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The Incompatibility of the ISDS Mechanism in the Energy Charter Treaty with EU Law: Nothing New Under the Sun

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7.1. INTRODUCTION[1]

Along with international trade, investment policy is an essential part of the world economy, given that economic development is dependent on foreign capital inflows. However, investors are wary of state courts, which they criticise for their lack of independence and impartiality. To assuage their fears, many states have concluded bilateral investment treaties (BITs), which confer on investors particularly extensive substantive and procedural rights against state authorities: most favoured nation clause, fair and equitable treatment, free transfer of capital, prohibition on direct and indirect expropriations, and so forth. Regarding litigation, the investors who are nationals of the state that concluded the investment treaty may either initiate proceedings before the courts of the host state, or bring the dispute directly before an independent arbitral tribunal without having to exhaust judicial remedies in that state. As a result, investors can thus have recourse to arbitration, without the host state being able to object. Constituting a way of circumventing the jurisdiction of state courts, ISDS was developed on the initiative of developed capital-exporting states in order to protect their investors in other, third states. It thus differs from international commercial arbitration, in that the host state of the investment gives its consent to the arbitration in advance, with such consent being detached from any contractual relationship.

[1] This contribution is partly the result of discussions between the author and his colleague Ivana Damjanovic in Brussels in June 2022. Any errors or omissions remain the author's own.

This absence of a contractual basis thus characterises ISDS in relation to international commercial arbitration, and ISDS has become remarkably successful over the past few decades, given that such a mechanism removes investment disputes from the jurisdiction of state courts, which are more inclined to strike a balance between economic rights and the general interest. Since state courts often impose relatively strict conditions for the invocability of international treaties, arbitral tribunals appear to investors to be the most appropriate forum for settling their disputes with host states.[2] Moreover, the relative speed of the procedures and their confidentiality, and the amount of compensation awarded by these tribunals seem to meet investors' expectations better than traditional court procedures before state courts. ISDS also allows for the de-politicisation of investment disputes, without generating tensions between the investor's home state and the host state.[3]

In recent times, ISDS has given rise to heated debate. In 2014, *The Economist* published a critical analysis of ISDS:[4] the implementation of laudable ideas to protect investors from discrimination or expropriation was branded as 'disastrous'. For the esteemed, right-of-centre publication, it stated that, '[m]ultinationals have exploited woolly definitions of expropriation to claim compensation for changes in government policy that happen to have harmed their business'. At the same time, academics have started to question whether ISDS delivers the benefits it is supposed to. Due to broadly defined investment protection standards, investors can use ISDS to bring a wide variety of claims, also challenging host states' actions that seek to achieve legitimate public policy goals, such as the protection of health, the environment, or public safety.

The broad interpretation by the investment tribunals of the protection afforded to investors in the BITs has called into question state regulatory powers in sensitive areas such as public health and safety, financial regulation, or environmental protection. It follows that states' ability to regulate in policy matters of public concern is constrained by the existence of these treaties, which ultimately impinge on state sovereignty. There is a widespread belief that arbitral awards made by arbitral tribunals are generally favourable to foreign investors, and that international arbitrators ignore considerations of public health, the environment, or fundamental rights.[5] Furthermore, ISDS has come under fire during the course of negotiations for the Comprehensive Economic and Trade Agreement (CETA) with Canada, and the proposed Transatlantic Trade and

[2] Opinion of Advocate General Wathelet, Case C-284/16 *Achmea* ECLI:EU:C:2017:699, para 206.

[3] See generally I Damjanovic, *The EU and International Investment Law Reform: Between Aspirations and Reality* (CUP, 2023).

[4] 'The arbitration game' (*The Economist*, 10 October 2014), p 74.

[5] Empirical studies show, however, that investors are often unsuccessful in environmental litigation. See D Behn and M Langford, 'Trumping the Environment? An Empirical Perspective on the Legitimacy of Investment Treaty Arbitration' (2017) 18 *Journal of World Investment & Trade* 14–61.

Investment Partnership (TTIP) with the United States of America. Against this background, the EU has been pushing for the replacement of the current arbitration system with a mechanism for adjudicating investment disputes that enjoys greater legitimacy, specifically, a permanent Investment Court System (ICS), comprised of a permanent tribunal and an appeal tribunal.[6]

In the aftermath of the fall of the Berlin wall, individual Member States concluded around 190 BITs with Central and Eastern European (CEE) states before they joined the EU in 2004, 2007 and 2013. These treaties quickly gave rise to a number of questions. Could international arbitrators be allowed to interpret EU law, whereas the EU Treaties give the CJEU a monopoly on interpretation? Why resort to arbitration when state courts – national courts in Member States – are already required to uphold the fundamental freedoms of the internal market over national measures purporting to restrict them? Is effective judicial protection, enshrined in Article 47 of the EU Charter of Fundamental Rights, not an integral part of the rule of law, a founding value of the EU within the meaning of Article 2 TEU? Would it be conceivable, moreover, for an investor incorporated in, say, Massachusetts in the United States to claim compensation before an international investment tribunal for damage caused by regulations adopted in Utah? To ask the question is, in fact, to answer it.

In March 2018, the Court of Justice ruled in *Achmea* that the ISDS regime under an intra-EU investment treaty was incompatible with EU law.[7] While the *Achmea* ruling has already taken its place in the pantheon of the major decisions handed down by the Court of Justice,[8] its consequences met with strong opposition amongst the arbitral tribunals created by the intra-EU BITs, which are not willing to relinquish their jurisdiction.

In order to comply with the lessons of the *Achmea* judgment, on 5 May 2022, 23 Member States concluded an international agreement terminating 181 BITs that they had concluded between themselves.[9] However, divided on the compatibility of the ECT with EU law, these Member States had not denounced the later treaty.[10] In a dispute which, at first sight, seemed to be unconnected with

[6] CETA Ch 8, F, Resolution of investment disputes between States and investors.

[7] Case C-284/16 *Achmea* ECLI:EU:C:2018:158. See especially N de Sadeleer, 'The End of the Game. The Autonomy of the EU Legal Order Opposes Arbitral Tribunals under Bilateral Investment Treaties Concluded between Two Member States' (2018) 1 *European Journal of Risk Regulation* 355–70.

[8] Xavier Groussot and Marja-Liisa Öberg. 'The Web of Autonomy of the EU Legal Order: Achmea' in Graham Butler and Ramses A Wessel (eds), *EU External Relations Law: The Cases in Context* (Oxford, Hart Publishing, 2022), 927–38.

[9] Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union [2020] OJ L169/1. The agreement was concluded by all Member States except Ireland, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden.

[10] Recital 10 of the preamble.

EU law,[11] insofar as it opposed the Republic of Moldova and a Ukrainian company, the compatibility of the ISDS mechanism established by the ECT with EU law was raised before the CJEU in the *Komstroy* case.[12] In this case, the CJEU was asked by the Paris Court of Appeal (Paris CA) to give a preliminary ruling on an action for annulment against an award issued by an ad hoc tribunal constituted under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) sitting in Paris which had been brought by a third state, Moldova. It concluded, in light of the Court of Justice's judgment in *Achmea*, that the ISDS provided for by the ECT violated EU law. The aim of this chapter is to explain the salience of the reasoning of the Court of Justice concerning the subjection of an ISDS mechanism provided for under a mixed agreement – concluded by both the EU and its Member States – to the key EU constitutional obligations.

7.2. THE ENERGY CHARTER TREATY, AND APPLICATION OUTSIDE THE EU LEGAL ORDER

The ECT, to which the EU and all its Member States except Italy are contracting parties, was concluded in the aftermath of the Cold War in 1994 to ensure the political and economic transition of the energy markets in the countries of CEE and the former USSR. As a strong supporter of this multilateral treaty, the EU sought at the time to protect investments in CEE made by companies incorporated in Member States. Currently, there are 53 Contracting Parties to the ECT.

The ECT has the same status in the EU legal order as an EU-only agreement, to the extent to which its provisions fall within the scope of EU competence.[13] However, since the ECT is a mixed agreement concluded by the EU and its Member States, it follows that it is implemented and managed jointly by the EU and the Member States. In addition, the compliance by EU secondary law with obligations under the ECT may be subject to review by the CJEU. In particular, insofar as this treaty is a mixed agreement, 'the EU is legally bound by the obligations of the fair and equitable treatment and non-expropriation contained in it and resembling the substantive provisions of the Investment Protection Agreement'.[14] As a result, the 27 Member States are bound by the obligations falling within the exclusive competences of the EU (investment,[15] energy and environment when the subject matter has been harmonised,[16]

[11] Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* ECLI:EU:C:2021:164, para 1.
[12] Case C-741/19 *Komstroy* ECLI:EU:C:2021:655.
[13] Case C-213/03 *Pêcheurs de l'étang de Berre* ECLI:EU:C:2004:464, para 25.
[14] Opinion of Advocate General Jääskinen, Case C-264/09 *Commission v Slovakia* ECLI:EU:C:2011:150, para 60.
[15] Article 3(1) TEU and Article 207 TFEU.
[16] Article 3(2) TEU.

etc).[17] Furthermore, EU secondary law must be interpreted in accordance with the obligations arising from the ECT.[18]

In particular, the ECT provides for the fair and equitable treatment of investors (Article 10 ECT), freedom from expropriation of investors' assets (Article 13 ECT), compensation (except where Article 13 ECT applies) (Article 12 ECT).[19] In addition, Article 26(6) ECT allows an investor from one contracting state, in the event of a dispute concerning its energy investments in the territory of the other contracting state, to bring an action against that state before an ad hoc arbitral tribunal. Unlike commercial arbitration, arbitral tribunals arise from the ECT itself, and not from the autonomy of the parties to the dispute.[20]

In *Komstroy*, the arbitral tribunal ordered Moldova to pay a sum of money to the Ukrainian company on the basis of its ECT obligations. Moldova challenged the tribunal's jurisdiction in an action brought before national courts in France under Article 1520 of the French Code of Civil Procedure. The Paris CA found in favour of Moldova, holding that the dispute concerned the settlement of a claim for the supply of electricity, which could not be classified as an 'investment', which was an essential criterion for the jurisdiction of the ad hoc tribunal under Article 26 ECT. The Court of Cassation of France (CCF), however, quashed the judgment of the Paris CA, holding that the latter had supplemented the definition of an investment by a condition not provided for by the ECT. The case was therefore referred back to the Paris CA for a decision on the merits. The Paris CA then referred questions through the reference for a preliminary ruling procedure to the CJEU, first, to determine whether the claim arising from an electricity sales contract that did not involve a contribution by the investor in the host state fell within the definition of investment (thereby justifying the application of the ECT), and, secondly, to verify the jurisdiction of the arbitral tribunal.

According to the Court of Justice, as from its entry into force, the provisions of the ECT form an integral part of the EU legal system. It follows that the CJEU has jurisdiction to give decisions through the reference for a preliminary ruling procedure concerning the interpretation of such an international agreement. That being said, the CJEU stated that it does not, in principle, have jurisdiction to interpret such an international agreement with regard to its application in a dispute outside the EU.[21]

[17] The ECT is not a case of 'facultative mixity' on the grounds that the ISDS mechanism does not fall within an exclusive competence. See *Opinion 1/17* ECLI:EU:C:2019:341 (*EU-Canada CETA*). See further Kieran Bradley, 'Investor-State Dispute Tribunals Established under EU International Agreements: Opinion 1/17 (EU–Canada CETA)' in Graham Butler and Ramses A Wessel (eds), *EU External Relations Law: The Cases in Context* (Oxford, Hart Publishing, 2022).

[18] Case C-61/94 *Commission v Germany* ECLI:EU:C:1996:313, para 52.

[19] See Damjanovic, *The EU and International Investment Law Reform* (n 3).

[20] Case C-741/19 *Komstroy* (n 12) para 59.

[21] Case 181/73 *Haegeman* ECLI:EU:C:1974:41, paras 2 and 4; Case C-321/97 *Andersson and Wåkeråas-Andersson* ECLI:EU:C:1999:307, para 26.

However, both Advocate General Szpunar and the judgment of the Court of Justice held that this was not the case when the referring court might be called upon, in a case directly falling under EU law, to rule on the interpretation of the provisions of a mixed agreement,[22] which the ECT was. In effect, where a provision can apply both to situations falling within the scope of EU law, and to situations not falling within that scope, it is clearly in the EU interest that, in order to forestall future differences of interpretation, that provision should be interpreted uniformly.[23] Accordingly, the Court of Justice acknowledged its jurisdiction to interpret provisions of a treaty that binds the EU in a dispute which falls outside the EU legal order.

In addition, the Court of Justice underscored that the parties to the dispute decided to establish the seat of arbitration in Paris, France – in the EU.[24] It follows that the national courts in France have jurisdiction to hear actions to set aside an arbitral award made in France for lack of jurisdiction of the arbitral tribunal given that EU law forms part of the law in force in every Member State.[25]

7.3. INTRA-EU ISDS AND THE DISPUTE SETTLEMENT MECHANISM ESTABLISHED BY ARTICLE 26 ECT

The Court of Justice declared itself competent to rule on the provisions of the ECT, since the international agreement, being concluded by the EU, constitutes a legal act of its own legal order.[26] The question then arose whether the *Achmea* judgment of the Court of Justice and subsequent case law could be transposed to this dispute, given that these cases involved bilateral investment treaties to which two Member States were parties, and not a mixed treaty.[27]

7.3.1. The Judgment in *Achmea* and Subsequent Judgments

In its landmark *Achmea* judgment, the Court of Justice ruled that recourse to an arbitral tribunal established on the basis of an investment agreement between the Netherlands and Slovakia was not permitted within the EU legal order. The Court of Justice's reasoning in *Achmea* rests on two pillars: on the one hand, the autonomy of the EU legal order deriving from a combined reading of Article 2

[22] Case C-741/19 *Komstroy* (n 12) paras 29–31; Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* ECLI:EU:C:2021:164, para 45.

[23] Case C-53/96 *Hermès* ECLI:EU:C:1998:292, para 32; Case C-741/19 *Komstroy* (n 12) para 29.

[24] Case C-741/19 *Komstroy* (n 12) paras 32–33.

[25] Alternatively, investors could choose the seat of the arbitration outside the EU in an attempt to escape the incompatibility of their jurisdiction with EU law.

[26] Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* (n 22) para 29; Case C-741/19 *Komstroy* (n 12) para 49.

[27] Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* (n 22) para 49.

TEU and Article 19 TEU and, on the other hand, the principle of mutual trust deriving from Article 2 TEU,[28] which goes hand in hand with the principle of loyal cooperation enshrined in Article 4(3) TEU. The reasoning was that, since the EU is based on shared values with the Member States, the national courts of Member States must cooperate with the CJEU, which guarantees the unity of interpretation of EU law.[29] In particular, the preliminary ruling procedure provided for in Article 267 TFEU is the 'keystone' of the EU judicial system.[30] The object of that procedure is to secure the 'uniform interpretation of EU law, thereby serving to ensure its consistency, its full effect and its autonomy as well as, ultimately, the particular nature of the law established by the [EU] Treaties'.[31]

Starting from these premises, the CJEU reasoned in three stages. First, the arbitral tribunal instituted by the Netherlands-Slovakia BIT 'may be called on to interpret or indeed to apply EU law, particularly the provisions concerning the fundamental freedoms, including freedom of establishment and free movement of capital'.[32] Second, as the tribunal at issue cannot be classified as a court or tribunal 'of a Member State' within the meaning of Article 267 TFEU,[33] and therefore is not part of the EU judicial system, ie, subject to no appellate jurisdiction nor oversight from the CJEU,[34] the tribunal is unable to make a reference for a preliminary ruling to the CJEU. Third, the judicial review can only be exercised by national courts of Member States 'to the extent that national law permits',[35] and the German Code of Civil Procedure provides only for limited review.

The CJEU therefore concluded that the dispute settlement mechanism in question was calling into question not only the principle of mutual trust between the Member States, but also the preservation of the particular nature of the law established by the EU Treaties, ensured by the preliminary ruling procedure provided for in Article 267 TFEU, and was not therefore compatible with the principle of sincere cooperation.[36]

Following on from this, the Court of Justice ruled in *PL Holdings* that an ad hoc arbitration agreement allowing the continuation of arbitration proceedings which had been initiated on the basis of an arbitration clause identical in content to that contained in the BIT concluded between Belgium and Luxembourg, on the one hand, and Poland, on the other, was incompatible with EU law. As a result, the Court of Justice ruled that, 'that clause is … incompatible with the

[28] Case C-284/16 *Achmea* ECLI:EU:C:2018:158, para 58.
[29] ibid para 35.
[30] ibid para 37.
[31] ibid para 37. See also *Opinion 2/13* ECLIEU:C:2014:2454 (*EU Accession to the ECHR II*), para 176 and the case law cited.
[32] Case C-284/16 *Achmea* (n 28) para 42.
[33] ibid para 46.
[34] ibid para 45.
[35] ibid para 53.
[36] ibid para 58.

principle of sincere cooperation set out in the first subparagraph of Article 4(3) TEU and has an adverse effect on the autonomy of EU law enshrined, inter alia, in Article 344 TFEU'.[37] The Member State is therefore obliged to challenge, before the arbitral tribunal or before the national court with jurisdiction, 'the validity of the arbitration clause or the ad hoc arbitration agreement on the basis of which the dispute was brought before that arbitration body'.[38]

Finally, *Micula*, a case at the crossroads between investment arbitration and state aid law, is also of interest, even though it was handed down by the Court of Justice four months after its judgment in *Komstroy*. Under a BIT concluded in May 2002 between Sweden and Romania, the latter at the time being a third state, investors incorporated in Sweden had initiated their proceedings before an arbitral tribunal under the ICSID Convention. These arbitration proceedings had been initiated on the basis of a BIT concluded between these two states prior to Romania's accession to the EU, and remained in force after the 2007 accession.

The Commission adopted a decision requiring Romania to immediately suspend any action that might lead to the implementation or enforcement of the arbitral award, on the grounds that such an award amounted to illegal state aid. This decision was annulled by the General Court.[39] On appeal, the Grand Chamber of the Court of Justice held that the compensation sought by the claimants who had invested in Romania did not relate exclusively to damage allegedly suffered prior to that state's accession to the EU in 2007. As a result, the dispute which those investors had initiated before the arbitral tribunal had to be regarded as being subject to 'the rules and principles' prohibiting such an arbitral tribunal from breaching Article 267 TFEU and Article 344 TFEU.[40] In this case, the Court of Justice established the principle of the immediate applicability of Union law to the future effects of a situation arising prior to accession to the Union.

7.3.2. The Scope of the Judgment in *Achmea* as Regards the ECT

However, the Court of Justice in these judgments had not settled all the questions concerning the relationship between investment arbitration and EU law. It should be recalled that the ECT – a mixed treaty concluded by the EU – is not, *a priori*, fully comparable to the bilateral investment treaty at the heart of the judgments commented on above.[41]

In *Komstroy*, the Court of Justice held that the fact that the EU is a party to the ECT and thus bound by that treaty does not obliterate the incompatibility

[37] Case C-109/20 *PL Holdings* ECLI:EU:C:2021:875, para 46.
[38] ibid para 52.
[39] Cases T-624/15, T-694/15 and T-704/15 *European Food v Commission* ECLI:EU:T:2019:423.
[40] Case C-638/19 P *Commission v European Food* ECLI:EU:C:2022:50.
[41] Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* (n 22) para 72.

of the intra-EU ISDS mechanism with EU law. On the one hand, the ECT has the effect of establishing a mechanism of judicial protection outside the national courts of state,[42] while, on the other hand, these arbitral tribunals are likely to interpret a treaty that falls within the scope of EU law without constituting a state court, and thus cooperate with the CJEU.[43]

Although Article 26(6) ECT provides that the arbitral tribunal is to decide the issues in dispute in accordance with the ECT, and 'applicable rules and principles of international law', the Court of Justice ruled that the tribunal in question may be obliged to interpret or even apply EU law.[44] The Court of Justice departed from the reasoning followed by the Stockholm Chamber of Commerce in *FREIF Eurowind Holdings v Spain*, according to which the case law in *Achmea* could not be applied to the ECT on the grounds that the latter, as a mixed agreement, was not akin to an intra-EU BIT.[45] Thus, in *Komstroy*, the Court of Jutice has solemnly affirmed the superiority of EU law over the ECT.

While in French law, the respect of public policy by the arbitral tribunal set up under the ECT is reviewed by the civil courts, the Court of Justice points out, as it did with regard to German procedural law in the *Achmea* case,[46] that the Code of Civil Procedure only provides for a limited review of the jurisdiction of the arbitral tribunal.[47] In contrast to commercial arbitration, where the review is more extensive, there is no safety valve. From there onwards, the ISDS provided for in the ECT is deemed incompatible with EU law when the disputes are between an investor from one Member State and another. In accordance with the principle of loyal cooperation,[48] all Member States must, in line with the *Achmea* and *Komstroy* judgments, denounce the ISDS clauses of intra-EU investment agreements, which is not yet the case for a minority of them,[49] challenge the jurisdiction of any court established at the request of an investor in the context of an intra-EU ISDS dispute, and ensure that their courts find such arbitral awards incompatible with public policy.

On the other hand, the Court of Justice accepts that the ECT may require Member States to comply with the arbitration mechanisms provided for by it with regard to relations with investors from third states. In practical terms, claims initiated by investors from third states (Tajikistan, Kazakhstan, etc) that are parties to the ECT will be adjudicated by arbitral tribunals, as the *Achmea* case law concerns only the intra-EU dimension of ISDS.[50] In effect, the principle

[42] Case C-741/19 *Komstroy* (n 12) paras 51–52.

[43] Opinion of Advocate General Szpunar, Case C-741/19, *Komstroy* (n 22) para 78.

[44] ibid para 75.

[45] Stockholm Chamber of Commerce final award of March 2021, case n. 2017/060 *FREIF Eurowind Holdings v Spain*, para 304.

[46] Case C-284/16 *Achmea* (n 28) para 53.

[47] Case C-741/19 *Komstroy* (n 12) para 57.

[48] Article 4(3) TEU.

[49] Therefore, both the EU and the 26 Member States should denounce Article 26 ECT, at least for intra-EU disputes, or to ratify a modifying treaty providing for a disconnection clause.

[50] Case C-741/19 *Komstroy* (n 12) para 65.

of mutual trust does not apply in relations between the EU Member States and third states, provided that the seat of arbitration is in a non-EU state.[51]

7.3.3. The Concept of 'Investment' in Article 1(6) ECT in the EU Legal Order

Finally, the Court of Justice had to verify whether the electricity supply contract constituted an investment within the meaning of the ECT. Article 1(6) ECT defines the concept of 'investment', as used in the provisions of the ECT, and determines the material scope of the ECT. This provision thus has the effect of triggering the application of the substantive protective provisions of the ECT.

The Court of Justice's reasoning can be broken down into two stages. In order to fall within the definition of investment within the meaning of the first subparagraph of Article 1(6) ECT, two cumulative conditions must be fulfilled. The first condition requires that 'it must concern an asset of a type owned or controlled directly or indirectly by an investor'. Given that a claim arising from a contract for the supply of electricity constitutes an asset held directly by an investor, this condition was satisfied in *Komstroy*.[52] The second condition is more complex. It should be noted that the assets in question should include at least one of the elements referred to in points (a) to (f) listed in the first subparagraph of Article 1(6) ECT. The Court of Justice uses as a potential criterion salient point (c) of the first subparagraph, which states that the concept of 'investment' includes 'claims to money and claims to performance pursuant to [a] contract having an economic value and associated with an investment'.

Although the claim at issue in *Komstroy* was of a fixed amount, and arose from a contract, namely the contract for the supply of electricity concluded between two undertakings,[53] it appeared that that claim did not arise from a contract connected with an investment.[54] In effect, the contractual relationship between the two undertakings concerned only the supply of electricity.

7.4. EU CLIMATE CHANGE POLICY

When the ECT was adopted, the possibility of differentiating among energy sources depending on their impact on the climate crisis was not considered during negotiations. In hindsight, the failure to address this issue seems astounding. In fact, when the ECT was signed in December 1994, the United Nations Framework Convention on Climate Change (UNFCCC) had already been in force since 21 March 1994.

[51] Opinion of Advocate General Szpunar, Case C-741/19 *Komstroy* (n 22) para 87.
[52] Case C-741/19 *Komstroy* (n 12) para 70.
[53] ibid paras 73–74.
[54] ibid para 78.

As the flagship measure of the European Green Deal (EGD) adopted in December 2019 was the adoption in 2021 of a European Climate Law,[55] that requires a drastic reduction in GHG emissions in a variety of sectors such as industry, transport, energy, agriculture and the heating and cooling of buildings. The aim is to achieve negative emissions after 2050. All in all, the EGD intended to create the largest shockwave since the creation of the single market in 1986 by turning the European Union (EU) into the first decarbonised (achieving carbon neutrality by 2050) and circular economy in the world aiming at zero pollution. In addition, the lending policy of the European Investment Bank (EIB), adopted by EU finance ministers in December 2019, is to phase out the financing of unabated fossil fuel energy. Furthermore, national courts in various Member States have increasingly adjudicated claims brought by city councils, NGOs and citizens concerning climate inaction, taking account of climate obligations under EU secondary law.[56]

While the forthcoming EU climate and energy measures will increase investment in green energy (renewables, hydrogen, etc), they will lead to a significant decline in fossil fuel investment across Europe and affect the rights of foreign investors under the ECT. Critics have been arguing that the ECT could undermine the EU's 2050 carbon neutrality target.[57] These fears were not exaggerated. Through its private arbitration mechanism, the ECT was likely to hold a sword of Damocles over national authorities that decide to move away from fossil fuels.[58]

In fact, the ECT has become the most litigated investment agreement in the world, with the majority of disputes being of an intra-EU nature. It has already given rise to more than 136 disputes, the vast majority of which involve Member States, with Spain currently the main target for private investors. It must be noted that under the ECT, the majority of the claims are brought in relation to renewable energy, and not fossil fuel production. In 2012, Vattenfall claimed EUR 4.7 billion from Germany to compensate for its alleged losses due to the phase-out of nuclear reactors. By the same token, the German company RWE claimed EUR 1.4 billion in compensation from the Netherlands for phasing out coal by 2030. Against this background, the ECT could prompt a regulatory chill. In order to avoid being taken to court, several national authorities could delay the energy transition. What is more, with the enlargement of the EU to

[55] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality [2021] OJ L243/1.

[56] In the Netherlands, see Case C-19/0035 *Urgenda* [2019] HR: 2019: 2006. In Germany, see BvR 2656/18, 1 BvR 96/20, 1 BvR 288/20, 1 BvR 78/20. In France, see Council of State, *Grande-Synthe*, FR:CECHR:2021:427301.2021070. In Belgium, see Brussels Court of Appeal, *Klimaatzaak*, 30 November 2021. See N de Sadeleer 'Belgian public authorities held liable for flawed climate policy: Klimaatzaak case' (2024) 24 *Elni Review* 4–11.

[57] For more on this debate, see ch 13.

[58] N de Sadeleer, 'L'avenir de la Charte de l'énergie: comment accommoder la protection des investisseurs à la transition énergétique', Blog de droit européen, Working paper 8/2022.

CEE states in 2004, and the development of a single energy market within the EU, the ECT has lost its initial relevance for the EU. The EU and several of its Member States had been expressing the view that it was necessary to align the ECT with the Paris Agreement, and to abolish the ISDS procedure provided for in Article 26 ECT.

In order to modernise the ECT, the modernisation group established by the Energy Charter Conference held 15 formal negotiation rounds between July 2020 and June 2022. After two years of intense negotiations, a tentative agreement was reached on 24 June 2022 among 53 Contracting Parties for the modernised ECT. In the absence of an EU position, the EU was unable to vote on the adoption of the modernised ECT at this conference.

The ECT Secretariat took the view that the modernised ECT will have a much stronger climate focus, will be aligned with the objectives of the Paris Agreement and will support the global energy transition while ensuring affordable energy for all.[59] By the same token, the European Commission considered in 2022 that, once approved and ratified, the modernised ECT will facilitate sustainable investments in the energy sector by creating a coherent and up-to-date framework and will fully preserve the EU's ability to develop its climate policies.[60] It must be noted that a disconnection clause for Regional Economic Integration Organisations (REIOs) has been included in the modernised treaty with a view to assuaging EU's objections. Given that the only REIO under the ECT is the EU, this provision was deemed to exclude intra-EU investment disputes from the scope of the modernised ECT. Such an exclusion appeared to be in line with the *Komstroy* judgment.

Although the modernised treaty was negotiated by the European Commission within the mandate given to it by the Council of Ministers, we took the view in 2023 that this modernised treaty would affect the competences of the Member States. Indeed, the extra-EU ISDS regime that is maintained in the new treaty was likely to cover new investments, notably in the field of biofuels, biomass and synthetic fuels. In addition, it was unlikely that the modernisation of the ECT would end the extra-EU ISDS mechanism, which as a matter of principle does not fall within the scope of exclusive EU competence.

Furthermore, the modernised ECT makes changes to the ISDS (third party financing) procedures.[61] Lastly, it revises the fair and equitable treatment clause[62] which will change the way arbitral tribunals review government measures related to portfolio investments. Straddling exclusive (direct investment, energy) and shared (indirect investment, dispute settlement) competences, the modernised ECT – if it is to see the light of day – will not only have to be concluded by the

[59] Communication of the Secretary General on the modernisation of the Energy Charter Treaty, 1 July 2022.
[60] DG Trade, Agreement in principle reached on Modernised Energy Charter Treaty.
[61] New provision, Part IV.
[62] Article 10.

Council of the EU, with the prior approval of the European Parliament,[63] but it will also have to be ratified by national parliaments.

The Energy Charter Conference of 22 November 2022 should have unanimously adopted the ECT modernisation agreement. While the Union and the 26 Member States (Italy no longer being a party since 2016) could, in accordance with the principle of loyal cooperation, have formed a united front so that the modernisation of the ECT could have been initiated, France, Germany, Spain and the Netherlands abstained during the COREPER vote on 18 November 2022. As unanimity was not possible at this stage, the Conference of the Parties decided on 22 November to postpone the approval of the amending agreement. It was therefore a case of squaring the circle. On the one hand, it was doubtful that the Council of Ministers would have been able to reach a qualified majority due to opposition from several Member States. Moreover, for the Council to conclude the modernised treaty, the European Parliament would have to approve the reform. In a resolution adopted on Wednesday 23 November 2022, the European Parliament clearly stated its opposition to the conclusion of the modernisation treaty. On the other hand, since the modernised treaty covers mainly exclusive competences, individual Member States will not be able to adopt it. Finally, it became clear that the revised ECT was not matching the EU's climate change ambition. On 30 May 2024, having obtained the European Parliament's approval, the Council of the EU agreed upon the EU and Euratom's withdrawal from the ECT.[64] This withdrawal was notified on 27 June 2024.

There was an absence of consensus between EU Member States whether to support the modernised treaty. It must be noted that amendments to the ECT must be adopted by unanimity by the Conference. On 3 December 2024, the ECT Conference adopted, at the statutory session of its 35th meeting, the decision on the modernisation of the ECT. Given the EU withdrawal, the Member States still party to the ECT had to vote themselves. The amendments are supposed to enter provisionally in force from 3 September 2025.

Lastly, the modernised ECT which is provisionally in force will not resolve every problem for the EU. While it will no longer be possible for a German investor to bring its dispute against the Belgian authorities before an arbitration tribunal, an investor with its registered office in the UK will still be able to bypass the Belgian courts by bringing a case before an arbitration tribunal. As a result, the tribunal could interpret EU law. Consequently, arbitral tribunals instituted under the ECT are likely to continue to claim that they have jurisdiction to adjudicate investment cases related to investments in a Member State,

[63] Article 218(6) TFEU.

[64] Council Decision (EU) 2024/1638 of 30 May 2024 on the withdrawal of the Union from the Energy Charter Treaty, OJ L 2024/1638; Council Decision (EU) 2024/1677 of 30 May 2024 on the approval of the withdrawal of the European Atomic Energy Community from the Energy Charter Treaty, OJ L 2024/1677.

departing from the *Achmea–Komstroy* case law.[65] The question thus arises as to whether the ISDS mechanism provided for in Article 26 ECT is compatible with the standards laid down by the Court of Justice in *Opinion 1/17*.[66]

In addition to Italy, which denounced the ECT in 2016, France and Spain have been denouncing the ECT. Furthermore, Poland, Germany, Spain, Portugal, Slovenia, the Netherlands and Luxembourg are considering denouncing the ECT.[67] The Member States that have so far denounced the ECT have been abrogating the consent that they gave to arbitration.

However, by virtue of the ECT sunset clause, these Member States could still be sued by investors, for a period of 20 years after their decision to denounce the treaty.[68] Italy is a case in point. Since its denunciation of the ECT in 2016, this Member State has been facing seven claims based on the ECT sunset clause, for an amount of USD 400 million. By way of illustration, following Italy's adoption of a law in 2015 prohibiting offshore production within a certain distance of the Italian coastline due to environmental concerns, earthquake risks, as well as strong opposition from local residents, the UK-based company Rockhopper, which was planning to develop an oil and gas field at Ombrina Mare, located less than 12 miles off the Italian coast in the Adriatic Sea, referred the matter to an ICSID arbitration tribunal. On 23 August 2022, the tribunal ordered Italy to pay EUR 190 million in compensation to the British investor.[69] In international investment law, the sunset clause is nothing exceptional given that 97% of 2,061 BITs enshrine such a clause.[70] Nonetheless, in contrast to most BITs, the 20-year period is rather long.[71]

The question therefore arises as to whether the sunset clause of the ECT could prevent denunciation. In fact, these clauses are not permanent, as states can neutralise them by concluding an amending treaty or a so-called inter se agreement, followed by the denunciation of the original investment treaty. Thus, the obstacle could be overcome. Indeed, in the past, several states have done

[65] However, there has been recently an exception to this. In *Green Power Partners K/S SCE and SCE Solar Don Benito APS v The Kingdom of Spain* (SCC Arbitration V (2016/135)) ('*Green Power*'), the arbitral tribunal held on 16 June 2022 that it had no jurisdiction to adjudicate the case on the grounds that it was bound by the primacy of EU law.

[66] I Damjanovic and N de Sadeleer, 'Values and objectives of the EU in light of Opinion 1/17: "Trade for all", above all' [2020] 4(1): 6 *Europe and the World: A law review*. On 16 June 2022, the CJEU delivered its Opinion on Belgium's request on the compatibility of intra-EU investor-state arbitration under a modernised text of the ECT with EU law. The CJEU found that it 'does not have sufficient information on the actual content of the envisaged agreement and that, therefore, the present request for an Opinion, on account of its premature nature, must be regarded as inadmissible'. *Opinion 1/20* ECLI:EU:C:2022:485 (*Modernised Energy Charter Treaty*), para 48.

[67] Article 47 ECT fleshes out Article 54 on the Law of Treaties.

[68] Article 47(3) ECT.

[69] *Rockhopper Exploration Plc, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic*, ICSID Case No ARB/17/1.

[70] European Parliament, *Sunset Clauses in International Law and their Consequences for EU Law*, January 2022, p 23.

[71] Indeed, 85% of IIAs containing a survival clause refer to a period of less than 20 years; most provide for a period of 10 years or less.

so by denouncing sunset clauses in bilateral investment treaties between themselves. Last but not least, in its resolution of 24 November 2022, the European Parliament calls for the conclusion of such an agreement.[72]

7.5. CONCLUSION

In *Komstroy*, the Court of Justice applied its reasoning from the *Achmea* judgment as regards the compatibility of the dispute settlement mechanism provided for in Article 26 ECT, regardless of the fact that this is a mixed agreement. Indeed, the fact that the EU is a party to the ECT, and is therefore bound by it, does not change anything. The autonomy of EU law definitively prevails over international investment law, at least as regards intra-EU investments.

A fundamental principle of mutual trust obliges the investors in intra-EU disputes to rely on the national courts of the host Member States, whether Romanian or Bulgarian. Moreover, given that EU law guarantees sufficient protection for intra-EU investments (principles of non-discrimination, proportionality, legal certainty, and protection of legitimate expectations, etc[73]), and that investors enjoy effective judicial protection before national courts, there was little point in maintaining the effects of ISDS provided for by BITs or the ECT any longer.[74]

By involving the national courts in accordance with Article 19(1) TEU, second paragraph, the reference for a preliminary ruling procedure has become the 'keystone'[75] of the EU judicial system. Accordingly, national courts are the guarantors of the correct implementation of EU law. However, the *Komstroy* judgment will not put an immediate end to the tug-of-war between the proponents of the EU orthodoxy and the number of arbitral tribunals that tend to disregard the case law of the Court of Justice.

[72] Joint Motion for a Resolution on the outcome of the modernisation of the Energy Charter Treaty (2022/2934(RSP)).

[73] See, for instance, Case C-390/12 *Pfleger and Others* ECLI:EU:C:2014:281, paras 30–37.

[74] In this connection, see, Opinion of Advocate General Szpunar, Case C-741/19, *Komstroy* (n 22) para 65.

[75] Case C-284/16 *Achmea* (n 28) para 37.