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Consequences of Swedish Supreme Court's decision to annul arbitral awards on basis of public policy

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Introduction

In the most recent instalment of the saga that is the EU approach to intra-EU investment dispute settlement, the Swedish Supreme Court, on 14 December 2022, decided to annul the partial award[(1)] and the final award[(2)] issued in the dispute between PL Holdings and Poland.[(3)] This was the first time an arbitral award had been annulled by the Swedish Supreme Court under the Swedish Arbitration Act (SAA) for being contrary to public policy (*ordre public*).

The much-awaited and already much-commented-on judgment raises a number of interesting issues, in particular relating to the implementation of the preliminary ruling of the Court of Justice of the European Union (CJEU), the circumstances in which domestic courts may depart from the CJEU's decisions and the choice between declaring an award invalid by the law itself and setting it aside as a result of challenge proceedings.

Facts

Through the now-annulled awards, an arbitral tribunal seated in Sweden, acting under the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) (the SCC rules), had ordered the Republic of Poland to pay damages to PL Holdings Sárl, a company registered in Luxembourg, because of the respondent state's unlawful expropriation in breach of the Belgium/Luxembourg-Poland bilateral investment treaty (BIT).[(4)]

The awards were challenged by Poland before the Svea Court of Appeal, which argued that the arbitration agreement constituted a violation of EU law, rendering the agreement invalid.

First, Poland argued that the awards should be annulled (ie, declared invalid) as the issue was not arbitrable or because the arbitration agreement constituted a violation of Swedish public policy. Poland maintained that there was no binding arbitration agreement between the parties and that, in any case, such an agreement had to be set aside. PL Holdings, for its part, claimed that Poland was bound by the award as the state had failed to object to the existence of an arbitration agreement in time. In the investor's view, Poland was, for that reason, precluded from raising objections to the arbitration agreement in the challenge proceedings. Therefore, even if the arbitration agreement in the BIT was invalid, a new ad hoc agreement had formed, covering the specific dispute. Poland responded that the failure to object could not lead to the formation of a new arbitration agreement.[(5)]

Court of Appeal

The Court rejected Poland's action to annul the awards, while setting aside a minor portion relating to interest.[(6)] The Court held that the arbitration clause of the BIT was indeed invalid as a result of the principles laid down by the CJEU in the *Achmea* judgment.[(7)] However, the Court found that Poland had not objected to the existence of a valid arbitration agreement during the arbitration in time. Therefore, Poland was precluded from raising these objections in the challenge proceedings, which led the Court to the conclusion that the parties had indeed entered into an ad hoc arbitration agreement over the course of the arbitration. On that basis, the Court denied the application to annul or set aside the awards.

Both parties appealed to the Supreme Court.

Background

As the arbitration was seated in Sweden, the SAA applied as *lex arbitri*. The SAA is similar to the United Nations Commission on International Trade Law (UNCITRAL) Model Law in that it contains an exhaustive list over the legal grounds for challenging an award. Depending on the reason for the challenge, the award may either be annulled or set aside. If the award decides an issue is non-arbitrable under Swedish law, or if the award was rendered in manner that violates Swedish public policy, the award is invalid and will be annulled. If the award is not covered by a valid arbitration agreement between the parties, the award remains valid but may be set aside. The reason for this distinction has to do with whose interests the challenge procedure serves to protect. Invalidity of the award safeguards third-party interests, while setting aside the award safeguards the interests of the disputing parties. The former provisions may be invoked without limitation in time, whereas the latter must be invoked within a period of two months from the receipt of the award.

Supreme Court

Poland appealed on the same legal grounds as those relied upon before the Svea Court of Appeal (ie, that the arbitration agreement was invalid under EU law and therefore constituted a violation of Swedish public policy and/or that the matter was non-arbitrable). PL Holdings' appeal related to the part of the award concerning interest, which the Svea Court of Appeal had set aside. The Supreme Court referred to the case to the CJEU, which ruled that articles 267 and 344 of the Treaty on the Functioning of the European Union precludes:

national legislation which allows a member state to conclude an ad hoc arbitration agreement with an investor from another member state that makes it possible to continue arbitration proceedings initiated on the basis of an arbitration clause whose content is identical to that agreement, where that clause is contained in an international agreement concluded between those two member states, and is invalid on the ground that it is contrary to those articles.[8]

In response, PL Holdings argued that the Supreme Court was not bound by the preliminary ruling as it conflicted with central principles of EU law.[9]

With reference to CJEU and Supreme Court case law, the Supreme Court found that it could rule against the CJEU's interpretation only if it was required to avoid a clear and serious breach of a human right under the European Convention on Human Rights (ECHR). Although access to investment treaty arbitration could engage the right to access to court contained in the right to a fair trial under article 6 of the ECHR, the Supreme Court held, with reference to the CJEU, that it would be for the Polish judicial system, in cooperation with the CJEU, to safFeguard PL Holdings' rights under EU law. Therefore, the Supreme Court saw no reason to depart from the CJEU's preliminary judgment in the circumstances.

The Supreme Court then considered whether the awards should be annulled or set aside. The Court found that setting aside the awards would not sufficiently ensure the full effectiveness of EU law as objections and actions may be precluded. Structuring its reasoning around the concept of public policy, the Supreme Court observed that public policy, as a ground for annulment, was to be applied restrictively and only relied on when the award would constitute a grave violation of essential principles of Swedish procedural law. The Supreme Court noted that EU law forms part of Swedish law and that the CJEU case law on intra-EU BITs seeks to close the opportunity for member states to bypass the jurisdiction of domestic courts and, by extension, the integrity of the system of judicial remedies within the EU legal order. These judicial remedies constituted, in the view of the Supreme Court, an essential principle of a procedural nature justifying the application of the public policy provision. Because the awards had been rendered on the basis of an arbitration clause that constituted a violation of the essential principles of the legal system that governs the European Union, as well as Sweden, it would violate Swedish public policy to uphold them and the Supreme Court consequently declared them invalid.

Comment

In light of the preliminary judgment from the CJEU, the Supreme Court's ruling did not come as a surprise. It is an understatement that the principles presented in the *Achmea* case, and developed in subsequent preliminary rulings, have had a profound impact on investment arbitration within the European Union. Similar cases will likely be decided in national courts across EU jurisdictions over the coming years. The SAA provision on public policy is akin to article 34(2)(b)(ii) of the UNCITRAL Model Law and the same type of reasoning may be picked up by other courts.

It is nevertheless interesting that the Supreme Court decided to apply the public policy provision in section 33(2) of the SAA. This provision has never been applied to annul an award before. The fact that it is applied to protect not merely a fundamental principle of the Swedish legal order, but one of EU law, makes it even more important. Furthermore, the choice of legal basis by the Supreme Court was not obvious. Only a day before the Supreme Court judgment, the Svea Court of Appeal delivered a judgment in a similar matter, concerning an investment arbitration award in an intra-EU setting, where it decided instead to annul the award due to non-arbitrability.

Albeit on different grounds, both courts decided on annulment, indicating respect for concerns at the heart of the *Achmea* doctrine and recognition of the desire to ensure exclusive EU jurisdiction over the settlement of investment disputes within the European Union.

The Supreme Court's choice to annul the awards, rather than set them aside, may also have repercussions for other cases. The CJEU did not limit the application in time of the principles of the *PL Holdings* judgment. Under Swedish law there is no time bar on seeking the annulment of cases contrary to public policy. Based on the CJEU and Supreme Court precedents, intra-EU arbitration agreements would, in theory, be susceptible to annulment actions without limitation in time.

In practice, there is an argument raised in the jurisprudence that the strength of a challenge based on public policy – with the passing of time, compliance by the losing party with the award, or indeed a party's passivity – may diminish. However, these considerations may not stand in relation to the public policy reasons underlying the decision in *PL Holdings*. It is likely that this saga is not over yet.

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Endnotes

(1) Partial award, 28 June 2017, concerning the tribunal's jurisdiction and whether Poland had breached its obligations under the investment treaty.

(2) Final award, 28 September 2017, on quantum where the tribunal awarded PL Holdings damages of 654 million Polish zloty (approximately €150 million at the time of the award).

(3) The Supreme Court's judgment of 14 December 2022 in case No. T 1569-19.

(4) Agreement between the government of the Kingdom of Belgium and the government of the Grand Duchy of Luxembourg, of the one part, and the government of the People's Republic of Poland, of the other, concerning the reciprocal promotion and protection of investments, signed on 19 May 1987.

(5) Under Swedish arbitration law a party may lose its right to deny the existence of a valid arbitration agreement if the party participate in the arbitration without raising any objections.

(6) The issue concerned pre-award interest, an issue the court found should have been rendered two days before the final award at the latest.

(7) The Court of Justice of the European Union's judgment of 6 March 2016 in *Achmea v Slovak Republic* (Case C-284/16). In the judgment the Court stated that articles 267 and 344 of the Treaty on the Functioning of the European Union preclude a provision in an international agreement concluded between EU-member states under which an investor of one of the member states may bring proceedings against the other member state before an arbitral tribunal.

(8) The Court of Justice of the European Union's judgment of 26 October 2021 in *Republic of Poland v PL Holdings Sàrl* (Case C-109/20).

(9) Among others, article 19 of the Treaty on European Union, article 47 of the Charter of Fundamental Rights of the European Union, and articles 6 and 13 of the European Convention on Human Rights.