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INTRA-EU ARBITRATION UNDER THE ECT IS INCOMPATIBLE WITH EU LAW ACCORDING TO THE CJEU IN REPUBLIC OF MOLDOVA V KOMSTROY

To Our Clients and Friends:

On 2 September 2021, the Court of Justice of the European Union (the "**CJEU**") issued its ruling in *Republic of Moldova v Komstroy*[1] (the "**Decision**" or "***Komstroy***") concluding that, as a matter of EU law, Article 26 of the Energy Charter Treaty (the "**ECT**") is not applicable to "intra-EU" disputes (that is, disputes between an investor of an EU Member State on the one hand, and an EU Member State on the other).

The CJEU's Decision largely follows the CJEU's controversial reasoning in *Achmea BV v Slovak Republic*[2] ("***Achmea***") (2018), which concerned a bilateral investment treaty ("**BIT**") between two EU Member States (as opposed to a multilateral treaty such as the ECT). *Achmea* was addressed in a previous client alert here.[3]

Background

In October 2019, the Paris Court of Appeal (*cour d'appel de Paris*) made a request to the CJEU for a preliminary ruling addressing three questions.[4] These pertained to set-aside proceedings brought by Moldova in respect of an UNCITRAL arbitral award rendered against it for certain breaches of obligations under the ECT. Paris was the seat of the underlying arbitration.

The CJEU's Decision

Only one of the three questions referred by the Paris Court of Appeal ultimately was addressed by the CJEU. That question asked the CJEU to determine whether the definition of "investment" in Article 1(6) of the ECT requires any economic contribution on the part of the investor in the host State. The Decision found, in essence, that an economic contribution was required in its view.

The CJEU also set out its views on whether Article 26 of the ECT is compatible with EU law insofar as it provides for arbitration between EU based investors and EU Member States.[5] This question was not referred by the Paris Court of Appeal, nor was it directly relevant to the questions before the CJEU (which concerned investments in a non-EU Member State (Moldova)). This separate question had been raised by the European Commission, together with certain EU Member States,[6] acting as interveners in the CJEU proceedings. The Decision indicates that intra-EU arbitration under the ECT is incompatible with EU law. The CJEU's reasoning is summarised below.

First, following its reasoning in *Achmea*, the CJEU explained that in order to preserve the autonomy of EU law, as well as its effectiveness, national courts of EU Member States may make a preliminary reference to the CJEU pursuant to Article 267 of the Treaty on the Functioning of the European Union

(the "**TFEU**"). This referral procedure was described as the "*keystone*" of the EU judicial system with the "*objective of securing the uniform interpretation of EU law, thereby ensuring its consistency, its full effect and its autonomy*".[7]

Second, the CJEU reasoned that because the EU is a Contracting Party to the ECT, the ECT itself is a so-called "*act of EU law*".[8] Having reached this conclusion, the CJEU then determined that because the ECT is an "*act of EU law*", an ECT tribunal would necessarily be required to interpret, and even apply, EU law when deciding a dispute under Article 26.[9] This reasoning appears to be directly at odds with the CJEU's Opinion 1/17, in which it accepted that CETA tribunals[10]– though standing outside the judicial system of the EU – could nonetheless interpret and apply the CETA itself without running afoul of EU law.[11] The Decision does not explain how CETA, to which the EU is also a party and must likewise be considered an "*act of the EU*" by the CJEU, can be compatible with EU law, but the ECT cannot. Likewise, the CJEU did not explain how its finding that the ECT is an "*act of EU law*" would not apply equally in the extra-EU context (i.e., where a dispute involves an EU Member State and an investor from a third State), leaving these questions unanswered.

Third, having found that an ECT tribunal would need to apply EU law on the basis that the ECT is an "*act of EU law*", the CJEU then ascertained whether an ECT tribunal is situated within the judicial system of the EU such that a preliminary reference could be made to the CJEU to ensure the effectiveness of EU law.[12] In the CJEU's view – in "*precisely the same way*" as in *Achmea* – ECT tribunals are outside the EU legal system, thus preventing effective control over EU law.[13] The CJEU found that the judicial review that arises in the context of EU-seated investor-state arbitration is limited since the referring court can only perform a review insofar as its domestic law permits.[14] In other words, according to the CJEU, the full effectiveness of EU law cannot be guaranteed.

Finally, given that commercial arbitration tribunals routinely interpret and apply EU law outside of the EU legal system (which could mean that any arbitration would be incompatible with EU law), the Decision attempts to distinguish investor-state arbitration from commercial arbitration. The distinction, according to the CJEU, is that commercial arbitration is different because it "*originate*[s] *in the freely expressed wishes of the parties concerned*", whereas investor-state arbitration apparently is not based on the parties' "*freely expressed wishes*".[15] Unfortunately, however, the CJEU did not elaborate on its conclusion in this regard. That conclusion appears to be inconsistent with well-established principles of public international law, which confirm that States can (and must) enter into treaties such as the ECT of their own free will.

In light of the foregoing, the CJEU concluded that Article 26 of the ECT is incompatible with EU law insofar as it provides for arbitration between EU investors and EU Member States.[16]

Implications of the CJEU's Decision

The ECT remains in force between all Contracting Parties, which includes all EU Member States, as well as the EU. Indeed, a modification of the ECT to remove its application as between EU Member States would require the participation not just of the EU and its Member States, but of all 53 Contracting

Parties to the ECT. The CJEU's Decision does not (and cannot) modify the express terms of the ECT itself.

To date, all ECT tribunals that have considered jurisdictional objections based on the intra-EU nature of the dispute have rejected the suggestion that the ECT does not apply on an intra-EU basis. That is unlikely to change in light of the Decision. Indeed, the CJEU did not offer any analysis under the Vienna Convention on the Law of Treaties (the "**VCLT**"), which governs the interpretation of the ECT. Nor did the CJEU address the substantial body of case law under the ECT on the interpretation of Article 26 of the ECT, all of which reaches the opposite conclusion to the CJEU. Those cases set forth what is now a well-established principle that EU law is not relevant to the question of jurisdiction under the ECT. Thus, the Decision (which is limited to an analysis under EU law) should have no bearing on an ECT tribunal's jurisdiction.

Another implication of the Decision is that EU-based investors considering energy investments in EU Member States may now view these investments as more risky. First, the applicability of Article 26 to intra-EU disputes was not a question that was before the CJEU and it had no impact on the *Komstroy* case, which (paradoxically) did not involve an intra-EU dispute. The Decision provides scant and inconsistent reasoning and may therefore be considered to be based on political considerations rather than a sound and reasoned interpretation of the law. The Decision thus has the potential to undermine investor confidence in the EU judicial system and the rule of law within the EU.

Second, the CJEU's Decision may create uncertainty regarding the extent of investor protection within the EU for energy investments as EU Member States may believe that they can (or must) disapply the ECT to investors from other EU Member States. This, of course, would make investments by EU investors into EU Member States both less attractive and more expensive (as it will drive up risk premiums). The CJEU's decision may, therefore, undermine investor confidence at a time when the EU is seeking substantial private investment in its energy sector as part of its efforts to de-carbonise. In other words, the Decision ultimately could be an "own goal" for the EU and its Member States.

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[1] Judgment of the Court (Grand Chamber), Case C-741/19, *Republic of Moldova v Komstroy, a company the successor in law to the company Energoalians*, ECLI:EU:C:2021:655, 2 September 2021 (the "**Decision**"), available here.

[2] Judgment of the Court (Grand Chamber), Case C-284/16, *Slowakische Republik (Slovak Republic) v Achmea BV*, ECLI:EU:C:2018:158, 6 March 2018, available here.

[3] In short, in *Achmea*, the CJEU determined that arbitration provisions such as the one found in the intra-EU BIT at issue in that case (which, in contrast to the ECT, explicitly required a tribunal to consider EU law) are not compatible with EU law.

[4] Request for a preliminary ruling from the Cour d'appel de Paris, Case C-741/19, *Republic of Moldova v Komstroy, a company the successor in law to the company Energoalians*, 8 October 2019, available here.

[5] Decision, ¶ 40.

[6] France, Germany, Spain, Italy, The Netherlands and Poland.

[7] Decision, ¶ 46.

[8] Decision, ¶ 49.

[9] Decision, ¶¶ 49-50.

[10] *I.e.*, tribunals established to hear disputes arising under the under the EU-Canada Comprehensive Economic and Trade Agreement ("**CETA**").

[11] Opinion 1/17 of the Full Court (*CETA*), ECLI:EU:C:2019:341, 20 April 2019, ¶¶ 116-118, available here.

[12] *See* Article 267 TFEU (the preliminary reference procedure).

[13] Decision, ¶ 52.

[14] Decision, ¶ 57.

[15] Decision, ¶ 59.

[16] Decision, ¶ 66.

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