2 September 2021 (updated version)

Legality of the Energy Charter Treaty in question: what next after the Komstroy ruling?

On 2 September 2021, the Court of Justice of the European Union (CJEU) confirmed in **Case C741/19 *Republic of Moldova v Komstroy*** that investment arbitrations between an EU investor and an EU Member State based on the Energy Charter Treaty (ECT) are incompatible with EU law. This policy brief provides some background on this ruling and upcoming rulings that deal with the legality of the ECT under EU law. It also discusses its potentially far-reaching implications for the future of the ECT.

1. What has the Court decided?

The CJEU decided on 2 September 2021[1] on questions referred to by the French Court of Appeal, which asked the CJEU for its interpretation of certain ECT provisions in an arbitration dispute between two non-EU members (Ukrainian investor Komstroy v. Moldova). The questions referred to the CJEU did not directly concern the question of compatibility between intra-EU investor-state dispute settlement (ISDS) and Union law.[2] Nevertheless, the Court decided to clarify the intra-EU application of Article 26 ECT (the ISDS provision) when interpreting these provisions.[3] This issue of legality of the intra-EU applicability of the ECT has been debated widely in legal circles for years.

In 2018, in the landmark ruling *Achmea*,[4] the CJEU decided that ISDS provisions in bilateral investment treaties between EU countries (intra-EU BITs) are incompatible with EU law

[1] CJEU, Case C-741/19, Republic of Moldova v Komstroy, 2 September 2021, https://curia.europa.eu/juris/document/document.jsf?text=&docid=245528&pageIndex=0&doclang=FR&mode=req&dir=&occ=first&part=1&cid=3161919

[2] The initial dispute took place between the Ukrainian company Komstroy and the Republic of Moldova arising from a non-payment of a debt for energy supplied by the investor. In an arbitration brought by the investor, Moldova was ordered to pay USD 49 million to the investor in compensation. Moldova subsequently challenged the award in the Paris Court of Appeal, which found that the arbitral tribunal had not had jurisdiction to hear the dispute and thereby annulled the tribunal's decision. The French Court of Cassation, however, found that the Court of Appeal had erred in its interpretation of the meaning of "investment" and, therefore, its decision on the tribunal's jurisdiction was not correct. As a result, the Paris Court of Appeal referred the case to the CJEU, seeking a preliminary ruling on the correct interpretation of the ECT.

[3] The court noted in para 41 that "if the fact that the dispute at issue in the main proceedings, based on Article 26(2)(c) ECT, is between an operator from a third State and another third State does not exclude, for the reasons set out in paragraphs 22 to 38 of the present judgment, the jurisdiction of the Court to answer those questions, it cannot be inferred from this that this provision of the ECT also applies to a dispute between an operator from a Member State and another Member State".

[4] CJEU, Case C-284/16, Slovak Republic v Achmea, 6 March 2018, https://curia.europa.eu/juris/document/document.jsf?docid=199968&doclang=EN

because they sideline and undermine the power of EU courts.[5] The CJEU confirmed today in Komstroy that despite the multilateral character of the ECT and the fact that it also governs relationships with non-EU countries, "the preservation of the autonomy and specific character of EU law precludes the ECT from being able to impose the same obligations on the Member States among themselves" (para 65). The Court thereby confirmed the *Achmea* reasoning equally applies to the ECT and concluded that the ISDS provisions of the ECT "**must be interpreted as not applicable to disputes between a Member State and an investor from another Member State concerning an investment made by the latter in the first Member State**" (para 66).

The CJEU follows the opinion of the Advocate General Szpunar in this case that was delivered on 3 March 2021, and in which he held that Article 26 ECT is not compatible with EU law.[6]

The CJEU expressed its views on the intra-EU *applicability* of the ECT ISDS provision as an obiter - i.e. these considerations as such are not necessary to directly answer the questions referred and interpret the ECT provisions. But it provides a very clear indication of what the Court may decide in two other upcoming cases, in which the Court has been specifically asked to clarify the *compatibility* of the ECT ISDS provisions within the EU:

1) Opinion 1/20, in which Belgium is seeking legal clarification on the compatibility under Union law of the ISDS mechanism provided under Article 26 in the draft *modernised* ECT;[7]

2) A preliminary reference from the Svea Court of Appeal (Sweden) on the enforcement of an arbitration award (Novenergia v. Italy, i.e. a Luxembourg/Denmark investor against another EU Member State).[8]

Both cases should be decided in the course of 2022, and it is now expected that the CJEU will rule that the intra-EU application of the ECT ISDS provision is incompatible with EU law. This could mean that the Council Decision adopted to conclude the agreement at the time is illegal.

2. What are the immediate consequences?

This clarification by the CJEU in the Komstroy ruling confirms that foreign companies/investors should have never brought ISDS claims based on the ECT from the start. ECT-based intra-EU investment arbitrations shall thus be declared invalid. Yet, despite the very clear terms of the Court, and even if the CJEU further declares the ECT ISDS provision illegal in the context of the above-mentioned rulings, this may not be sufficient to fully stop pending and future intra-EU cases. This is because ISDS tribunals have so far ignored CJEU rulings and refused to decline their jurisdiction. The European Commission and EU Member States will thus have to take concrete action to stop intra-EU disputes under the ECT (see below section 3).

In the meantime, the Komstroy decision will certainly be relied upon by respondent EU Member States involved in ECT arbitrations brought by EU investors. They will stand a chance to seek annulment of awards or resist their enforcement before EU domestic courts. In other terms, this means EU investors are at greater risk to see (1) the enforcement of their

---

[5] Laurens Ankersmit of ClientEarth and Layla Hughes of CIEL, Implications of Achmea: How the Achmea Judgment Impacts Investment Agreements with Non-EU Countries, April 2018, https://www.documents.clientearth.org/wp-content/uploads/library/2018-04-19-implications-of-achmea-judgment-coll-en.pdf

[6] Advocate General Szpunar, Opinion in Case C-741/19, 3 March 2021 https://curia.europa.eu/juris/document/document.jsf?text=&docid=238441&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=4725892

[7] https://diplomatie.belgium.be/en/newsroom/news/2020/belgium_requests_opinion_intra_european_application_arbitration_provisions

[8] Case C-155/21, Request for a preliminary ruling, 10 March 2021, https://curia.europa.eu/juris/showPdf.jsf?text=Novenergia%2Bv.%2BItaly&docid=240361&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=4758871

intra-EU awards be refused by domestic EU courts on public policy grounds or (2) their awards be annulled in set aside proceedings domestic EU courts. However, whether non-EU courts (seized on matters relating to the recognition or enforcement of ECT arbitral awards) will apply EU law and the Komstroy ruling remain highly uncertain risk.

3. What options do EU Member States have to end the intra-EU application of the ECT?

The Commissions and EU Member States must take the necessary steps to end intra-EU disputes. There are two main options to do so:

1) **Amend the ECT**, i.e. change the legal text. There is an ongoing reform process that aims to amend certain ECT provisions. However, such changes require notably unanimous approval by all contracting parties present and voting at the Conference of the Parties, which is a very high threshold. Moreover, a carve-out for intra-EU application is not even being discussed, and adding a new topic to the reform agenda would also require consent of all other contracting parties. It is therefore highly unlikely that the ongoing reform process is a suitable avenue to comply with the upcoming CJEU rulings.

2) **Joint withdrawal of all EU Member States and the EU itself.** Such a move would have to be accompanied with an inter-se agreement to neutralise the sunset clause. This clause allows investors to continue to bring ISDS claims in relation to existing investments for another 20 years after withdrawal. The additional inter-se agreement would make this clause inapplicable for intra-EU disputes. This option is described in some more detail in ClientEarth and IISD article "Why withdrawal is an option".[9]

   This is the best of the two options. It will address the question of intra-EU applicability but also solve another incompatibility with EU law arising from the CJEU's Opinion 1/17. In this judgement, the CJEU sets certain minimum criteria for international investment arbitration clauses in agreement between the EU and third countries, which the ECT does not meet. For the ECT to comply with the requirements set out in Opinion 1/17, its ISDS provisions would have to be amended to include equivalent safeguards to those in CETA's investment chapter in order to preserve the judicial and regulatory autonomy of the EU's unique legal order. However, such a reform has already strongly been rejected by Japan, who has refused to agree to any changes to the ECT's ISDS provisions.[10]

   Not least, this option would result in the lowest possible risk of climate-related ISDS challenges, in particular if the EU manages to convince non-EU countries to join such a solution.

[9] ClientEarth and IISD, Energy Charter Treaty: Why withdrawal is an option, June 2021, https://www.clientearth.org/latest/documents/energy-charter-treaty-reform-why-withdrawal-is-an-option/

[10] See notably ClientEarth, Legal briefing on The Commission's draft proposal for the modernisation of the Energy Charter Treaty, April 2020, https://www.documents.clientearth.org/wp-content/uploads/library/2020-04-23-legal-briefing-on-the-commission039s-draft-proposal-for-the-ect-modernisation-ce-en.pdf

For further information, please contact:

Amandine Van den Berghe
Trade and Environment Lawyer
avandenberghe@clientearth.org
www.clientearth.org

Cornelia Maarfield
Senior Trade and Investment Policy Coordinator
Climate Action Network Europe
cornelia@caneurope.org