judicial system", even though dispute resolution through these tribunals is advocated in the directive on tax dispute resolution mechanisms that was adopted on 10 October 2017 (Council Directive (EU) 2017/1852) and, as Jonathan Schwarz notes, one would expect that directive's strength to be "its status in EU law subject to the general jurisdiction of the Court of Justice of the EU and national courts."[10]

As a postscript: on 20 March 2018 the Council adopted the negotiation directives authorising the Commission to negotiate, on behalf of the EU, a Convention establishing a multilateral court for the settlement of investment disputes (MIC).[11] This permanent court should replace the ad-hoc ISDS tribunals. According to paras. 6 and 7 of the negotiation directives, the Convention should not only allow the EU to bring agreements to which the EU is or will be a party to under the jurisdiction of the MIC, but also Member States and third countries should be allowed to nominate agreements to which they are or will be Parties to. Interestingly, the footnote relating to the latter option reads:

"Without prejudice to the question of their validity or applicability under EU law, bilateral investment treaties concluded among Member States (i.e. intra-EU BITs), as well as the intra-EU application of the Energy Charter Treaty shall not fall within the scope of these directives."

One might infer from this footnote that: (i) interpretation of intra-EU BITs should remain within the EU judicial system (as decided in *Achmea*) and (ii) interpretation of BITs between Member States and third countries may apparently be tasked to an institution outside the EU judicial system (the MIC). This latter inference, of course, hinges upon how the MIC would be legally positioned. The negotiation directives are silent about what one would expect to be the EU's position in the negotiations, that disputes liable to relate to the interpretation of EU law remain open to review by the CJEU.

[1] Case C-284/16, *Slowakische Republik (Slovak Republic) v Achmea BV*, 6 March 2018, EU:C:2018:158.

[2] http://eulawanalysis.blogspot.nl/2018/03/the-cjeu-ruling-in-achmea-death.html.

[3] Case C-377/13, *Ascendi Beiras Litoral e Alta, Auto Estradas das Beiras Litoral e*

Alta, 12 June 2014, EU:C:2014:1754, paras. 25-26.

[4] See a.o. Case C-337/95, *Parfums Christian Dior*, 4 November 1997, EU:C:1997:517, par. 21.

[5] The CJEU refers to its earlier decision in Case C-196/09, *Miles and Others*, 14 June 2011, EU:C:2011:388, par. 41.

[6] See Advocate-General Bobek's Opinion of 14 December 2017 in Case C-382/16, *Hornbach-Baumarkt*, EU:C:2017:974, par. 22.

[7] See, for instance, Paulina Szotek's contribution on Kluwer International Tax Blog, 6 July 2017.

[8] See Case C-648/15, *Republic of Austria v Federal Republic of Germany*, 12 September 2017, EU:C:2017:664 and the comment by Han Verhagen on this case on Kluwer International Tax Blog, 13 September 2017.

[9] http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

[10] See http://arbitrationblog.kluwerarbitration.com/2017/11/11/eu-sets-standard-international-tax-dispute-resolution/.

[11] Available on http://www.consilium.europa.eu/en/press/press-releases/2018/03/20/multilateral-investment-court-council-gives-mandate-to-the-commission-to-open-negotiations/.