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# **The compatibility of the Energy Charter Treaty with EU law**

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## Summary

This study answers the question whether the Energy Charter Treaty (ECT) as an agreement binding on the EU and the Member States is compatible with the EU Treaties. It finds that ECT as it currently stands is not compatible with the EU Treaties and that therefore the EU institutions and the Member States are required to either withdraw from the ECT or ensure that it is amended.

The first main defect of the current text of the ECT is that the ECT adversely affects the autonomy of EU law by enabling investment tribunals to interpret and apply EU law without introducing the necessary safeguards that preserve the EU's unique legal and judicial framework (*autonomy of EU law*). The second main defect is that the ECT adversely affects the operation of the EU institutions in accordance with the EU's constitutional framework.

The European Court of Justice (ECJ) in *Opinion I/17* (2019) placed emphasis on the legal safeguards that were introduced in EU-Canada Comprehensive Economic and Trade Agreement (CETA) to protect the EU's autonomy and the EU institutions' ability to regulate in the public interest. The Court concluded that, in light of these safeguards, CETA sufficiently protected the autonomy of the EU legal order (*jurisdictional autonomy*) and EU institutional framework (*regulatory autonomy*) in the particular context of CETA as an international trade agreement concluded between the EU and its Member States, as one party, and a non-EU country, as the other. The ECT, by contrast, as a product of the early 1990's, does not contain any such safeguards. In addition, it is a very different type of agreement, namely a multilateral investment agreement that allows for arbitration in different constellations, including between investors from one EU Member State and another Member State (intra-EU arbitration). In addition to the incompatibility with the EU's autonomy (both jurisdictional and regulatory autonomy), we find several other incompatibilities of the ECT with the EU constitutional framework: the ECT adversely affects the principles of mutual trust, equal treatment, and effectiveness, the operation of the internal market (state-aid), and Article 47 of the Charter of Fundamental Rights (access to an independent tribunal). This justifies that both the EU institutions and the Member States have an obligation under EU loyalty to end this incompatibility by taking all legal means to terminate their obligations under the ECT that are incompatible with EU law.

The EU text proposal of May 2020 seeks to address a number of the identified incompatibilities; however, a general amendment of the ECT follows a cumbersome and long procedure and it remains to be seen whether the ECJ would declare such a text compatible with EU law. First, it requires unanimity of the contracting parties present and voting at the Conference of the Parties and second, the agreed amendments enter into force only between the Contracting Parties that have ratified them on the 90th day after deposit of the instruments of ratification of at least three fourths, or 41, Contracting Parties. CETA is in this respect a reminder that the ratification requirement may prove to be an obstacle for a swift entering into force. It has not yet been ratified by all EU Member States.<sup>1</sup> In addition, the necessary amendments to Article 26 ECT as proposed by the EU are unlikely to be part of a modernized ECT, because the Energy Charter Conference did not include Article 26 ECT in the list of topics that are part of the discussions on the modernization effort.<sup>2</sup> In other words, the EU text proposal is outside the scope of discussions as agreed by the Energy Charter Conference.

The fact that the EU and 26 Member States (all but Italy) are party to an international agreement that is incompatible with its own constitutional framework, the EU legal order, is currently still a

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<sup>1</sup> Jean Monnet Network on Transatlantic Trade Politics, 'CETA Ratification Tracker' (Carleton.ca, 20 April 2022) <<https://carleton.ca/tradenetwork/research-publications/ceta-ratification-tracker/>> accessed 20 April 2022

<sup>2</sup> Energy Charter Conference, Decision on Report by the Chair of the Subgroup on Modernisation, CCDEC 2018 21 NOT, 27 November 2018.



significant problem. The EU institutions and the Member States are bound by the EU Treaties and have to take the necessary steps to remedy such incompatibility. The interpretation of the ECT as EU law and its compatibility with the EU Treaties has already been brought to the ECJ and it is likely to be raised again in different contexts. In *Komstroy*, the ECJ ruled that intra-EU arbitration under the ECT is contrary to EU law. This already requires the Member States to use all legal means to terminate their obligations to take part in intra-EU arbitration under the ECT. In addition, Opinion 1/20 on the EU text proposal to amend the ECT is pending. Yet, the ECJ may also via other proceedings be asked to address the compatibility of the ECT with EU law, *e.g.*, through a preliminary question on the validity of the Council decision concluding the ECT or the compatibility of an enforcement of an ECT award by a national court.

The options under international law to remedy this incompatibility come down to general amendment, withdrawal from the ECT, inter-se modification, and/or making an additional declaration to the ECT. Of these options the combination of withdrawal, inter-se modification, eliminating the effects of the sunset clause between the withdrawing parties, and an attached interpretative declaration that avoids circumvention of the inter-se modification through relocation to a not withdrawing, non-EU Contracting Party to the ECT, appears in this respect the most promising way forward for the EU and the Member States to avoid regime conflict with the ECT.

## Introduction

The Energy Charter Treaty (ECT) is an unusual and anachronistic agreement to which the EU is party. It remains to this day the EU's only international agreement in force that contains investor-state dispute settlement (ISDS) provisions. The ECT is also the only agreement that has resulted in an investor claim filed against the EU (*Nordstream 2*).<sup>3</sup>

It was negotiated by the EU many years before the EU obtained exclusive competence in the field of foreign direct investment under the Common Commercial Policy (CCP) and many years before the EU started to develop its own policy on international investment protection. The ECT was also concluded long before agreements containing ISDS became part of major public controversy and debate, in particular in Europe. In fact, it is the operation of ISDS under the ECT's extensive investment protection provisions that sparked the debate in the wake of the increasing amount of public interest measures challenged by investors under the ECT.

The ECT contains ISDS provisions that were drafted long before the European Court of Justice (ECJ) clarified the constitutional limits of the EU's ability to subject itself to international dispute settlement in international agreements in *Opinion 2/13*, *Opinion 1/09* and *Opinion 1/17*. As such, the ECT's provisions are not comparable to the investment protection provisions in modern trade and investment agreements such as the Comprehensive Economic and Trade Agreement (CETA) between the EU and the Member States and Canada. In the wake of this case-law, the Commission, on a mandate from the Council, has made several proposals to amend and 'modernise' the ECT in order to remedy the outdated provisions in the ECT. The EU text proposal of May 2020 is discussed in detail below.

Investment law has become a prime example of an area in which the ECJ's decisions, *e.g.*, in *Achmea* and *Opinion 1/17*, place limits on the EU's external actions that could be seen as hindering the EU to establish and maintain an effective international presence. In particular, the principle of autonomy has been identified to stand in tension with other principles, which underpin the EU's external action, including the principle of effectiveness and openness to international law.<sup>4</sup>

With regard to the ECT more specifically, the ECJ held in *Komstroy* in September 2021 (rather predictably) that there is no place for intra-EU arbitration proceedings under the ECT, *i.e.*, arbitration brought by an investor from one EU Member State against another EU Member State. However, this does not necessarily end intra-EU arbitration because arbitral tribunals are not likely to follow the case law of the ECJ. Given that Member State authorities (including Member State courts) are bound by EU law, this means that investors are likely to seek enforcement of awards against Member States and the EU outside of the EU. In other words, the situation that intra-EU arbitration is illegal from the standpoint of EU law but legally and factually possible under international law creates great potential for regime conflicts.

In addition, Belgium brought a request for an opinion under Article 218(11) TFEU (*Opinion 1/20*) to the ECJ asking whether the envisaged 'modernised ECT' with its article 26 on ISDS applying to

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<sup>3</sup> [Nord Stream 2 v. EU, Investment Dispute Settlement Navigator, UNCTAD Investment Policy Hub](https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1008/nord-stream-2-v-eu) <https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1008/nord-stream-2-v-eu>.

<sup>4</sup> Marise Cremona, Anne Thies, Ramses A. Wessel, 'The European Union and International Dispute Settlement: Introduction' in Marise Cremona, Anne Thies, Ramses A. Wessel (eds), *The European Union and International Dispute Settlement* (Hart 2017) 4.

intra EU would be compatible with EU law. The Court has repeatedly held that Article 218(11) TFEU has the function ‘to forestall, by a prior referral to the Court, possible complications at EU level and at international level which would result from the invalidation of an act concluding an international agreement’, emphasising that this means that ‘the mere risk of such invalidation suffices for the referral to the Court to be allowed’.<sup>5</sup> However, in light of the fact that at present we only have a text proposal of the EU, it remains an open question whether this qualifies as an ‘envisaged agreement’ in the sense of Article 218(11) TFEU. This however is the requirement for the ECJ to be able to exercise jurisdiction in Opinion 1/20 on the compatibility of the proposed amendments to the ECT. In addition, several other cases relating to the ECT are pending before the ECJ.<sup>6</sup>

The issues of the compatibility with EU law of intra-EU arbitration and extra-EU arbitration, *i.e.*, arbitration by an EU investor against a non-EU state or a non-EU investor against an EU Member State, under the ECT including in relation to the EU’s membership of the ECT are inextricably linked. These issues concern the ability of the ECT’s ISDS mechanism to adversely affect the judicial and institutional framework of the EU. Yet, while *Komstroy* makes clear that there is no place for intra-EU arbitration under the ECT, the question of the compatibility of ECT with EU law as regards extra-EU arbitration has so far not been explicitly addressed by the Court. At the same time, the Court has given important guidance on the question under which conditions the EU itself may be party to an international agreement that contains ISDS in *Opinion 1/17*. This case-law and previous judgments of the ECJ, including *Achmea* and *Komstroy* may at least be seen as raising questions as to whether the EU’s conclusion of the ECT is compatible with EU law.

This study seeks to answer the question whether the ECT as an agreement binding on the EU and its Member States is compatible with the EU Treaties. It does so by first outlining the relevant provisions in the ECT, notably the ECT’s dispute settlement provisions (Section 1). The study then proceeds with an analysis of the ECT’s compatibility with EU law along the lines of the main principles of the Court’s case-law. The study will analyse the ECT on the basis of the Court’s case-law on autonomy of EU law, mutual trust, regulatory autonomy of EU law, the proper functioning of the EU’s internal market, principle of equal treatment, the right of access to an independent tribunal under Article 47 EU Charter for Fundamental Rights (CFR), the monopoly of jurisdiction under Article 344 TFEU, and the principles of loyalty (Section 2). Section 3 discusses different options available under international law to address compatibilities, including general amendment of the ECT, withdrawal from the ECT by the EU and its Member States, as well as inter-se modification and the effects of an additional declaration. Section 4, lastly, analyses the possibilities of legal challenges of the Council and Commission decision to conclude the ECT in lack of success in the efforts to modernise and amend the ECT at international level. The study’s explicit standpoint is hence the standpoint of EU law; yet, it addresses issues of international law to the extent that they are relevant to the analysis.

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<sup>5</sup> Opinion 1/17, paragraph 194; with reference to Opinion 1/15 (EU-Canada PNR Agreement), of 26 July 2017, EU:C:2017:592, paragraph 74;

<sup>6</sup> *E.g.*, Case C-348/20 P, *Nord Stream 2 v Parliament and Council*; see the Opinion of AG Bobek, ECLI:EU:C:2021:831.

## 1 The EU and its Member States as parties to the Energy Charter Treaty

### 1.1 The Energy Charter Treaty

*Origins* – The ECT resulted from the collapse of communist regimes in Eastern Europe. Western European countries sought to safeguard their energy supply by seeking access to fossil rich countries in the East, in particular access to Russia. Eastern European countries sought foreign investments and Western technology for their energy sector. The means to seek cooperation between East and West was in line with the prevailing political climate of the time: liberalisation of energy markets and protection of foreign investors in the energy sector. At the initiative of Dutch prime minister Ruud Lubbers, the Council of the European Union asked the European Commission to come up with a proposal how to accelerate cooperation between East and Western Europe in the sector. The Commission subsequently invited Eastern and Western European states and members of the OECD to participate in negotiations that would result in the declaration of the European Energy Charter (EEC) in 1991.<sup>7</sup>

The EEC took the form of a declaration, not an internationally binding agreement. It contained a commitment to negotiate a ‘Basic Agreement’ containing binding obligations on the liberalisation of energy markets and the protection of investments in the energy sector. This would become the ECT. The ECT is a multilateral agreement, currently ratified by 53 countries and the European Union. It was signed in 1994 and entered into force in 1998. 26 Member States of the EU are party to the ECT (Italy withdrew in 2016). Initially, the Energy Charter process was dominated by the relationship between Russia and other European states. However, Russia never ratified the ECT and withdrew from the agreement in 2009, because the ECT was not able to resolve the gas dispute between Russia and Ukraine and because of the high-profile investor-state dispute *Yukos* that was undertaken under the provisions of the ECT.<sup>8</sup> The withdrawal of Russia has prompted a reorientation towards geographic expansion. In 2015, a new declaration was signed by 75 parties, the International Energy Charter (IEC). Its main function is to pave the way for an enlargement of membership of the ECT.

*Objectives and main features* – The objective of the ECT is to ensure ‘long-term cooperation in the energy field’ by adopting a legal framework that commits parties ‘to promote access to international markets on commercial terms, and generally to develop an open and competitive market, for energy materials and products.’<sup>9</sup> The legal tools by which this cooperation is realised are typical instruments popular in the 1990’s: liberalising of trade in energy products (article 29, based on the more general WTO-GATT regime), securing their free transit (article 7), protecting foreign investors in the energy sector (based on bilateral investment agreements negotiated at the time, see Part III of the ECT, in particular Articles 10 and 13 ECT) and provide for investor-state (Article 26 ECT) and state-to-state dispute settlement (Article 27, 29, Annex D and Article 7 (7) ECT).

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<sup>7</sup> Final Act of the Conference on the European Energy Charter [1994] OJ 2 380/24.

<sup>8</sup> Kyla Tienhaara and Christian Downie, ‘Risky Business? The Energy Charter Treaty, Renewable Energy, and Investor-State Disputes’ [2018] 24(3) Global Governance 451-471, 455.

<sup>9</sup> Council and Commission Decision of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects [1998] OJ 2 69/1, Articles 2 and 3 of the ECT.



A key principle of the ECT is the provision on sovereignty over energy resources (Article 18 ECT). It is not part of the liberalisation instruments. The ECT also contains a provision on exceptions (Article 24 ECT) and relatively detailed institutional framework (Part VII ECT). All the annexes of the ECT and Decisions taken by the Energy Charter Conference form an integral part of the ECT.<sup>10</sup>

## 1.2 ECT substantive provisions

*Investment protection* – In numerical terms (known number of ISDS cases initiated) the ECT is the most widely-used international agreement by foreign investors to bring investor-state claims.<sup>11</sup> On the one hand, this may be surprising because disputes are limited to economic activities in one particular sector (the energy sector) and investment protection only covers the post-investment phase (parties are only subject to best-efforts obligations concerning the pre-investment or market access phase). On the other hand, it corresponds well to the number of parties to the agreement, but especially because several key provisions in the ECT are very favourable to investors post-investment.

Article 10 ECT on the promotion, protection and treatment of investments is one of the two key provisions under the ECT for investment protection. It covers a multitude of well-known but poorly defined standards of protection that a host state must accord to a foreign investor after an investment has been made. The most important ones are those that protect the post-investment phase:

- ‘fair and equitable treatment’ (FET, Article 10 (1) ECT);
- ‘most constant protection and security’ (Article 10 (1) ECT);
- ‘no unreasonable or discriminatory measures’ (Article 10 (1) ECT);
- ‘treatment no less favourable than that required by international law, including treaty obligations’ (Article 10 (1) ECT);
- ‘observance of obligations’ (the umbrella clause. Article 10 (1) ECT);
- National treatment (Article 10 (7) ECT);
- Most-favoured nation treatment (MFN, Article 10 (7) ECT).

According to statistics from the UNCTAD, 68 of 135 known disputes brought on the basis of the ECT are based on an alleged breach of the fair and equitable treatment standard.<sup>12</sup> It is known to be ‘broad and vague’ and ‘impossible to provide a definition in the abstract’ for the standard.<sup>13</sup> Arbitral tribunals have shown a variety in levels of deference towards state conduct when applying the standard.<sup>14</sup> The themes that feature in arbitral tribunals’ decisions when applying the standard under the ECT are:

- ‘stability and predictability (including legitimate expectations);
- transparency;

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<sup>10</sup> Kaj Hobér, *The Energy Charter Treaty* (Oxford University Press 2020), 4.

<sup>11</sup> The UNCTAD has registered 135 known disputes brought on the basis of the ECT, almost double of the second-most used agreement (NAFTA, 71).

<sup>12</sup> As of 4 January 2022, UNCTAD, ‘Investment Dispute Settlement Navigator’ (Investment Policy Hub, 8 April 2022) <<https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search>> accessed 8 April 2022.

<sup>13</sup> Hobér, *The Energy Charter Treaty*, 190

<sup>14</sup> Standards based on the *Neer* case (not an investment law case) (‘treatment of an alien to amount to an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency’) are more deferential than others.

- denial of justice and due process; and
- freedom from harassment and discrimination.’<sup>15</sup>

Article 13 ECT protects foreign investors against unlawful expropriation. According to Article 13 ECT investments shall not be expropriated or subject to a measure having equivalent effect except where such expropriation is: ‘

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the investment expropriated at the time immediately before the expropriation or impending expropriation became known in such a way as to affect the value of the investment (hereinafter referred to as the ‘valuation date’).’

This standard is used in Article 13 ECT for the amount of compensation (‘prompt, adequate, and effective compensation’, the so-called Hull-standard) and the method of determining the amount (‘fair market value’) are also currently used in EU trade agreements and are considered to give investors the highest level of protection compared to other standards.<sup>16</sup>

In relation to indirect expropriation, Article 13 ECT does not provide a definition of a standard. In other more modern investment agreements, parties have sought to define the standard of indirect expropriation in response to expansive and inconsistent interpretations by investment tribunals.<sup>17</sup> This gives arbitral tribunals the task under the ECT of distinguishing between legitimate governmental action and indirect expropriation. This is a key issue, because if state conduct cannot be qualified as indirect expropriation, the generous compensation standards and requirements for expropriation do not have to be met. In the past, several ECT tribunals have focussed on the question whether regulatory action of a state had the effect of substantially diminishing investments or depriving a significant part of their value.<sup>18</sup>

*Environmental provisions* - During negotiations several governments and the fossil fuel industry were concerned over introducing any ‘hard-law’ provisions on environmental protection.<sup>19</sup> On environmental protection, the ECT contains what one commentator has described as a ‘collection of declarations of intent on good-will, good practices and neighbourly collaboration’.<sup>20</sup> Article 19 ECT contains a number of best-endeavour provisions that are qualified with language requiring

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<sup>15</sup> Hobér, 190

<sup>16</sup> The Indian Model BIT article 5 for instance does not employ the Hull standard, but refers to ‘adequate compensation. See the Government of the Republic of India, ‘Model Text for the Indian Bilateral Investment Treaty’ (Department of Economic Affairs, 8 April 2022) <[https://dea.gov.in/sites/default/files/ModelBIT\\_Annex\\_0.pdf](https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf)> accessed 8 April 2022. This gives governments more freedom of action.

<sup>17</sup> See for instance Annex 8-B CETA, Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part [2017] OJ 2 11/23.

<sup>18</sup> AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary, Award dated 23 August 2010, at 14.3.2-3; Electrabel S.A. v. Republic of Hungary, Award dated 30 November 2012. at 6.52-53;

<sup>19</sup> Thomas W. Wälde, ‘European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and energy charter protocol on energy efficiency and related Environmental aspects’ [1995] 34(2) International Legal Materials 360-454, 362.

<sup>20</sup> Ibid, 365.

parties to be ‘economically efficient’ and ‘cost-effective’ in doing so.<sup>21</sup> Parties are furthermore required to ‘promote’ and ‘encourage’ various (market-oriented) environmental measures and initiatives.<sup>22</sup> The Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (the Energy Efficiency Protocol) contains the best-endeavour and promotional language on energy efficiency and environmental protection. The protocol’s objective is to ‘promote energy efficiency’, to create market-based instruments to reduce spillage, and to foster cooperation.<sup>23</sup>

A notable feature of the ECT is to structurally subordinate environmental protection to investment protection and trade liberalisation provisions. Article 13 (1) of the Energy Efficiency Protocol contains a hierarchy clause that subordinates the provisions of the protocol to the ECT. Both the Energy Efficiency Protocol and Article 19 of the ECT are not covered by the dispute settlement procedures of Article 26 (ISDS) and Article 27.<sup>24</sup> The parties to the ECT through the Energy Charter Conference may on the basis of unanimity take decisions on the interpretation and implementation of Article 19 ECT.<sup>25</sup>

The general exceptions clause in Article 24 ECT is very unfavourable to environmental protection measures. It is, similar to Article XX GATT, based on a closed list and unlike Article XX GATT subject to even further limitations. Significantly, parties cannot rely in the context of ISDS disputes on the exception that allows parties to adopt or enforce any measure ‘necessary to protect human, animal or plant life or health’.<sup>26</sup> The wording of this exception is identical to that of Article XX (b) GATT. This is one of the two key derogations for environmental measures under the GATT. What is more, the other key derogation found in the GATT (Article XX (g) relating to conservation of exhaustible natural resources) is not even reproduced in Article 24 ECT.<sup>27</sup>

Moreover, Article 18 (1) ECT on resource sovereignty falls outside the scope of the ISDS procedures in Article 26 ECT. Article 18 (1) stipulates that sovereign rights over energy resources and sovereignty ‘must be exercised in accordance with and subject to the rules of international law’. Article 18 (3) ECT makes clear that subject to the ECT’s obligations each state continues to hold the right to ‘regulate the environmental and safety aspects’ of ‘exploration, development and reclamation’ of energy resources.

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<sup>21</sup> Accordingly, Article 19 (1) ECT states that ‘In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall *strive to minimize* in an *economically efficient manner* harmful environmental impacts occurring either within or outside its area from all operations within the energy cycle in its area, taking proper account of safety. In doing so each Contracting Party shall act *in a cost-effective manner*. In its policies and actions each Contracting Party shall *strive* to take precautionary measures to prevent or minimize environmental degradation. The Contracting Parties agree that the polluter in the areas of Contracting Parties, should, *in principle*, bear the cost of pollution, including trans-boundary pollution, with due regard to the public interest *and without distorting investment in the energy cycle or international trade*’ (emphasis added).

<sup>22</sup> Article 19 (1) ECT.

<sup>23</sup> Article 1 Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects.

<sup>24</sup> Article 19 (2), 26 (1) and 27 (2) ECT.

<sup>25</sup> Article 19 (2), see also Wälde (19) for this view 365.

<sup>26</sup> Article 24 (2) (b) see also Hobér (10), 390.

<sup>27</sup> Moreover, reliance on the exception necessary for the protection of human, animal or plant life and health is subject to the qualification that ‘no such measure shall constitute a disguised restriction on economic activity in the energy sector, or arbitrary or unjustifiable discrimination between Contracting Parties or between investors or other interested persons of Contracting Parties. Such measures shall be duly motivated and shall not nullify or impair any benefit one or more other Contracting Parties may reasonably expect pursuant to this Treaty to an extent greater than is strictly necessary to the stated end.’ See Article 24 (2) (iii) ECT.

### 1.3 Dispute settlement under the ECT

The ECT contains two forms of dispute settlement procedures: investor-state (Article 26 ECT) and state-to-state dispute settlement (Article 27, 29, Annex D and Article 7 (7) ECT). The investor-state dispute settlement (ISDS) procedure set out in Article 26 ECT is a procedure similar to many ISDS procedures contained in bilateral investment treaties of states concluded in the 1990's. Parties to the ECT give unconditional consent to foreign investors to submit disputes concerning an alleged breach of the investment provisions of the ECT (Part III) to arbitration. Three routes are open to investors for seeking to establish an arbitral tribunal: ICSID, UNCITRAL, and the Stockholm Chamber of Commerce.

A notable feature of Article 26 ECT is that it contains a so-called 'fork-in-the-road' clause.<sup>28</sup> Parties to the ECT can make a reservation that investors must choose between ISDS or other forms of dispute resolution (in particular domestic litigation). Such Parties are listed in Annex ID. Several Member States of the EU have made such a reservation. The EU is listed in Annex ID since 17 July 2019. The EU submitted a statement that replaced its earlier statement made on 17 November 1997.

### 1.4 The ratification by the EU of the Energy Charter Treaty

The ECT was concluded on behalf of the EU by Council and Commission Decision 98/181/EC on 23 September 1997 and deposited on 16 December 1997.<sup>29</sup> EU Member States ratified the agreement before or after that date, but not jointly with the EU.<sup>30</sup> No detailed declaration of competences exists between the EU and the Member States. The EU's statement submitted to the ECT secretariat pursuant to Article 26 (3) (b) (ii) ECT simply mentions that 'The European Union, Euratom and their Member States are internationally responsible for the fulfilment of the obligations contained within the Energy Charter Treaty, in accordance with their respective competences.'

### 1.5 EU text proposal for the modernisation of the Energy Charter Treaty (May 2020)

In November 2018, the Energy Charter Conference adopted a decision to approve a list of topics for modernisation of the Energy Charter Treaty.<sup>31</sup> The European Commission has, on behalf of the EU and the EU Member States, made text proposals for the amendment of the ECT.<sup>32</sup> According to the Commission, these proposals have three main aims:

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<sup>28</sup> Article 26 (3) (b) ECT.

<sup>29</sup> See above (9).

<sup>30</sup> Usually, ratification by the EU is only completed once all the Member States have completed their ratification procedures. This is a political choice and not legally required, see *Opinion 1/19 (Istanbul Convention)* ECLI:EU:C:2021:198, para 249.

<sup>31</sup> Decision of the Energy Charter Conference on the list of topics for modernisation of the Energy Charter Treaty, [https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201818\\_-\\_STR\\_Modernisation\\_of\\_the\\_Energy\\_Charter\\_Treaty.pdf](https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201818_-_STR_Modernisation_of_the_Energy_Charter_Treaty.pdf).

<sup>32</sup> The Commission received a mandate in 2019, see European Commission, 'Energy Charter Treaty modernisation: Commission welcomes Council's mandate' (European Commission, 15 July 2019) <<https://trade.ec.europa.eu/doclib/press/index.cfm?id=2049>> accessed 8 April 2022. The proposals can be found at European Commission, 'Energy Charter Treaty: Further progress in modernisation negotiations' (European Commission, 15 November 2019) <<https://trade.ec.europa.eu/doclib/press/index.cfm?id=2049>> accessed 8 April 2022.

- (1) to bring the investment provisions of the ECT in line with the EU's more recent investment agreements;
- (2) to bring the ECT more in line with the goals of the Paris Agreement and decarbonisation efforts and;
- (3) to bring the ISDS provisions more in line with the EU's approach on reform of ISDS within UNCITRAL.

Accordingly, these text proposals have the following main features:

#### *Regulatory freedom or 'right to regulate'*

In response to the criticism that standards of investment protection and their use before ISDS tribunals have a negative effect on the ability of governments to regulate in the public interest, the EU currently has an article in each of its international investment agreements that 'reaffirms' the right to regulate. It consists of several paragraphs that are also featured in the ECT text proposal for an article to be included in Part III of the ECT (where the standards of investment protection are featured). One paragraph reiterates the 'right to regulate' in general terms, while another provides for a clarification that the investment standards 'shall not be interpreted as a commitment from a Contracting Party that it will not change the legal and regulatory framework, including in a manner that may negatively affect the operation of investments or the investor's expectations of profits.' Two of the paragraphs are specifically dedicated to the issue of repayment of unlawful state-aid, an issue that has featured prominently in recent years.

#### *Fair and equitable treatment standard*

The EU text proposal also contains an amendment to Article 10 ECT that provides a list of five situations in which there is a breach of fair and equitable treatment. The same wording is used as in the other EU investment agreements and while elaborate is in line with practice by most arbitral tribunals.<sup>33</sup> In particular, the text proposal would codify 'legitimate expectations' into the ECT.

#### *National treatment and MFN*

Article 10 (7) ECT would be amended as to ensure that less favourable treatment can only result in a breach if that less favourable treatment is done 'in like situations'.

#### *Expropriation*

The EU's text proposal provides a definition for direct and indirect expropriation, in line with its other investment agreements. This definition seeks to prevent legitimate regulatory action from being considered indirect expropriation by investment tribunals. However, it also makes clear that even non-discriminatory measures can amount to indirect expropriation where they are 'manifestly excessive'. This standard is more intrusive of government freedom of action than for instance the standard used by the Indian government in its Model BIT.

#### *Trade and sustainable development provisions*

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<sup>33</sup> Gus Van Harten, Key Flaws in the European Commission's Proposals for Foreign Investor Protection in TTIP (November 17, 2015). Osgoode Legal Studies Research Paper No. 16/2016, Available at SSRN: <https://ssrn.com/abstract=2692122> or <http://dx.doi.org/10.2139/ssrn.2692122>.

The EU text proposal incorporates the EU's approach to 'trade and sustainable development' chapters found in its most recent trade and investment agreements. These provisions require Parties to reaffirm their commitment to international environmental and labour agreements to which they are Party and to effectively implement them, not to lower domestic levels of environmental and labour protection or fail to enforce them. Specific provisions address climate change, transparency, labour, environmental impact assessments. The EU text proposal makes the resolution of disputes over these provisions inferior to the state-to-state dispute settlement provisions that apply to the trade liberalisation and investment protection standards contained in the ECT. Findings of tribunals shall not be binding (in contrast to awards under other provisions of the ECT). Instead, tribunals can issue mere recommendations whose implementation the Parties to the dispute shall discuss.<sup>34</sup>

#### *The General Exceptions clause*

The EU text proposal for the amendment of the general exceptions clause is oddly enough not fully in line with the stated aims by the Commission of the EU text proposal to bring the ECT more in line with the goals of the Paris Agreement and decarbonisation efforts. The proposal expands the list of public interests that may be invoked to justify a breach of a number of ECT provisions, notably by including data protection and the conservation of exhaustible natural resources. However, these exceptions do not apply to violations of Articles 10 (1) and 13 ECT, the two key provisions that investors rely on the most.

#### *Investor-state dispute settlement*

The EU text proposal invites, in a note, other Contracting Parties to consider the Investment Court System as an alternative to the ISDS mechanism under Article 26 ECT, but does not propose an amendment to replace the ISDS with an ICS. The proposal however adds the possibility for investors to have recourse to a future multilateral investment court (MIC). This means the Commission relies on the negotiations ongoing at the UN level – UNCITRAL – and the hypothetical establishment of the MIC. It is important to note that these negotiations are very slow, and there is no assurance that this MIC will ever come to light, and if so, when and how many countries will support it and subscribe to it. Moreover, the EU text proposal also proposes amendments to the applicable law. The proposal's text is different from standard texts used in other new investment agreements such as CETA. In CETA, the jurisdiction of tribunals excludes legality and interpretation of domestic law and allows tribunals to only assess domestic law as a matter of fact. CETA also requires tribunals to follow the prevailing interpretation of domestic law by domestic courts.<sup>35</sup> In the EU's text proposal, however, this important provision is presented as an issue of interpretative clarification.<sup>36</sup> In any case, article 26 is not subject to the reform process, as dispute settlement is not part of the list of topics adopted by the ECT Secretariat.

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<sup>34</sup> New Article 28A.

<sup>35</sup> Article 8.31 (2) CETA (17).

<sup>36</sup> 'For greater certainty, the domestic law of a Contracting Party shall not be part of the applicable law. Where a tribunal is required to ascertain the meaning of a provision of the domestic law of a Contracting Party as a matter of fact, it shall follow the prevailing interpretation of that provision given by the courts or authorities of that Contracting Party and any meaning given to the relevant domestic law of a Contracting Party by the tribunal shall not be binding upon the courts or authorities of that Contracting Party. A tribunal shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of the obligations under Part III of this Treaty, under the domestic law of a Contracting Party'.

### *Investments in fossil fuels*

In 2021, the Commission made an additional text proposal to limit the scope of protection of Part III of the ECT (promotion and protection of investment) by progressively excluding investments in fossil fuels. In its additional text proposal, the provisions of Part III of the ECT would not apply to Coal, Natural Gas, Petroleum and Petroleum Products. Part III would also only apply to Electrical Energy produced by these products for a limited time period, depending on the carbon emissions emitted. A similar regime would exist for investments in gas pipelines. The text proposal does nonetheless contain a significant phase out period (10 years) for the protection of fossil fuel investments made before the entry into force of the amendment.

### *Non derogation clause*

The EU text proposal of May 2020 does not propose to amend Article 16, the ECT's so-called non derogation clause. Under this clause, foreign investors are guaranteed the more favourable treatment if another applicable agreement also contains investment protection standards similar to the ECT. In other words, it serves as a conflict clause, allowing for the more favourable agreement for the investor to be applied. The clause has been interpreted by several tribunals in relation to the question whether the ECT could be applied to intra-EU disputes. These tribunals have generally relied on Article 16 to apply the ECT over less-favourable EU law provisions.<sup>37</sup>

## **2. Compatibility with EU law**

Any international agreement to which the EU becomes a party has to comply both procedurally and substantively with the European Treaties. From the standpoint of Union law, as is the case for all domestic legal orders, the binding force of international agreements within the EU legal order depends on whether they have been validly concluded according to the rules of the primary law of the European Union.<sup>38</sup>

### *Intra-EU and extra-EU arbitration*

When arbitration mechanisms under international investment agreements are assessed as to their compatibility with EU law, usually two different contexts are distinguished: intra-EU and extra-EU arbitration. Intra-EU arbitration refers to arbitration brought by an investor from one EU Member State against another Member State. Extra-EU arbitration comprises both arbitration between third country nationals and EU Member States or arbitration brought by investors from an EU Member State against a non-EU Member States. This is a line that the Court draws in *Komstroy*.<sup>39</sup>

However, first of all, this line between intra-EU and extra-EU arbitration is not static. Investors may move their seat to a non-EU state. Second, this still leaves quite some uncertainties concerning the geographies of the proceedings (as opposed to those of the investor). What is the relevance of the fact that arbitral awards rendered in extra-EU arbitration are enforced within the EU? What about the procedural and supervisory jurisdiction of EU courts in such proceedings? What about administration of such proceedings by arbitral institutions based in the EU, *e.g.*, the Arbitration

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<sup>37</sup> Hobér (10), 318-323.

<sup>38</sup> Settled case law since Case 181/73, *Haegeman v Belgium*, ECLI:EU:C:1974:41.

<sup>39</sup> Case C-741/19, *Komstroy*, ECLI:EU:C:2021:655, paras 47 and 65-66.

Institute of the Stockholm Chamber of Commerce (AI-SCC)? All these aspects relate arbitration to the EU legal order and may result in a situation that EU law is applicable and affected.

The ECJ explains in *Komstroy* that its jurisdiction does not in principle extend to disputes ‘not covered by EU law’, *i.e.*, between an investor of a non-Member State and another non-Member State;<sup>40</sup> yet, that this is different when the international agreement – as is the case with the ECT – can apply both to situations falling within the scope of EU law and to situations not covered by that law’.<sup>41</sup> In that latter context, the consistent interpretation of EU law may be at stake. The ECJ also contends that when the seat of arbitration is located within the EU territory that this entails the application of EU law.<sup>42</sup> Two aspects must hence be distinguished: first, intra-EU and extra-EU arbitration, depending on the seat of the investor and the host state of the investment; and second, arbitration that falls within the scope of EU law and hence triggers the jurisdiction of the ECJ. The latter covers all arbitration (intra-EU and extra-EU) within the EU, including when a court from an EU Member State exercises procedural or supervisory jurisdiction or when the administration of proceedings is based within the EU.

On the basis of the ECT, both types of arbitration take place. However, while it is firmly established that intra-EU arbitration is incompatible with EU law, the assessment of the compatibility of extra-EU arbitration on the basis of the ECT requires a more detailed examination. Such an examination of the compatibility of extra-EU arbitration on the basis of the ECT with EU law must start from the case law of the ECJ, including its evaluations of intra-EU arbitration mechanisms.

#### *Intra-EU arbitration breaches EU law*

The *European Court of Justice* has unambiguously held in 2018 in *Achmea* (Dutch-Slovak BIT) and in 2021 in *Komstroy* (ECT) that intra-EU arbitration is incompatible with EU law. This position is also in line with ECJ’s prior case law.<sup>43</sup> In other words, even before *Achmea* and *Komstroy*, good legal reasons existed to assume the incompatibility of intra-EU arbitration with EU law. This is also reflected in the European Commission’s position prior to *Achmea* and *Komstroy*. In 2015, the Commission already asked the EU Member States to terminate their intra-EU bilateral investment treaties.<sup>44</sup> It has repeatedly submitted *amicus curiae* briefs on this point.<sup>45</sup> It also started infringement actions against specific Member States for not terminating their intra-EU BITs<sup>46</sup> and

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<sup>40</sup> *Komstroy*, para 28.

<sup>41</sup> *Komstroy*, para 29.

<sup>42</sup> *Komstroy*, para 34.

<sup>43</sup> C Eckes, ‘Some Reflections on Achmea’s Broader Consequences for Investment Arbitration’, *European Papers*, Vol. 4, 2019, No 1, pp. 79-97.

<sup>44</sup> See ‘Commission asks Member States to terminate their intra-EU bilateral investment treaties’, Press release, 18 June 2015, [https://europa.eu/rapid/press-release\\_IP-15-5198\\_en.htm+&cd=1&hl=it&ct=clnk&gl=it](https://europa.eu/rapid/press-release_IP-15-5198_en.htm+&cd=1&hl=it&ct=clnk&gl=it).

<sup>45</sup> See, e.g., *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain*, Decision on Jurisdiction (6 June 2016) ICSID Case No. ARB/13/30, para 20; *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, Final Award (4 May 2017), ICSID Case No. ARB/13/36, para 70.

<sup>46</sup> see J. Dahlquist, H. Lenk, L. Rönnelid ‘The infringement proceedings over intra-EU investment treaties – an analysis of the case against Sweden’, Swedish Institute for European Policy Studies, European Policy Analysis no. 4 (2016).



sent a letter to the Dutch Government explicating that intra-EU arbitration breaches EU law and that national courts are obliged under EU law to disapply ICSID in case of conflict.<sup>47</sup>

*Komstroy* confirmed that the ECT, as far as intra-EU arbitration is concerned, breaches EU law. While the ECJ's choice of including this finding in the answer to the *Cour d'appel de Paris*<sup>48</sup> has attracted some criticism,<sup>49</sup> it has significant practical consequences. Real-life pressures, such as big EU-based multinational energy suppliers, for example *RWE* and *Uniper*, bringing arbitration cases on the basis of the ECT against national climate policies make this a highly relevant legal question.<sup>50</sup> The real-life pressures are likely to increase because of the inherent substantive tension pointed out above.<sup>51</sup> The ECJ explicitly left open the issue of extra-EU arbitration on the basis of the ECT, stating 'the ECT *may* require Member States to comply with the arbitral mechanisms for which it provides in their relations with investors from third States'.<sup>52</sup>

Until now, the absolute largest share of cases brought on the basis of the ECT against EU Member States concerned intra-EU arbitration. Yet, following the legal uncertainty resulting, on the one hand, from the high likelihood of tribunals ignoring *Komstroy*, and, on the other, from the fact that Member States' courts are obliged under EU law to refuse enforcing intra-EU arbitration awards and that Member States themselves are required to do all in their power to end (the possibility of) illegality under EU law, different law firms have already advised companies to move their seat outside of the EU.<sup>53</sup> They may of course also opt for a seat of arbitration outside the EU and enforce their awards in non-EU courts. In short, first the line between intra-EU and extra-EU arbitration is not static. Several options exist and are likely to be used to make intra-EU arbitration as defined above, namely arbitration between an investor from one EU Member States against another EU Member State, extra-EU either by changing seat of company. Second, investors may seek to establish arbitral tribunals outside of the EU, or take other aspects of the arbitration, *e.g.*, enforcement, to non-EU courts. The latter means that (under EU law illegal) intra-EU arbitration is taken outside the EU, where it remains legally and factually possible.

### *Structure of the assessment of the compatibility of extra-EU arbitration with EU law*

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<sup>47</sup> See at: <https://www.iareporter.com/articles/revealed-european-commission-addresses-compatibility-of-icsid-convention-with-eu-law-for-the-purpose-of-intra-eu-arbitrations/>.

<sup>48</sup> *Komstroy*, para 29.

<sup>49</sup> For an example of a law firm criticising *Komstroy*, see: GIBSON DUNN, (2021) Intra- EU Arbitration on the basis of the ECT is incompatible with EU law according to the ECJ in *Komstroy*, available at: <https://www.gibsondunn.com/intra-eu-arbitration-under-the-ect-is-incompatible-with-eu-law-according-to-the-cjeu-in-republic-of-moldova-v-komstroy/>.

<sup>50</sup> *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4; and *Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22.

<sup>51</sup> G Kahale, Submission to the OECD's Public Consultation on Investment Treaties and Climate Change 24 March 2022, available at: [https://www.isds.bilaterals.org/IMG/pdf/kahale\\_-\\_submission\\_to\\_oecd\\_consultation\\_on\\_climate.pdf](https://www.isds.bilaterals.org/IMG/pdf/kahale_-_submission_to_oecd_consultation_on_climate.pdf).

<sup>52</sup> *Komstroy*, para 62.

<sup>53</sup> Jones Day (Michelle Bradfield, James Egerton-Vernon, Melissa Stear Gorsline, Fahad A. Habib, Sylvia Tordova and Philip J. Devenish), Climate Change and Investor-State Dispute Settlement, February 22, 2022, available at [www.jonesday.com/en/insights/2022/02/climate-change-and-investorstate-dispute-settlement](http://www.jonesday.com/en/insights/2022/02/climate-change-and-investorstate-dispute-settlement).

The remainder of this section examines to what extent the main principles of EU law that make intra-EU arbitration illegal under EU law also justify the conclusion that extra-EU arbitration is contrary to EU law.

The first subsection below (Section 2.1) examines the level of substantive protection offered to investors under EU law and the ECT. Subsections 2.2-2.9 turn to specific principles with whom a conflict may be identified. Besides *Achmea* and *Komstroy*, *Opinion 1/17* on the EU-Canada Comprehensive Economic and Trade Agreement (CETA) must be considered in order to establish the fundamental principles that determine whether arbitration is compatible with EU law. The first principle of consideration appears to be the autonomy of EU law (Section 2.2). Second, while the principle of mutual trust was held to constitute an obstacle to intra-EU arbitration in *Achmea*, *Opinion 1/17* raises serious doubt whether mutual trust also has bearing on the legality of extra-EU arbitration. We explore this point in subsection 2.3 below. Third, subsection 2.4 addresses regulatory autonomy. Fourth, subsection 2.5 discusses the proper functioning of the internal market. Subsection 2.6 turns to the principle of equal treatment. Subsection 2.7 assesses the ECT in light of the right of access to an independent tribunal. The penultimate section (Section 2.8) then turns the monopoly of interpretation of the European Treaties under Article 344 TFEU and to what extent it is an obstacle for extra-EU arbitration. Finally, the relevance of the principle of loyalty as the very foundations of the institutional relationships within the EU legal order, is examined both for intra-EU and extra-EU arbitration on the basis of the ECT (Subsection 2.9).

## 2.1 Level of substantive protection

### *Sustainability*

Substantively, EU law and the ECT may *prima facie* appear pursuing similar or at least compatible objectives. Both EU law and the ECT promote international economic integration in a way that appears based on a paradigm that further integration is inherently positive and capable of promoting other values, such as economic growth and energy efficiency but also environmental protection, with the ECT even making specific reference to the United Nations Framework Convention on Climate Change (UNFCCC).<sup>54</sup>

However, as mentioned above in section 1.1, the ECT structurally subordinates environmental protection to investment protection and trade liberalisation provisions and includes weaker language for its environmental provisions than its investment provisions. It is no surprise therefore that arbitration awards have not given much significance to the ECT's references to the UNFCCC or environmental protection.<sup>55</sup>

The inherent substantive tensions are growing between the ECT, which protects the *status quo*, by protecting expected future profits for past and present investments, including of the fossil fuel industries, and both the urgent need and far-reaching commitments of the EU and its Member States

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<sup>54</sup> See preamble paras 5, 13, 14, and 15 and Articles 19 and 24(2) of the ECT.

<sup>55</sup> A Ipp, A Magnusson and A Kjellgren, *The Energy Charter Treaty, Climate Change and Clean Energy Transition - A Study of the Jurisprudence*, The Climate Change Council. 2022.

to reduce CO<sub>2</sub> emissions in the present and immediate future.<sup>56</sup> The increase of sustainability policies and sharply growing numbers of (strategic) climate cases intended to speed up the transition towards renewable energy may be reasonably expected to result in a growing number of “phase-out cases” under the ECT. The cases of RWE and Uniper against the Netherlands are in this respect likely to be but the first signs of a new wave.<sup>57</sup>

### *Relevance of EU law*

One way how EU law has been considered by arbitral tribunals and may be considered even more forcefully in the future is ‘as a fact’ in the assessment of whether the claimant can argue that at the time of the investment it could reasonably expect legal stability.<sup>58</sup> With increasing EU law obligations to reduce emissions, it will be more difficult for future investments to establish such expectations. However, for past investments, depending on the time they were made, this line of argument will only apply to a more limited extent. Similar points can be made with regard to climate litigation.<sup>59</sup>

The EU has adopted a range of instruments with the objective to create a legal framework for achieving the objectives of its political plans under the so-called European Green Deal and meeting its international commitments of reducing emissions. These instruments include for example the EU climate law,<sup>60</sup> the EU Emissions Trading System (EU ETS),<sup>61</sup> Effort Sharing,<sup>62</sup> and emission performance standards for cars.<sup>63</sup>

On the one hand, this further increases the substantive tensions with the ECT, aimed at protecting existing investments in the energy sector, including by fossil fuel industries. On the other hand, it raises the question of to what extent respondent state parties may in ECT arbitration rely on EU law in their defence. The short answer to the second question is: it is unlikely that arbitral tribunals established on the basis of the ECT will allow respondent states to justify their actions with their EU law obligations. They are not bound by the primacy of EU law.

The longer answer is more complex. From the perspective of the ECT and hence the tribunals established on the basis of the ECT, EU law could either be seen as a distinct legal order constituting domestic law or as international law. However, even if accepted to be domestic law, this does not allow the EU (or its Member States) to rely on domestic law as a defence for avoiding responsibility under an international agreement, *i.e.*, the ECT. Pursuant to Article 27 of the VCLT/VCLTIO 1986 (the latter is not in force but widely accepted to constitute customary international law) a State

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<sup>56</sup> IPCC reports. COP 26. Fit for 55.

<sup>57</sup> A Ipp, A Magnusson and A Kjellgren, *The Energy Charter Treaty, Climate Change and Clean Energy Transition - A Study of the Jurisprudence*, The Climate Change Council. 2022.

<sup>58</sup> See e.g., *Watkins Holdings S. r.l. and others v. Kingdom of Spain*, ICSID Case No. ARB/15/44, Award (21 January 2020), para. 527. *Photovoltaik Knopf Betriebs-GmbH v. The Czech Republic*, PCA Case No. 2014-21, Award (15 May 2019), para. 522.

<sup>59</sup> Eckes, *the Courts strike back*, *Verfassungsblog* 2021.

<sup>60</sup> Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 (‘European Climate Law’).

<sup>61</sup> Directive 2003/87/EC of 13 October 2003.

<sup>62</sup> Effort Sharing Regulation (EU) 2018/842.

<sup>63</sup> Regulation (EU) 2019/631 on carbon dioxide (CO<sub>2</sub>) emission performance standards for new passenger cars.

cannot rely on domestic law as an excuse for failing to comply with treaty obligations.<sup>64</sup> The ECT does not identify domestic law of the parties, including EU law, as a source of applicable law.

Article 27 VCLTIO 1986<sup>65</sup>

Internal law of States, rules of international organizations and observance of treaties

1. A State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform the treaty.
2. An international organization party to a treaty may not invoke the rules of the organization as justification for its failure to perform the treaty.
3. The rules contained in the preceding paragraphs are without prejudice to article 46.

If, by contrast, EU law was seen as international law and hence as at least potentially ‘applicable rules and principles of international law’ under Article 26(6) ECT,<sup>66</sup> its applicability would still depend on whether the substantive protections that it provides are more favourable to investors than are the investment protection of the ECT.<sup>67</sup> The latter is the condition for applicability in the conflict clause of Article 16 ECT. In other words, EU law could not easily justify a restriction of the investor’s rights under the ECT. It should be added that a different position was taken in *Electrabel v. Hungary*,<sup>68</sup> which, however, appears not to have been followed by subsequent tribunals as far as information is publicly available.

#### *Level of investor protection*

The higher protection afforded to international investors is one of the core points of criticism in the literature, namely that ISDS in general and the ECT in particular treat international investors inequitably favourably as compared to ordinary persons or national investors.

In line with Article 16 ECT, which allows for the application of international rules that offer a higher level of investment protection, the European Communities made a declaration under Article 25 ECT. This declaration establishes a carve-out from the ECT in that it allows the extension of EU law benefits between the Member States to the extent that these rules are more favourable for investors. It does not shield respondent states from obligations under the ECT if the rules under the ECT are more favourable for investors.

This leads to a situation that the ECT logically is set up in a way that gives investors, including the fossil fuel industries, greater protection for their investments. It is correct that the ECT may also give greater protection to investments into renewables where Member States withdraw originally offered preferential schemes or subsidies for investment into renewables. However, the growing

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<sup>64</sup> *SolEs Badajoz v. Spain* (2019), para 150.

<sup>65</sup> For reasons of clarity and simplicity this report will, in its remainder, refer to the VCLT, rather than the VCLTIO.

<sup>66</sup> See also: Article 31(3)(c) VCLT, stipulating that courts and tribunals should interpret a treaty taking into account ‘any relevant rules of international law applicable in the relations between the parties’.

<sup>67</sup> *SolEs Badajoz v. Spain* (2019), para 164. RREEF Infrastructure (GP) Limited and RREEF Pan-European Infrastructure Two Lux S r l v Kingdom of Spain, ICSID Case No ARB/13/30, Decision on Jurisdiction (6 June 2016), para. 75. Vattenfall v. Germany (II) Decision on the Achmea Issue, para 229. FREIF Eurowind Holdings Ltd v. Kingdom of Spain, SCC Case No. 2017/060, Final Award (8 March 2021), para. 325.

<sup>68</sup> *Electrabel SA v Republic of Hungary*, ICSID Case No ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability (30 November 2012) para 4.187-4.191. See also: Anja Ipp, Annette Magnusson and Andrina Kjellgren, *The Energy Charter Treaty, Climate Change and Clean Energy Transition - A Study of the Jurisprudence*, 2022, p. 39.

climate emergency will only require more fundamental socioeconomic changes<sup>69</sup> and the tremendous gap between states' international commitments and their actual reduction policies at present<sup>70</sup> lead to the reasonable expectation that the greatest future beneficiary of the enhanced investment protection under the ECT will be the fossil fuel industries. They will necessarily be subject to the most far-reaching restrictions as a result of the necessary sustainability policies at national and EU level.

In addition, and more importantly, the case law of the ECJ on investment arbitration in general and the ECT in particular, highlights numerous institutional and constitutional conflicts between the ECT and EU primary law. These institutional and constitutional conflicts have led the ECJ to conclude that intra-EU arbitration on the basis of the ECT breaches EU law.

## 2.2 Autonomy of EU law

### *Jurisdictional Autonomy as the very foundation of the EU legal order*

The autonomy of EU law (*jurisdictional autonomy*) is what makes EU law a legal order.<sup>71</sup> It means that EU law is not dependent on laws external to its own law, be it national or international, for either its validity or its interpretation. In practice, this means that the ECJ has exclusive jurisdiction over determining the definitive meaning, scope, and validity of EU law. The ECJ justifies EU law's autonomy 'by the essential characteristics of the EU and its law, relating to the constitutional structure of the European Union and the very nature of that law'.<sup>72</sup> It refers to the 'independent source of law', the 'primacy over the laws of the Member States', and the 'direct effect' within the national legal order.<sup>73</sup>

In other words, the Court justifies its conception of the autonomy of the EU legal order in a circular reasoning: the essential characteristics of EU law justify its autonomy and autonomy makes its essential characteristics as a domestic legal order possible.<sup>74</sup> Yet, it is in this circular reasoning that all legal orders establish their necessary self-contained nature. Hence, it is this conception of autonomy and its consequences that allow construing EU law as a domestic legal order. It is what lies at the very core of what makes the Union different from international organisations. At the same time, this conception of autonomy remains essentially contested by other international actors, as well as the highest national courts of the EU Member States. Both the centrality of the claim of EU law to autonomy and the fact that it is contested may explain why the ECJ has attached so much value to this principle and has given strong rulings aiming to exclude even the possibility of undermining the autonomy of EU law.<sup>75</sup>

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<sup>69</sup> IPCC 2021 & 2022.

<sup>70</sup> Climate action tracker, <https://climateactiontracker.org>.

<sup>71</sup> This section draws on: C. Eckes, *EU Powers Under External Pressure - How the EU's External Actions Alter its Internal Structures* (Oxford University Press, 2019). See Section 3 of ch. 1 for a detailed conceptualization of the autonomy of EU law.

<sup>72</sup> *Komstroy*, para 43; see also: *Achmea*, para. 33.

<sup>73</sup> *Ibid.*

<sup>74</sup> See also: Eckes, *The Autonomy of EU law, Europe and the World*, 2019, available at: <https://www.scienceopen.com/hosted-document?doi=10.14324/111.444.ewlj.2019.19>.

<sup>75</sup> In particular, Opinion 2/13, ECLI:EU:C:2014:2454; Eckes, *EU Powers Under External Pressure* (OUP, 2019), Chapter 6.

The fundamental nature of the Court's autonomy concern and its position that potential effects on autonomy are sufficient to render the external (quasi-) judicial mechanism contrary to EU law become also apparent in the general abstract reasoning in *Achmea*. While the AG focused on the specific dispute at hand and on whether this specific award could have had 'any impact on questions of EU law'<sup>76</sup> the Court pondered generally whether disputes that an arbitral tribunal under the BIT in question 'is called on to resolve are *liable* to relate to the interpretation or application of EU law.'<sup>77</sup> By taking such an abstract approach and considering the *potential* scope of disputes settled by any tribunal rather than the *actual* scope of the specific dispute the Court revealed its deep unwillingness to take any chances that the domestic and autonomous nature of the EU legal order might come under pressure.<sup>78</sup> This indirectly confirms the high relevance of this concern for any and all ISDS mechanisms.

In short, the EU law's very claim to being a domestic legal order depends on its autonomous character, that is, its self-referential nature of not depending on national and international law for its validity and interpretation. This formal legal (and absolute) autonomy allows the ECJ to uphold the claim that the effects of EU law within the national legal order are a matter of EU law, rather than national law. This in turn ensures the effectiveness of EU law on the ground, which is its most distinctive characteristic.

#### *Preliminary ruling mechanism as the procedural protection of autonomy*

The preliminary ruling procedure (Art. 267 TFEU) is the institutional backbone of this effectiveness. It is the mechanism that ensures the 'consistency and uniformity of the interpretation of EU law'<sup>79</sup> and allows a regular confirmation of the ECJ's autonomy claim by national courts.<sup>80</sup> The EU's history of integration and ability to achieve a unique level of effectiveness of EU law within the national legal order has largely been triggered by and hinges on the decentralized enforcement of EU law by individuals in national courts and with the possibility of involving the ECJ via a preliminary ruling request. Under EU law, direct actions of individuals before the ECJ were much less relevant in the transformation of EU law than the ability and willingness of national courts to give effect to EU law and to refer questions to the ECJ under the preliminary ruling procedure.

More specifically, the ECJ held both in *Achmea* and in *Komstroy* that the protection of the (jurisdictional) autonomy of the EU legal order requires that no field of EU law be removed from the substantive reach of the preliminary reference procedure.<sup>81</sup> This is also fully in line with Opinion 1/09 on the European Patent Court<sup>82</sup> and *Komstroy* on intra-EU arbitration on the basis of the ECT.<sup>83</sup> In *Komstroy*, the ECJ emphasised that 'by concluding the ECT the European Union and the Member States which are parties to it established a mechanism for settling such a dispute that could exclude

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<sup>76</sup> Opinion of AG Wathelet, *Achmea*, paras 177-8.

<sup>77</sup> *Achmea*, para. 39 *emphasis added*.

<sup>78</sup> See C. Eckes, *EU Powers Under External Pressure*, Chapters 1 and 6 on the plausibility of this concern.

<sup>79</sup> *Komstroy*, para 45.

<sup>80</sup> See C. Eckes, *EU Powers Under External Pressure*.

<sup>81</sup> *Komstroy*, para 62.

<sup>82</sup> Opinion 1/09, ECLI:EU:C:2011:123.

<sup>83</sup> *Komstroy*.

the possibility that that dispute, notwithstanding the fact that it concerns the interpretation or application of EU law, would be resolved in a manner that guarantees the full effectiveness of that law'.<sup>84</sup> This point is also confirmed by the Court's rulings in *Commission v. Poland*<sup>85</sup> and in *Associação Sindical dos Juízes Portugueses*,<sup>86</sup> which confirm the constitutional role of the Member States' courts under Article 19(1) TEU as the prime guardian of the rule of law and the entry point for the institutionalised judicial dialogue under the preliminary ruling procedure.

Offering an *alternative* route for dispute settlement and as a consequence removing disputes from the ordinary judiciary is the *very purpose* of the ECT's investor-state dispute settlement mechanism. *Ad hoc* tribunals are not courts or tribunals in the sense of Article 267 TFEU. They cannot refer questions to the ECJ. This was specifically confirmed for ad hoc arbitral tribunals such as those referred to in Article 26(6) ECT.<sup>87</sup>

In addition, while the so-called fork in the road clause in Article 26(3)(b)(i) ECT aims to protect judicial proceeding that are already ongoing in national courts this clause may not prove able to exclude parallel arbitration. While the provision in principle hinders claimants from submitting a dispute to international arbitration on the basis of the ECT if they have already submitted the same dispute to the national courts of one of the contracting states listed in Annex ID to the ECT, the test that the submission concerns the same dispute is not easily met. In *Yukos*, for example, the Russian government objected to the jurisdiction of the tribunal, arguing that the claimant had already submitted the dispute to national Russian courts, as well as the European Court of Human Rights (ECtHR). The arbitral tribunal developed a 'triple identity test'.<sup>88</sup> This test is met if the identity of parties, the cause of action, and the object of the dispute are identical. In *Yukos*, the tribunal this was not case for any of the actions brought by the claimants against the Russian government in any of the other fora, as in particular none of these cases contained alleged breaches of the ECT. *Yukos* hence demonstrates that even if proceedings are pending in national or international courts, it is not easy to rely on the fork of the road clause. In other words, parallel proceeding concerning the same exercise of sovereign power, *i.e.*, the same public act, remain possible.

*Autonomy is protected not only from actual but from potential effects*

The potential effects of the institutional arrangement of the international court or tribunal must be considered when deciding whether the arrangement removes disputes from the preliminary ruling procedure. In 2014, the Court rejected the EU's planned accession to the European Convention on Human Rights (ECHR) in a controversial opinion that focussed on all eventualities and excludes even the remote possibility of a challenge to the autonomy of EU law.<sup>89</sup> Also, in *Achmea* and in *Komstroy*, the ECJ did not focus on the specific arbitration at hand but considered how the

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<sup>84</sup> Komstroy, para 60.

<sup>85</sup> C-619/18, *European Commission v Republic of Poland (Independence of the Supreme Court)* [2019] ECLI:EU:C:2019:531, paras 47-50; and Case C-216/18, *PPU Minister for Justice and Equality (Deficiencies in the system of justice)* [2019] ECLI:EU:C:2018:586.

<sup>86</sup> Case C-64/16 *Associação Sindical dos Juízes Portugueses v Tribunal de Contas* [2018] ECLI:EU:C:2018:117, paras 29-37

<sup>87</sup> *Komstroy*, para 52.

<sup>88</sup> paragraph 1257 of that award.

<sup>89</sup> Opinion 2/13 (75). Eckes, *EU Powers* (75), Chapter 6.

international agreement set up arbitration and whether any (hypothetical future) arbitration could have negative effects for the (autonomy of the) EU legal order.<sup>90</sup>

The Court's reasoning concerned the removal of *potential questions about EU law* from the preliminary ruling procedure. It was *not limited* to situations in which the arbitral tribunal actually *strictly speaking interprets EU law*. Questions about EU law can also arise from *prima facie* purely national legal issues, because they fall within the widely defined scope of EU law or because they touch upon the Union's interest.<sup>91</sup>

Not so much the cases' outcomes but the Court's reasoning make *Achmea* and *Komstroy* bad news for extra-EU arbitration on the basis of the ECT. The Court introduced the *Achmea* ruling with eight paragraphs of principled considerations on the *autonomy of the EU legal order* before turning to the central question about the compatibility of the ISDS mechanism with EU law. It found the ISDS in *Achmea* to be in conflict with the *autonomy of the EU legal order* because it *removes disputes from the jurisdiction of the courts of the Member States*.<sup>92</sup> This is not a new criticism. In fact, the ECJ had highlighted this point as the decisive feature of the investment chapter in the EUSFTA that requires Member States to endorse the investment arbitration mechanism in that agreement.<sup>93</sup> In *Achmea* and *Komstroy*, it added more specifically that the autonomy of the EU legal order can only be preserved by an internal EU judicial system that remains able 'to ensure the consistency and uniformity in interpretation of EU law'.<sup>94</sup>

#### *Opinion 1/17: an opening for extra-EU arbitration?*

*Opinion 1/17* confirms the legality of Investment Court System (ICS) envisaged under CETA. One core contextual difference between the Court's rulings in *Achmea* and *Komstroy*, on the one hand, and *Opinion 1/17*, on the other, is the fact that the former concerned *intra*-EU arbitration while the latter concerns *extra*-EU arbitration under CETA. However, this is not the only difference. Even in light of *Opinion 1/17*, good reasons support that extra-EU arbitration on the basis of the ECT is incompatible with the principle of the autonomy of EU law.

First of all, ISDS mechanisms as the one envisaged under CETA and the ECT are exceptions. Besides the ISDS mechanism under the ECT, the EU is not currently subject to the jurisdiction of any binding international court of tribunal that allows *individuals* to act as parties or directly receives complaints from individuals.

Second, the ECJ took a more protective position towards the EU's autonomy in *Opinion 2/13* than in *Opinion 1/17*. This becomes particularly apparent in the comparison of the discussion of the effects on the operation of the EU institutions. *Opinion 2/13* aims to exclude the possibility of effects on the institutional interaction ('stress test').<sup>95</sup> *Opinion 1/17* by contrast examines the

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<sup>90</sup> *Achmea*, paras 50–52; *Komstroy*, para 60.

<sup>91</sup> See for the ECJ's interpretation of the scope of EU law: Case C-617/10, *Åkerberg Fransson*, para. 22, and Case C-206/13, *Siragusa*.

<sup>92</sup> See also *Achmea*, paras 50–52.

<sup>93</sup> Court of Justice, opinion 2/15 of 16 May 2017, para. 292.

<sup>94</sup> *Achmea*, cit., para. 35.

<sup>95</sup> Eckes, 'Autonomy of EU Law', *Europe and the World* 2019, p. 1-19, at 8.



probability of effects.<sup>96</sup> The stringent approach in *Opinion 2/13* may be explained in light of the exceptional authority of the ECtHR, the broad scope of the ECHR having the potential to affect all areas of life, and the fact that it concerns a multilateral agreement with 47 Contracting Parties.

The ECT, while it does not have the exceptional status of the ECHR, cannot be compared to the much more limited CETA either. The ECT is a multilateral treaty with 53 Contracting Parties. In *Komstroy*, however, the ECJ, while acknowledging the multilateral nature of the ECT, considered the arbitration mechanism in Article 26 ECT ‘to govern bilateral relations between two of the Contracting Parties’.<sup>97</sup> Perhaps not so much the nature but the effects of the different ‘bilateral relations’ governed by the arbitration mechanism in the ECT are directly relevant for the question of the compatibility of the ECT with EU law as regards *extra-EU arbitration*.

At first glance, it may seem reasonable to evaluate extra-EU arbitration straight-forwardly in light of *Opinion 1/17*. However, besides the differences in scope and number of Contracting Parties, extra-EU arbitration within an overarching framework that permits both intra- and extra-EU arbitration is different from a separate agreement between the EU and the Member States as one party to an agreement with one or several third states. As explained above, the dividing line between intra- and extra-EU arbitration is not static. This is in any event very different from CETA, for example, where all arbitration under the agreement is extra-EU arbitration. In addition, extra-EU arbitration may have effects on intra-EU arbitration.

While ISDS in general and the ECT in particular do not rely on precedents, arbitral tribunals regularly reason their awards in light of the position of earlier arbitration.<sup>98</sup> Hence, interpretations of the ECT but also potentially of EU law in extra-EU arbitration have an indirect effect on the interpretation of the ECT and potentially EU law beyond the ECT, including in intra-EU arbitration, to the extent that it still takes place. This becomes particularly apparent in areas of EU law that have extraterritorial effects, such as EU competition law, the CFR, or EU financial regulations related to derivatives trading.<sup>99</sup>

In relation to the issue of how protective the ECJ may be of the jurisdictional autonomy of the EU in relation to the ECT, it should not be disregarded that the ECT has, as we have seen above, the structural potential to trigger a large number of arbitrations in relation to an already ongoing and irreversible deep socioeconomic transition.

In addition, an important difference between the ECT and CETA is that the ECT does not offer either the same *substantive or procedural safeguards* as CETA. The substantive safeguards are addressed below in Section 2.4 on regulatory autonomy. Yet, CETA also contains a procedural separation provision in Article 8.31.2. This provision takes a four-pronged approach. It states, first, that the ISDS mechanism ‘shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of [CETA]’; second, it ‘may consider, as appropriate, the domestic law of a

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<sup>96</sup> Opinion 1/17, para. 138.

<sup>97</sup> *Komstroy*, para 64.

<sup>98</sup> See for the ECT in particular: CCC report.

<sup>99</sup> M Cremona and J Scott, *EU law beyond EU borders: the extraterritorial reach of EU Law* (OUP, 2019).

Party as a matter of fact’; third, it ‘shall follow the prevailing interpretation given to the domestic law by the courts or authorities of that Party’; and, fourth, ‘any meaning given to domestic law by the Tribunal shall not be binding upon the courts or the authorities of that Party’. The ECT does not offer any of these procedural safeguards, aiming to separate the activities of the arbitral tribunals from the EU legal order.

As was discussed above, the status of EU law in arbitral tribunals established on the basis of the ECT is entirely uncertain. Some tribunals have treated EU law as domestic law and hence as facts in the context of determining reasonable expectations. Others have considered EU law as international law and assessed whether it could be applicable law under Article 26(6) ECT. No provision in the ECT requires arbitral tribunals to follow the prevailing interpretation of the ECJ. So far, as we have seen above, the majority has not done so. Finally, the ECT does not contain a clause stipulating the limited legal bindingness of the arbitral tribunals’ findings for the national courts of the Member States or the ECJ. However, while claims on the basis of the ECT primarily aim for financial compensation, the primary remedy sought in some claims based on the ECT appears to request specific performances. An example is the by NordStream2 case against the European Union.<sup>100</sup> It appears to request the ‘disapplication’ of the Gas Directive from the project.

If we hence consider the condition for compatibility as established by the ECJ in *Opinion 1/17*, namely that the arbitration system must (1) guarantee that arbitration panels do not interpret EU law ‘other than the provisions of the [international investment agreement]’ and (2) not have ‘*effect on the operation of the EU institutions* in accordance with the EU constitutional framework’,<sup>101</sup> we must conclude that, first, the ECT tribunals interpret EU law, including as (international) law; second, they are likely to carry out balancing tests that entail the interpretation of EU policies and their assessment in light of the ECT; and, third, and most importantly, this means that the fundamental concerns of the ECJ regarding the removal of disputes from the preliminary ruling procedure as the backbone of the autonomy and effectiveness of EU law also apply to extra-EU arbitration on the basis of the ECT. Matters that at least potentially affect EU law and hence fall within the widely interpreted scope of EU law are decided by judicial bodies that cannot refer preliminary rulings to the ECJ.

Finally, the Commission reform proposal<sup>102</sup> suggests including a footnote to Article 26 ECT, stating the following:

For greater certainty, the domestic law of a Contracting Party shall not be part of the applicable law. Where a tribunal is required to ascertain the meaning of a provision of the domestic law of a Contracting Party as a matter of fact, it shall follow the prevailing interpretation of that provision given by the courts or authorities of that Contracting Party and any meaning given to the relevant domestic law of a Contracting Party by the tribunal shall not be binding upon the courts or authorities of that Contracting Party. A tribunal shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of the obligations under Part III of this Treaty, under the domestic law of a Contracting Party.

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<sup>100</sup> [Nord Stream 2 v. EU, Investment Dispute Settlement Navigator, UNCTAD Investment Policy Hub](https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1008/nord-stream-2-v-eu)  
<https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1008/nord-stream-2-v-eu>.

<sup>101</sup> Stated in *Opinion 1/17*, para 119 and elaborated in paras 120 et seq. and 137 et seq., respectively.

<sup>102</sup> See Section 1.4 above.

In essence, this text replicates the above-discussed procedural separation mechanisms of CETA. If this text was introduced into the ECT one would need to conclude that the ECT textually offers the same safeguards as CETA. Whether these safeguards however are sufficient, considering the different nature of a multilateral agreement covering both intra-EU and extra-EU arbitration is a different question. Arguably, as long as intra-EU arbitration remains legally and factually possible outside the EU and as long as investors can flexibly move their arbitration from intra-EU to extra-EU by changing their seat, the effects on the EU legal order may still be classified as being of a different order than the effects of CETA. In addition, as explained above, the proposed amendment of including a footnote to Article 26 ECT falls outside the scope of agreed topics for discussion by the Energy Charter Conference. It is therefore highly uncertain whether that amendment would be part of a modernized ECT, if modernisation succeeds at all.

Substantively, the Commission's proposal aims to reduce the tension between the ECT and EU law, in particular by bringing the former in line with the Paris Agreement and restricting the scope for claims by the fossil fuel industries; yet, it does not resolve that tension. While the Commission reform proposal may significantly reduce protection under the ECT of *future* investments in fossil fuels, it does not affect protection of existing investments. Under EU's proposal, investments in fossil fuels made before the entry into force a modernised ECT, would continue to be protected for another 10 years after the entry into force or provisional application of the amendments to the Energy Charter Treaty.

### 2.3 Mutual Recognition and Mutual Trust

The mutual recognition of judicial decisions and mutual trust between the national courts and administrations of the Member States are distinguishable principles but closely related to the autonomy doctrine.<sup>103</sup> Mutual trust as the precondition for mutual recognition serves the effectiveness of EU law in national courts and administrations. In other words, it is necessary for actual effectiveness of EU law on the ground.

The ECJ identifies a properly functioning and independent national judiciary as the very essence of the rule of law within the Union<sup>104</sup> and a precondition for the principle of mutual trust.<sup>105</sup> The Court further and more specifically expressed that the independence of national courts is 'essential to the proper working of the judicial cooperation system embodied by the preliminary ruling mechanism under Art. 267 TFEU' and repeatedly confirmed that the preliminary ruling mechanism 'may be activated only by a body responsible for applying EU law which satisfies, *inter alia*, that criterion of independence'.<sup>106</sup> In *Achmea*, the Court concluded that the ISDS mechanism under the Dutch-

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<sup>103</sup> See K. Lenaerts, *La vie après l'avis: exploring the principle of mutual (yet not blind) trust*, in CMLRev 2017 vol. 54, p. 805 *et seq.*, p. 806.

<sup>104</sup> Court of Justice, judgment of 27 February 2018, Case c-64/16, *Associação Sindical dos Juizes Portugueses*, EU:C:2018:117, paras 31-37 and the case-law cited. See also: Court of Justice, judgement of 25 July 2018, case C-216/18 PPU, *LM*, paras 49-54.

<sup>105</sup> This was the central issue in, *LM*, *ibid*, and the Court held that 'only in exceptional circumstances' based on 'a specific and precise assessment of the particular case' the national court may reject execution of a European Arrest Warrant if 'there are substantial grounds for believing' that the surrendered person runs a real risk of his fundamental rights to an independent tribunal and a fair trial (para. 73).

<sup>106</sup> *Associação Sindical dos Juizes Portugueses*, *cit.*, para. 43. Case C-216/18 PPU, *LM*, *ibid*, para. 54.

Slovak BIT ‘call[ed] 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 Treaties, ensured by the preliminary ruling procedure provided for in Art. 267 TFEU.’<sup>107</sup>

Mutual trust straightforwardly plays a role between the courts and administrations of the Member States, that is within the intra-EU context. It could even be argued that in light of the *objective* of alternative dispute settlement mechanisms, that is to offer an alternative judicial route outside and independent from the ordinary courts, the very establishment of such alternative dispute settlement mechanisms demonstrates a level of mistrust of one Member State towards another if agreed between two Member States. The consequences for mutual trust among Member States of agreements with non-EU states are however more difficult to establish. Logically, the establishment of an alternative dispute settlement mechanism in the extra-EU context only demonstrates mistrust by the non-EU party towards the judicial system of either the EU or the Member State, which should be irrelevant for the trust between the Member States and the functioning of the EU legal order.

In addition, the ECJ stated specifically in *Opinion 1/17*:

‘[the] principle of mutual trust, with respect to, inter alia, compliance with the right to an effective remedy before an independent tribunal, *is not applicable in relations between the Union and a non-Member State.*’<sup>108</sup>

However, in light of the strong pressure on the rule of law in the EU in the past years,<sup>109</sup> it is also worth considering to what extent the trust of the bodies of one national system in the other depends more broadly on their way of conforming to the rule of law and delivering justice. The ECJ’s considerations about the potential negative effects of ECT arbitration on the preliminary ruling procedure and the ECJ’s monopoly to offer the correct interpretation of EU law are valid also in the extra-EU context. The question is hence whether the possibility of removing disputes between natural and legal persons of third states and EU Member States from the judicial system of one EU Member State is problematic for the trust of another Member State in that judicial system. This is the case, also because within an overarching framework that permits both intra- and extra-EU arbitration, *i.e.*, the ECT, possibilities for shifting any dispute from intra-EU to extra-EU arbitration, *i.e.*, by moving the seat of the investor.

Within the EU, cooperation between national courts and administrations is built on the *principle of mutual trust*, which in turn is based on the shared commitment to the values in Art. 2 TEU and the enforcement of these values and EU law more generally in the Member States. This enforcement falls pursuant to Art. 19 TEU both to national courts and the ECJ connected by the preliminary ruling procedure.<sup>110</sup> Hence, removing disputes from the national jurisdiction and from the preliminary ruling procedure also undermines the mechanism that ensures that the Union and its Member States adhere to the rule of law, which is in turn the basis of principle of mutual trust. In other words, when arbitration side-lines international law other than the ECT and constitutional

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<sup>107</sup> *Achmea*, para. 58.

<sup>108</sup> *Opinion 1/17*, para 129, *emphasis added*.

<sup>109</sup> See, *e.g.*, C-619/18 *Commission v Poland* (Retirements from Supreme Court) and Case C-585/18 *A.K. v KRS* (Independence of the Disciplinary Chamber of the Supreme Court).

<sup>110</sup> *Achmea*, para. 36-37.

principles and common values guaranteed under EU law, this undermines adherence to the rule of law. It undermines coherence and uniform application of EU law on the territory of the EU Member States. This may also affect mutual trust in the judicial system of the other Member States. In particular, from the perspective of those Member States that are no longer bound by the ECT, such as Italy.

In other words, the fact that the effective application of EU law in the Member States is threatened by moving disputes to ISDS mechanisms that are not embedded within the national judicial system is also liable to undermine mutual trust and, by extension, this threatens the effectiveness and (autonomous) nature of EU law. This may be a matter of frequency and political salience of the removed matters. Yet in light of the great socioeconomic changes necessitated by the climate emergency and aimed for by EU climate laws, which fundamentally affect the business cases of the fossil fuel industries, arbitration on the basis of the ECT may be expected to meet both criteria in the near future. To a much greater extent than CETA does.

## 2.4 Regulatory autonomy of EU law

*Opinion 1/17* introduced an additional element to the requirement for international agreements of the EU that there is no adverse effect on the autonomy of the EU legal order. In paragraphs 131-161 the Court introduced a test that can be best described as protecting the regulatory autonomy of the EU institutions.<sup>111</sup> This additional element follows the requirement that an international agreement cannot adversely affect the jurisdictional autonomy. In other words, this additional understanding of the autonomy of the EU legal order focuses more on the independence of the institutions involved in the EU's regulatory processes. This new test for the constitutional limits of EU international agreements containing dispute settlement provisions can be found in paragraph 150 of *Opinion 1/17*:

‘if the Union were to enter into an international agreement capable of having the consequence that the Union – or a Member State in the course of implementing EU law – has to amend or withdraw legislation because of an assessment made by a tribunal standing outside the EU judicial system of the level of protection of a public interest established, in accordance with the EU constitutional framework, by the EU institutions, it would have to be concluded that such an agreement undermines the capacity of the Union to operate autonomously within its unique constitutional framework.’

The introduction of this new test followed after an assessment made by the Court that the tribunals under the ISDS-mechanism in CETA would be weighing ‘the interest constituted by the freedom to conduct business’ against ‘public interests’.<sup>112</sup> In particular, tribunals would be called upon to make findings whether an EU measure was a violation of the ‘fair and equitable treatment’ or the ‘indirect expropriation’ standard and accordingly make definitive decisions binding on the EU.<sup>113</sup>

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<sup>111</sup> Laurens Ankersmit. Regulatory autonomy and regulatory chill in *Opinion 1/17*. *Eur. World*. Vol. 4(1). DOI: 10.14324/111.444.ewlj.2020.25

<sup>112</sup> *Opinion 1/17 (CETA)* ECLI:EU:C:2019:341, para 137

<sup>113</sup> *Ibid*, para. 138

The Court noted that such situations ‘are likely to occur often’.<sup>114</sup> The Court concluded however, that the legal safeguards introduced in CETA were sufficient to prevent tribunals from calling into question the levels of protection sought by the EU and consequently adversely affecting the regulatory autonomy of the EU.

#### *Not the same as regulatory chill*

The introduction of this test by the Court coincides with a wider debate over ‘regulatory chill’ that may be caused by investment agreements that contain ISDS. However, the test developed by the Court is notably more limited. The Court focusses on the *ex-post* effects of multiple awards of tribunals on the EU and the Member States: legislation would have to be amended or withdrawn *as a result* of an assessment made by an arbitral tribunal. ‘Regulatory chill’, on the other hand, is understood as the phenomenon whereby ‘governments will fail to enact or enforce bona fide regulatory measures (or modify measures to such an extent that their original intent is undermined or their effectiveness is severely diminished) as a result of concerns about ISDS’.<sup>115</sup> Regulatory chill thus also covers those forms of chill of regulation because of threats to use ISDS (*threat chill*) or other forms of preventive action by the government in order to avoid claims. The Dutch government, for instance, has refused to take stricter measures in phasing out the use of coal in the Netherlands to combat climate change, because of ‘significant legal risks in the context of current claims’.<sup>116</sup> These claims refer to ISDS-proceedings brought by Uniper and RWE on the basis of the Energy Charter Treaty against the Dutch government’s decision to phase out the use of coal by 2030. *Internalisation chill*, for instance, refers to decision-makers taking into account the potential of investment disputes before drafting policy, pre-empting disputes in a more general way, and thereby ‘prioritizing the avoidance of such disputes over the development of efficient regulation in the public interest’.<sup>117</sup> This happens even before threats for claims arise.

What is more, the Court’s understanding of regulatory autonomy also does not concern the effects of awards, claims or threats of claims in relation to third countries can have on the regulatory process. Such *cross-border chill* occurs where a government fails to enact or enforce a measure, or modifies a measure that is contemplated and easily transferrable in several jurisdictions, because of an investment arbitration claim against another country. A clear example of this form of chill is New Zealand’s decision to delay its plain packaging legislation for tobacco products until the investment arbitration case initiated by Philip Morris against Australia had been resolved.<sup>118</sup>

#### *Main elements of the test*

The regulatory autonomy test developed by the Court in *Opinion I/17* consists of two main steps.

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<sup>114</sup> Ibid

<sup>115</sup> Kyla Tienhaara, ‘Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement’ (2018) 7 *Transnational Environmental Law*, 233

<sup>116</sup> The Parliament of the Netherlands, ‘Schriftelijke antwoorden op vragen gesteld tijdens de eerste termijn van de begrotingsbehandeling van Economische Zaken en Klimaat 2022 op 3 november 2021’ (Tweede Kamer der Staten-Generaal, 3 November 2021) <[https://www.tweedekamer.nl/kamerstukken/brieven\\_regering/detail?id=2021Z19314&did=2021D41482](https://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2021Z19314&did=2021D41482)> accessed 8 April 2022

<sup>117</sup> Tienhaara (115), 233-235

<sup>118</sup> Jane Kelsey, ‘Regulatory Chill: Learnings from New Zealand’s Plain Packaging Tobacco Law’ (2017) 17 *QUT Law Review* 21; Tienhaara (115), at 229

1. In the first step, the Court pointed out a number of elements (we refer to these as *problematic features*) of the ISDS-mechanism contained in CETA that could lead a tribunal to call into question the level of protection of a public interest sought by the EU and as a result lead the EU to change its levels of protection (and hence have a negative effect on the regulatory autonomy of the EU). Only, if an agreement contains such problematic features, is it necessary to look at the second step.
2. In the second step, the Court assessed the legal *safeguards* in CETA that would prevent tribunals from calling into question the levels of protection of public interests sought by the EU institutions. For the ISDS-mechanism in CETA, the Court concluded that these safeguards were sufficient to ensure that there was no adverse effect on the regulatory autonomy of the EU.

We now turn to applying this test to the ISDS-mechanism in the ECT (contained in Article 26) and the EU text proposal of May 2020.

1. *First step: problematic features and the ECT*

In this first step, the Court outlined the following problematic features of the ISDS mechanism contained in CETA that would allow tribunals to call into question the levels of protection sought by EU institutions:

- a. a broad definition of ‘investment’ (para. 139)
- b. compulsory jurisdiction for the EU and EU Member States as a respondent to claims by investors (para. 140)
- c. measures of general application can be challenged (paras. 141-143)
- d. a tribunal may award damages and this award is final (paras. 144-146)

All of these features are present in the ECT and the EU text proposal of May 2020.

- a. *A broad definition of investment*

The ECT’s definition of investment is broader than under CETA albeit limited to investments ‘associated with an economic activity in the energy sector’.<sup>119</sup>

‘Investment’ under the ECT is defined as ‘very kind of asset, owned or controlled directly or indirectly by an investor’. The limitation in CETA that investment must include ‘a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk’ is not present in the ECT, although it is featured in the EU text proposal of May 2020. The list of examples in CETA (and the EU text proposal) is also more circumscribed than in the ECT. Investment on the basis of the ECT covers those types of investment listed by the Court in *Opinion 1/17*: immovable property, securities, intellectual property rights, claims to money and any other type of investment.

Notably, however, the ECT covers investments in the energy sector only. What is more, the additional text proposal of the EU progressively excludes the application of Part III of the ECT (the investment protection provisions) to fossil fuel materials and products.<sup>120</sup> This does mean that disputes do *not* concern ‘any area that relates, within the Union, to business

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<sup>119</sup> Article 1 (6) ECT.

<sup>120</sup> See above under 1.4

activity’ and the use of investments.<sup>121</sup> However, tribunals established on the basis of the ECT can still hear ‘a wide range of disputes’. As stated above, the ECT is the most widely used treaty by investors for ISDS claims, and the energy sector is not only a crucial sector for the EU economy, it is also a widely regulated one by the EU. The EU has a separate legal basis to regulate energy policy (Article 194 TFEU) and has adopted numerous pieces of legislation under Articles 114 and 192 TFEU that regulate this sector.

*b. Compulsory jurisdiction for the EU and EU Member States as a respondent to claims by investors*

Similar to Article 8.25.1 CETA, Article 26 (3) (a) ECT establishes that the EU and the EU Member States that are party to the ECT give ‘unconditional consent to the submission of a dispute to international arbitration’. The EU and several Member States are listed in Annex ID and therefore have opted in to the ‘fork in the road’ clause that is both present in CETA (Article 8.22 (f-g)) and the ECT. The clause in CETA is slightly more favourable to investors as it allows investors to bring a claim where they withdraw their domestic claim. In any event, both systems set up a system of compulsory jurisdiction for ISDS tribunals: the EU ‘will not be able to object, when the contested measure was adopted by it, to that measure being examined by that Tribunal’.<sup>122</sup>

*c. Measures of general application can be challenged*

Similar to CETA, the ECT does not preclude that a dispute can concern a measure of general application or an act implementing a measure of general application. Any dispute may be brought ‘relating to an investment’ of an investor of one party in the area of the other party.<sup>123</sup> The definition of ‘investment’ (discussed above under a) does not contain any such carve-out. In fact, disputes brought before the ISDS tribunals established on the basis of the ECT have regularly concerned a measure of general application or an act implementing a measure of general application. Examples are: the complex series of laws, incentive schemes and taxes in the renewables sector that resulted in the boom of ECT cases in Spain and Italy or the implementation by Poland of Directive requiring an increase in the mandatory fuel reserves held by energy firms.<sup>124</sup> More recently, the EU itself has found itself in a dispute with a Swiss company Nord Stream 2 AG over its amendment of the Gas Directive 2009/73/EC.<sup>125</sup>

*d. A tribunal may award damages and this award is final*

Article 26 (8) ECT provides that the ‘awards of arbitration, which may include an award of interest, shall be final and binding upon the parties to the dispute. An award of arbitration concerning a measure of a sub-national government or authority of the disputing

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<sup>121</sup> *Opinion 1/17*, para 139

<sup>122</sup> *Ibid*, para. 140

<sup>123</sup> Article 26 (1) ECT

<sup>124</sup> Luke Eric Peterson, 'Poland wins investment treaty arbitration with eu investor; government sits on growing cache of unpublished rulings' (IAReporter, 7 February 2012) <<https://www-iareporter-com.proxy.uba.uva.nl/articles/poland-wins-investment-treaty-arbitration-with-eu-investor-government-sits-on-growing-cache-of-unpublished-rulings/>> accessed 8 April 2022

<sup>125</sup> Nord Stream 2 AG v. European Union, PCA Case No. 2020-07



Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted. Each Contracting Party shall carry out without delay any such award and shall make provision for the effective enforcement in its area of such awards.’ Accordingly, this element has also been satisfied in relation to the ISDS-mechanism in the ECT.

2. *Second step: safeguards and the ECT*

In *Opinion 1/17* the Court lists a number of legal safeguards in CETA that allow it to conclude that tribunals cannot call into question the level of protection sought by the EU. These are the following:

- a. The agreement contains a general exceptions clause for public interest measures (paras. 152-153);
- b. The agreement contains ‘right to regulate’ clauses (para. 154);
- c. There is a decision by the parties to the agreement that commits to not lowering levels of protection of public interests (para. 155);
- d. The scope of the investment protection standards is circumscribed (paras. 157-159).

It is not clear from the Opinion whether an agreement needs to meet *all safeguards listed* by the Court to conclude that an agreement is compatible with the EU Treaties. It may be that several of these safeguards, depending of their wording, may suffice. The legal value of the ‘Joint Interpretative Instrument’ listed by the Court under (c) is dubious, given the imprecise language and the fact that it is not linked to any specific provision in CETA. The language of the decision suggests an overall assessment based on a reading of the provisions together. The Court concluded after ‘reading provisions together’ that ‘it is apparent from all those provisions’ the parties had ‘expressly restricting the scope’ of investment provisions and therefore the agreement was compatible with the EU Treaties.

Nonetheless, the ECT does not offer these safeguards and the EU text proposal of May 2020 does not include all safeguards considered by the Court in *Opinion 1/17*, either. We address these safeguards in turn:

a. *A general exceptions clause*

It should be noted, first of all, that the reference by the Court to the general exceptions clause in CETA is surprising, given its limited value for investment disputes. Article 28.3.2 CETA does not apply to disputes alleging infringement of the ‘fair and equitable treatment’ standard, nor the direct and indirect expropriation standard. Moreover, the public interests listed in Article 28.3.2 are limited. A systematic reading of that Article suggests that protecting climate change, for instance, is excluded, given that is only featured in Article 28.3.1 CETA.

The ECT does contain an exceptions clause. However, it is more limited than that of CETA and the limited exceptions clause is only partially applicable to Part III of the ECT on investment protection. Significantly, parties cannot rely in the context of ISDS disputes on the exception that allows parties to adopt or enforce any measure ‘necessary to protect human, animal or plant life or health’.<sup>126</sup> These grounds of public interest protection are

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<sup>126</sup> Article 24 (2) (b) ECT see also Hobér (10), at 390

explicitly listed by the Court in *Opinion 1/17*.<sup>127</sup> The EU text proposal of 2020 expands the general exceptions clause, but excludes its application in relation to the two key provisions for investment (Articles 10 (1) and 13). This includes national treatment and most-favoured nation treatment, the only provisions in CETA covered by the general exceptions clause of Article 28.3.2 CETA.

b. *Right to regulate clauses*

The ECT does feature a ‘right to regulate’ clause (Article 18 ECT on resource sovereignty) that is somewhat comparable to Article 8.9.1 CETA although it only applies to resource sovereignty. However, Article 18 ECT is located in Part IV of the ECT, not part III of the ECT. Article 26 ECT limits the jurisdiction of the tribunals to disputes concerning ‘an alleged breach of an obligation of the former under Part III’..<sup>128</sup> The ECT does not feature a clause similar to 8.9.2 CETA. Therefore the current ECT does not meet this particular safeguard.

The EU text proposal of May 2020 does include these ‘right to regulate’ clauses in Part III of the ECT.

c. *Interpretative instruments*

No Annexes or Decisions under the ECT offer interpretative safeguards as to the levels of protection established by the Parties in their respective territories. The EU text proposal of May 2020 concerns amendments to the ECT and is not an interpretative instrument that clarifies the object and purpose of the ECT. Unlike the Joint Interpretative Instrument in CETA, the ECT text proposal of May 2020 does not explicitly state that the ECT ‘will ... not lower [the standards and regulations of each Party] related to food safety, product safety, consumer protection, health, environment or labour protection’, that ‘imported goods, service suppliers and investors must continue to respect domestic requirements, including rules and regulations’, and that the ECT ‘preserves the ability of the European Union and its Member States to adopt and apply their own laws and regulations that regulate economic activity in the public interest’. These sections of the Joint Interpretative Instrument were cited by the Court in *Opinion 1/17* in finding CETA compatible with the regulatory framework in the EU.<sup>129</sup>

d. *Circumscription of the investment protection provisions*

The ECT does not circumscribe the scope of the ‘fair and equitable treatment’ and indirect expropriation standard as referred to by the Court in *Opinion 1/17*. The text of the ECT does not state that non-discriminatory public interest measures can only constitute ‘indirect expropriation’ where such measures ‘are so severe in light of its purpose that it appears manifestly excessive’. Oddly, though, this provision in CETA seems to specifically allow tribunals to call into question the level of protection sought by a party. The limitations (excessive measures) nonetheless appear to satisfy the Court.

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<sup>127</sup> *Opinion 1/17*, para. 152

<sup>128</sup> Hobér, therefore, suggests that means that ‘the provisions in Article 18 cannot be made the subject of the dispute settlement mechanism in Article 26 of the ECT’ and seems to read this provision as solely in the interests of investors, not parties seeking to preserve their regulatory autonomy, Hobér (10), at 347

<sup>129</sup> *Opinion 1/17*, para.155.

In relation to the ‘fair and equitable treatment’ standard in the ECT, Article 10 ECT does not contain an exhaustive list, nor have the parties to the ECT explicitly ‘concentrated on [...] situations where there is abusive treatment, manifest arbitrariness and targeted discrimination’. Rather, ‘fair and equitable treatment’ is neither defined nor does Article 10 (1) ECT provide an exhaustive list when a violation of this standard has occurred.

As regards the EU text proposal of May 2020, the EU has essentially introduced the same texts for the ‘fair and equitable treatment’ standard and ‘indirect expropriation’ standard as under CETA.

Furthermore, the ECT and CETA differ in other respects. While both agreements predominantly seek to liberalise trade and protect foreign investment, the parties to the CETA have been more explicit in underlining the importance of protecting the ability for parties to regulate in the public interest and to have the freedom to set the levels of protection of those public interests. The Joint Interpretative Instrument of CETA refers to the CETA as a ‘modern and progressive trade agreement’ with various provisions that seek to protect the ability of the Parties to protect public interests such as environmental protection and to choose the appropriate level of protection.

What is more, the ECT contains two provisions that negatively affect the regulatory autonomy of the EU institutions that are not present in CETA. First, the ECT contains a non-derogation clause in Article 16 ECT.<sup>130</sup> This clause makes the regulatory safeguards introduced in the EU ‘s text proposal of May 2020 nugatory if an agreement exists with more favourable standards for investors and less safeguards for regulatory action.<sup>131</sup> Even if the ECT is the only agreement to which the EU is party, *Opinion 1/17* makes clear that regulatory autonomy can also be adversely affected were Member States are implementing EU law and Member States are party to a significant number of investment agreements with states that are party to the ECT. Second, the ECT is explicit in structurally subordinating environmental protection to investment protection in the text.<sup>132</sup> For instance, Article 13 (1) of the Energy Efficiency Protocol contains a hierarchy clause that subordinates the provisions of the protocol to the ECT and both the Energy Efficiency Protocol and Article 19 of the ECT are not covered by the dispute settlement procedures of Article 26 (ISDS) and Article 27.<sup>133</sup>

We conclude therefore that the ECT in its current form is incompatible with the EU Treaties, because the ECT gives ISDS tribunals sufficient powers without sufficient legal safeguards to call into question the levels of protection sought by the EU. The EU text proposal for the modernisation of the Energy Charter Treaty (May 2020), on the other hand, offers several but not all of the safeguards include in CETA. Notably, any interpretative instruments such as the one added to CETA are missing. Moreover, the ECT even with several safeguards similar to CETA remains a different agreement to CETA. If not all of the regulatory safeguards are included in the modernized draft ECT, Member States, the European Commission, the Council or the European Parliament

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<sup>130</sup> See section 1.5

<sup>131</sup> Dafina Atanasova, 'The efforts to modernize the ECT and the hidden cost of non-derogation clauses' (Investment Treaty News, 30 March 2022) <<https://www.iisd.org/itn/en/2022/03/30/the-efforts-to-modernize-the-ect-and-the-hidden-cost-of-non-derogation-clauses/>> accessed 19 April 2022

<sup>132</sup> See section 1.2

<sup>133</sup> Article 19 (2), 26 (1) and 27 (2) ECT.

should consider requesting an Opinion of the Court of Justice through Article 218 (11) TFEU to ensure compatibility of the modernized ECT with EU law.

## 2.5 The proper functioning of the internal market (state-aid)

### *General*

The EU's internal market rules seek to merge the national markets of the EU Member States into a single market bringing about conditions as close as possible to those of a genuine internal market.<sup>134</sup> This means that not only restrictions by Member States to free movement of goods, services, persons and capital are only permitted to the extent that they serve a public interest, but also that both Member States and undertakings are no longer allowed to distort competition on that market. The EU's state-aid rules in particular are designed to protect competition on the EU's internal market by prohibiting unlawful state-aid to undertakings. The underlying rationale is simple: giving public funds to a specific company gives it a competitive advantage over others. On the other hand, it is normal practice of governments to give funds to undertakings to for public interest purposes. As such EU law has set up a system for the notification and assessment of state-aid to and by the Commission. Where such aid has not been notified or is considered to be unlawful, Member States are required under EU law to recover such aid in full to the recipient.<sup>135</sup>

In recent years, several arbitral tribunals have found efforts by Member States to recover unlawful state-aid from undertakings to be in breach of the obligations of those Member States under investment agreements, including the ECT. In *Micula*, an investment tribunal awarded an award against Romania for recovering tax advantages that were considered by the Commission to be unlawful state-aid.<sup>136</sup> In *Antin*, an investment tribunal rendered an award against Spain because the Spanish government had reduced its renewable energy support scheme under the ECT. That scheme, however, was not notified and is currently being investigated by the Commission as unlawful state aid.<sup>137</sup> As a result, the very functioning of the EU's internal market rules are upset, as *de facto* unlawful state-aid is being maintained to these companies.

In the recent *Micula* judgment of the ECJ, the Court moreover emphasised that the system of judicial remedies established by the EU Treaties 'replaced' arbitration procedures such as those in *Micula* and therefore consent of the part of Member States 'lacked any force'.<sup>138</sup> This is significant, as the awards of investment tribunals cannot be seen as a lawful action for damages, distinct from state-aid. Investment tribunals are nonetheless capable under the ECT to render awards against Member States that seek to recover unlawful state aid. In essence, arbitral tribunals tend to view 'legitimate

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<sup>134</sup> Case 15/82 *Gaston Schul* ECLI:EU:C:1982:135, para. 33

<sup>135</sup> Case 70/72 *Commission v Germany* ECLI:EU:C:1973:87, para. 13; Council Regulation 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union OJ L 248, 24.9.2015, 9, Article 16

<sup>136</sup> ICSID Case No. ARB/05/20, Ioan Micula et al. v. Romania, Award of 11 Dec. 2013, paras 317, 334–336.

<sup>137</sup> European Commission, State Aid: Commission Opens In-Depth Investigation into Arbitration Award in Favour of Antin to Be Paid by Spain, IP/21/3783, Press release of 19 July 2021, [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_21\\_3783](https://ec.europa.eu/commission/presscorner/detail/en/ip_21_3783).

<sup>138</sup> Case C-638/19P, *Commission v Micula and others* ECLI:EU:C:2022:50, para 145.

expectations' under the FET-standard much broader than it is understood in EU state aid law.<sup>139</sup> Because of the structure of the EU state aid rules, unlawful state aid must be recovered, regardless of whether an investor had any 'legitimate expectations' as understood in international investment law. This means that as the ECT currently stands the ECT conflicts with EU state aid law.

#### *EU text proposal of May 2020*

The EU text proposal of May 2020 underlines the conflict between EU state-aid law and the old ECT text by proposing additional text that seeks to exclude the possibility of awards on the basis of recovery of unlawful state aid. Similar to the CETA text, the new text proposal states under the new article on 'regulatory measures' that the ECT 'shall not be construed as preventing a Contracting Party from discontinuing the granting of a subsidy [...] or requesting its reimbursement, where such action is necessary to comply with obligations imposed upon the Contracting Party concerned by an international agreement establishing a Regional Economic Integration Organisation or been ordered by a competent court, administrative tribunal or other competent authority [...], or as requiring that Contracting Party to compensate the investor therefore.'

#### *Articles 101 and 102 TFEU*

Similar to EU state aid rules, competition law enforcement and the proper working of the internal market could be undermined, if arbitral tribunals could *de facto* undo fines issued to foreign investors for breaches of Articles 101 and 102 TFEU by the Commission and sanctioned by the EU courts. In *Opinion I/17* the Court found this risk in relation to the enforcement of Article 101 and 102 TFEU only to materialise in 'exceptional circumstances' given the regulatory precautions taken in the CETA text for the definition of indirect expropriation and the FET-standard.<sup>140</sup> As such, the Court found that CETA did not infringe the principles of effectiveness and equal treatment. These precautions are, however, not present in the current ECT, but are present in the EU text proposal of May 2020.

## **2.6 Compatibility with the general principle of equal treatment**

Primary EU law guarantees as one of its most fundamental principles non-discrimination on the basis of nationality in Article 21(2) CFR and more generally 'equality before the law' in Article 20 CFR. This also extends to investors. The European Communities at the time made a declaration in relation to Article 25 ECT.<sup>141</sup>

In states of law, the principle of equal treatment or in the specific context of investment the guarantee of an equal level playing field between competing companies is a central commitment. However, EU law allows in other areas, *e.g.*, free movement of persons, for a more privileged treatment of non-nationals (reverse discrimination).<sup>142</sup>

In *Opinion I/17*, the alleged breach of the principle of equality concerned the difference in treatment of Canadian investors as compared to investors from EU Member States, when investing within the

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<sup>139</sup> Claudia Saavedra Pinto, 'The Narrow Meaning of the Legitimate Expectation Principle in State Aid Law Versus the Foreign Investor's Legitimacy Expectations' (2016) 2016 Eur St Aid LQ 270

<sup>140</sup> *Opinion I/17 (CETA)* ECLI:EU:C:2019:341, paras. 185-188.

<sup>141</sup> The Declaration of the European Communities is available at: <https://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf>, p. 76.

<sup>142</sup> See also *Opinion I/17*, para 169 and the case law references therein.

EU.<sup>143</sup> The ECJ rejected that this difference in treatment amounted to a breach of the principle of equality, including because EU investors enjoyed the same special protection of their rights, when investing in Canada.

In the present context, differences in treatment arise under the ECT that are in their nature different from the scenarios in CETA. The ECT offers investment protection within the EU to investors from non-EU Contracting Parties to the ECT, as well as 26 EU Member States, including against another Member State. For Italy, past investment is still protected under the sunset clause, including the possibility for Italian investors to bring claims against another EU Member State.

In principle, intra-EU arbitration has been declared to breach EU law. Yet, as explained above, this does not exclude that intra-EU arbitration takes place and is enforced outside of the EU. This would result in a classic scenario of reverse discrimination, namely that investors of another Member State enjoy more rights than investors from the host Member State.

However, when courts of the Member States comply with EU law and do not allow for (enforcement of) intra-EU arbitration awards, another potential difference in treatment arises between investors from non-EU Contracting Parties and from EU Member States. Hence, it is not only the nationals of the host Member State of any given investment who are treated less favourably than investors from non-EU Contracting Parties but also investors from EU Member States other than the host Member State. They also do not receive any additional protection of their investment elsewhere, as investors from the EU received in Canada in the CETA scenario. Hence, the question here is whether the situation of investors from non-EU states is comparable to the situation of investors from EU Member States and whether the less favourable treatment of the latter amounts to a breach of the principle of equality.

Prima facie, this may amount to an extended version of the legally allowed phenomenon of reverse discrimination of one's own nationals to the nationals of the other EU Member States. The authors are not aware on case law directly on this aspect of treating EU-nationals of another Member State less favourable than non-EU nationals. The case law only speaks to related points. With regard to non-EU nationals, the Court held in the context of free movement of goods that a certain national provision could not be discriminatory towards EU nationals but it could towards non-EU nationals, because they could not claim the benefit of the relevant Treaty provisions.<sup>144</sup>

As a matter of principle, reverse discrimination is possible in the context of free movement of capital.<sup>145</sup> Free movement of capital, however, is different in that respect because it covers capital movements with third countries. In *Test Claimants*, the Court provided an opening to justify restrictions on capital movements from third country where these would not be justified for capital movements within the EU.<sup>146</sup> So different treatment is possible there, but this is not a situation of reverse discrimination.

The principles in *Opinion 1/17* allow arguing that investors from non-EU States and those from an EU Member State other than the host state of the investment are in a comparable situation and that the difference in treatment hence amounts to a breach of the principle of equality.

## 2.7 The right of access to an independent tribunal

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<sup>143</sup> Opinion 1/17, paras 179 et seq.

<sup>144</sup> C-291/09, *Guarnieri*.

<sup>145</sup> see also AG Hogan in C-388/19, fn 54.

<sup>146</sup> C-446/04 *Test Claimants*, para. 171.

*Opinion 1/17* made clear that international agreements need to comply not only with the EU Treaties, but also with the Charter of Fundamental Rights (CFR), in particular Article 47 CFR.<sup>147</sup> Article 47 CFR establishes the right to a remedy before an ‘independent and impartial tribunal previously established by law’ and to ‘effective access to justice’. *Opinion 1/17* lays down basic requirements for international tribunals need to meet in order to be compatible with Article 47 CFR. In particular, those tribunals must be both *accessible* and *independent*.

ISDS tribunals such as those that are set up on the basis of the ECT have faced criticism in the past for neither being accessible nor being independent. In terms of accessibility, the high fees and costs relating to investment arbitration have made such arbitration prohibitively costly for smaller enterprises. Costs for legal and administrative fees are generally several million euros.<sup>148</sup> In terms of independence, critics have pointed out problems relating to ‘double hatting’ of arbitrators and conflicts of interest where arbitrators have for instance acted as counsel for one of the parties in the past.<sup>149</sup> In fact, the most important improvement under ICS in CETA is that it abandons the system of selection of arbitrators under ISDS for a more permanent system based on a roster of tribunal members. The ICS therefore is a system of dispute settlement that contains more guarantees for judicial independence than ISDS. On face value, therefore, maintaining ISDS under the ECT is therefore highly problematic from the perspective of guaranteeing access to an independent tribunal. What is more, the EU text proposal of May 2020 also does not propose to include ICS.

However, it is unclear whether the ECT would be in violation of Article 47 CFR. The Court emphasises in *Opinion 1/17* that Article 47 CFR applies to bodies who exercise ‘judicial functions’. Paradoxically, investment tribunals constituted on the basis of the ECT, however, may in the eyes of the Court not constitute bodies that exercise ‘judicial functions’ and therefore fall outside the scope of Article 47 CFR. In particular, these tribunals are not permanent, but of an *ad hoc* nature and therefore are different from the Investment Court System scrutinized in *Opinion 1/17*. In contrast to CETA, these tribunals established on the basis of the ECT also do not have compulsory jurisdiction from the perspective of foreign investors. While the Court of Justice is unlikely to rule on the question whether the ECT has direct effect (given that the agreement itself is incompatible with EU law), the ECT does stipulate that disputes over Part III of the ECT can be submitted to domestic courts. In fact, the EU has opted in to the fork-in-the-road clause contained in Article 26 (3) (b) ECT.<sup>150</sup> This means that there are at least two ‘factors’ listed by the Court in *Opinion 1/17* that determine whether a tribunal exercises ‘judicial functions’ in the sense of Article 47 CFR that differentiate the ISDS-mechanism in the ECT from the ICS-mechanism in CETA.

If the Court does find that the ISDS tribunals established on the basis of the ECT exercise ‘judicial functions’, the ECT is likely to be found in violation of the requirement of accessibility under Article 47 CFR. The ECT contains no provisions that oblige the Energy Charter Conference to adopt measures that reduce ‘the financial burden on claimants who are natural persons or small and medium-sized enterprises’ and no such decisions have been taken by the Energy Charter

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<sup>147</sup> *Opinion 1/17* (5), paras. 165-167, 189-244.

<sup>148</sup> Matthew Hodgson, Yarik Kryvoi and Daniel Hrccka, “2021 Empirical Study: Costs, Damages and Duration in Investor-State Arbitration”, Allen & Overy and BIICL, London, 2021.

<sup>149</sup> Malcolm Langford, Daniel Behn, and Runar Hilleren Lie, ‘The Ethics and Empirics of Double Hatting’ 6:7 ESIL Reflection (2017).

<sup>150</sup> Statement submitted to the Energy Charter Treaty (ECT) Secretariat pursuant to Article 26(3)(b)(ii) of the ECT replacing the statement made on 17 November 1997 on behalf of the European Communities [2019] OJ 2 115/1.

Conference.<sup>151</sup> Moreover, significant costs for arbitration proceedings on the basis of the ECT since its existence are evidence that the requirement of accessibility under Article 47 CFR is not met. Similarly, no provision exists in the ECT that is similar to Article 8.30 CETA (ethics). This provision prohibits conflicts of interest. It is the key relevant provision on which the Court relied in *Opinion 1/17* to find CETA compatible with the requirement of independence under Article 47 CFR.<sup>152</sup>

## 2.8 Monopoly of jurisdiction over EU law under Article 344 TFEU

ECT arbitration, irrespective which one of the three possible routes is taken (UNCITRAL, SCC or ICSID),<sup>153</sup> is disconnected from any general, *i.e.*, not investment focussed, constitutional system. The tribunals do not respect the primacy of EU law. They do not meet the independence criterion as the arbitrators are chosen by the parties, the co-arbitrators, the arbitral institutions, or an appointing authority.<sup>154</sup> They are not embedded in a constitutional system. In fact, they do not form part of any system of general rights and principles. They do use the same language or aim to connect to any system that generally establishes the rights of individuals and the limitations on public power, as domestic constitutions do.

The Commission's reform proposal envisages the possibility of access to a multilateral investment court (MIC); yet, even such a MIC cannot satisfy the criteria for 'court or tribunal of a Member State' to make requests for preliminary references.<sup>155</sup> It is not bound by the primacy of EU law or embedded in a framework of general constitutional principles that would allow a broader balancing of the particular economic interests of investors against general interests of society.

The very purpose of ISDS mechanisms, including arbitration on the basis of the ECT, irrespective of whether it concerns arbitration under either of the three current routes or the possibility to access a MIC, is offering an alternative mechanism of dispute settlement that is neither embedded in the national constitutional system nor subject to review by the ordinary judiciary. The ECT provides that foreign investors must choose to bring proceedings either before domestic courts or before an arbitral tribunal established according to the rules of the ECT (see the discussion of the fork in the road clause above). This fork in the road clause effectively ensures that investment tribunals are the sole arbitrator.

The institutionalized interaction between the ECJ and national courts under the preliminary ruling procedure (Article 267 TFEU) is additionally protected by the Member States' obligation not to 'submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than' the ECJ (Art. 344 TFEU). While this was previously questioned, including

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<sup>151</sup> Article 8.39.6 CETA.

<sup>152</sup> *Opinion 1/17*, paras. 223-244. The provisions other than Article 8.30 CETA analyzed by the Court refer to remuneration of tribunal members and the ability of Parties to the CETA to remove members of the tribunal from the roster. These rules all relate to the more permanent character of the ICS tribunals that distinguish them from the ad hoc arbitration under the ECT.

<sup>153</sup> See Article 26(4) ECT.

<sup>154</sup> Article 37(2)(a) ECT.

<sup>155</sup> *Achmea*, para. 48.



by the referring Court, the ECJ considered Art. 344 TFEU in *Achmea* applicable to disputes between individuals and states and concluded that Art. 267 TFEU and Art. 344 TFEU must jointly be interpreted to preclude a dispute settlement mechanism as the one challenged in *Achmea*.<sup>156</sup>

The issue of jurisdiction has come up in a number of arbitration proceedings on the basis of the ECT and many tribunals have considered the relationship between EU law and the ECT as a result of the respondent state raising EU law as a *jurisdictional defense*, arguing – even before the explicit confirmation in *Komstroy* – that intra-EU arbitration is incompatible with EU law. The core issue on jurisdiction is that EU Member States as respondents in arbitration proceedings claim that the respective ‘Claimant is not a protected investor since Article 26 of the ECT does not apply to disputes between a national of the EU and an EU member State and asserts that EU law takes precedence over the ECT and bars the Tribunal’s Jurisdiction’.<sup>157</sup>

Arbitral tribunals reject these admissibility objections on a regular basis, including as regards *intra*-EU jurisdiction. This was for example the position of an arbitral tribunal in the award in *SolEs Badajoz GmbH and Spain* (2019).<sup>158</sup> The president of the tribunal was Joan E Donoghue, who should be considered representing an important voice of general public international law as she has been appointed the President of the ICJ in February 2021.

The core issue behind the considerations on jurisdiction is the nature of EU law and how it should be treated as a result, namely whether EU law is international law or domestic law; and if it is domestic law whether it is treated as fact rather than law in arbitration proceedings.<sup>159</sup>

In numerous arbitration proceedings, ECT tribunals have concluded that the applicable law was the ECT and that EU law did not form part of the law applicable.<sup>160</sup> At the same time, the ECJ does not accept international obligations of Member States (and/or the EU) as a reason for escaping EU law obligations. The apparent tension places Member States between a stone and a hard place. They are required to either breach their obligations under the ECT or under EU law. The latter is discussed in more detail in the next section.

## 2.9 Loyalty obligations

The principle of sincere cooperation appears in different forms in the Treaties, from the general and mutual principle in Article 4(3) TEU to numerous more specific forms, addressed to the Member

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<sup>156</sup> *Achmea*, cit., para. 60. AG Wathelet, had suggested the same position in his opinion of 19 September 2017 in *Achmea*, para. 144.

<sup>157</sup> ICSID Case No. ARB/15/38, dispatched to the parties on 31 July 2019, para 171.

<sup>158</sup> ICSID Case No. ARB/15/38, dispatched to the parties on 31 July 2019, Para 252.

<sup>159</sup> See Section 2.1 above. In *SolEs Badajoz GmbH and Spain* (2019), ICSID Case No. ARB/15/38, the claimant argued that EU law was ‘radically separate’ from international law (para 148) and that it could be ‘relevant at most as fact’ (para 150) because of Article 27 VCLT. The respondent argued that EU law ‘has a triple nature, as international law, as domestic law and as fact’ (para 152).

<sup>160</sup> ICSID Case No. ARB/15/38, dispatched to the parties on 31 July 2019, para 167.

States alone, as well as to the institutions alone. Together, the different expressions of the principle of sincere cooperation amount to a comprehensive duty of loyalty.<sup>161</sup>

#### *Obligations of national courts in particular*

For the Member States, the duty of sincere cooperation applies to all emanations of the state. It extends to the national legislator, the executive, and the judiciary.<sup>162</sup> Particularly strict cooperation duties are imposed on the national judiciaries.<sup>163</sup> In settled case law, the principle of sincere cooperation requires national judges to ensure effective judicial protection of rights under EU law.<sup>164</sup> and sometimes to raise EU law of their own motion.<sup>165</sup> Sincere cooperation has further been used by the ECJ to justify limiting national procedural autonomy.<sup>166</sup> This duty of loyalty obliges national courts to disapply law that is incompatible with EU law. It requires them in the present context not to give effect to awards rendered in breach of principles of EU law. After *Komstroy*, this unambiguously covers all awards from intra-EU arbitration on the basis of the ECT. Practically, only insofar as their annulment or enforcement is sought within the EU. Conceptually, however, intra-EU arbitration is, from the standpoint of EU law, illegal, irrespective of where annulment or enforcement is sought; only, non-EU courts are not bound to follow or even consider that position. Decisions rendered by non-EU courts in respect of intra-EU arbitral proceedings (e.g., procedural decisions, anti-suit injunctions, freezing orders etc.) are contrary to EU law.

As to extra-EU arbitration on the basis of the ECT, the situation is less clear. The ECJ has not (yet) declared extra-EU arbitration contrary to EU law. Hence, the obligation of national courts to disapply law that is incompatible with EU law does not extend to extra-EU arbitration. However, if an award only stems from ‘extra-EU’ arbitration because a company has moved its seat to a non-

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<sup>161</sup> C. Eckes, *EU Powers Under External Pressure*, cit., ch. 2; M Klamert, *The Principle of Loyalty in EU Law* (OUP 2014).

<sup>162</sup> For notification duties of the executive, see eg Case C-319/97, *Kortas* [1999] EU:C:1999:272, para 35.

<sup>163</sup> Case C-2/88 *Imm.*, *Zwartveld and Others* [1990] EU:C:1990:440, para 18. Case C-106/89, *Marleasing* [1990] EU:C:1990:395, para 8; Case C-312/93, *Peterbroeck* [1995] EU:C:1995:437 (hereafter Case C-312/93, *Peterbroeck*); Joined Cases C-300-392/98, *Dior* (n 37); Case C-453/00, *Kühne & Heitz* [2004] EU:C:2004:17, paras 24–27; Case C-526/04, *Laboratoires Boiron* [2006] EU:C:2006:528, paras 55 and 57; Joined cases C-261-299/07, *VTB-VAB and Galatea* [2009] EU:C:2009:244, para 39; Joined cases C-200-201/07, *Marra* [2008] EU:C:2008:579, para 41; Case C-234/89, *Stergios Delimitis* [1991] EU:C:1991:91 (Commission vis-à-vis national judiciary); Case C-205/06, *Commission v Austria (BITs)* [2009] EU:C:2009:118 para 44 (Commission must facilitate cooperation between Member States); Case C-298/12, *Confédération paysanne* [2013] EU:C:2013:630, para 37 (hereafter Case C-298/12, *Confédération paysanne*), citing to that effect the judgments in Case 106/77, *Simmenthal* [1978] EU:C:1978:49, para 24 (hereafter Case 106/77, *Simmenthal*) and Case C-617/10, *Åkerberg Fransson* [2013] EU:C:2013:105, para 45 (hereafter Case C-617/10, *Åkerberg Fransson*); Case C-105/03, *Pupino* [2005] EU:C:2005:386, para 42–43 (principle of loyal cooperation applicable in the former third pillar and in particular on the national courts). See also: Marise Cremona, ‘Defending the Community Interest: The Duties of Cooperation and Compliance’ in Marise Cremona and Bruno de Witte (eds), *EU Foreign Relations Law: Constitutional Fundamentals* (Hart Publishing 2008) 158.

<sup>164</sup> Case C-243/15, *Lesoochránárske zoskupenie VLK (Slovak Bear II)* [2016] EU:C:2016:838, para 50. See on the ambiguous use of effectiveness and effective judicial protection in the case law: Johanna Bergström, ‘The Principle of Effective Judicial Protection After the Lisbon Treaty’ (2011) 4 *Rev EAL* 53.

<sup>165</sup> Case C-312/93, *Peterbroeck* [1995] EU:C:1995:437.

<sup>166</sup> Case 33-76, *Rewe-Zentralfinanz* [1976] EU:C:1976:188, para 5 (‘impossible in practice’); Case C-662/13, *Surgicare* [2015] EU:C:2015:89 (‘impossible in practice or excessively difficult’).

EU state after its investment protected under the ECT national courts must conclude that this moving of its seat was an act to circumvent the applicability of EU, *i.e.*, avoid giving effect to EU law. They should come to a similar conclusion when EU-based investors pursue their claims outside the EU in order to avoid the applicability of EU law. National courts should hence equally refuse giving effect to such an award obtained in circumvention of EU law as established by the ECJ.

Such a move of seat, either of the investor (resulting in artificial extra-EU arbitration) or of the arbitral tribunal (resulting in intra-EU arbitration pursued outside of the EU legal order) with the purpose of escaping the effects of *Komstroy* should be seen to amount to an abuse of rights. The ECJ introduced the concept of abuse of rights in 1974 in the case of *Van Binsbergen*, concerning the freedom to provide services.<sup>167</sup> By now this exists in the ECJ's case law in different fields, examples are the provision of services, the common agricultural policy (CAP), company law, and tax legislation.<sup>168</sup> The case law largely focusses on situations where natural or legal persons escape national rules protecting a public interest by 'artificially' creating the possibility to rely on free movement rules or where they artificially create the possibility to obtain EU funds.

The ECJ clarified that '[a] finding of abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by [Union] rules, the purpose of those rules has not been achieved. It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it.'<sup>169</sup> In other words, the requirements for a certain conduct to amount to abusive practice lies in the artificial creation of conditions required to obtain a benefit, in combination with the subjective element of intending a circumvention.<sup>170</sup>

In addition, the ECJ emphasised that any national court aiming to end abuse must not undermine the full effect and uniform application of EU law, they must not alter the scope of the EU law provisions under consideration, and they must not compromise the objective pursued by EU law provisions. The ECJ stressed the need to strike a balance between the prejudice to the protected public interest and EU integration.

In the current, situation companies from the EU Member States moving their seat to a non-EU state or agreeing to arbitration outside of the EU with the intention to escape the clear prohibition of intra-EU arbitration in *Komstroy* act against both interests: first, the public interest protected by national regulation, *e.g.*, climate laws, but interfering with the interests of investors, and, second, the public interest in protecting the autonomy of the EU, which is an essential condition for the EU integration project.

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<sup>167</sup> Case 33/74, *Van Binsbergen*.

<sup>168</sup> L. Cerioni, The 'Abuse of Right' in EU Company Law and EU Tax Law: A Re-Reading of the ECJ Case-Law and the Quest for A Unitary Notion, available at:

<sup>169</sup> Case C-110/99, *Emsland-Starke*, *cit.*, para. 52 and 53.

<sup>170</sup> L. Cerioni, The 'Abuse of Right' in EU Company Law and EU Tax Law: A Re-Reading of the ECJ Case-Law and the Quest for A Unitary Notion.

In any event, since enforcement of intra-EU awards can also be sought in non-EU fora and most EU Member States hold commercial assets outside the EU, the lack of enforcement within the EU does not render intra-EU arbitration on the basis of the ECT moot.

### *Obligations of the Member States*

The Commission stated clearly in 2018, following the *Achmea* case that arbitration clauses included in intra-EU BITs are inconsistent with the principle of autonomy of the EU legal order<sup>171</sup> and that they are as a consequence inapplicable.<sup>172</sup> Inapplicability means that arbitral tribunals established pursuant to these treaties lack under EU law jurisdiction over the investment disputes submitted to them. The Commission further emphasises that Member States ‘must also draw all necessary consequences from the *Achmea* judgment’.<sup>173</sup> EU loyalty requires national courts to annul arbitral awards rendered by arbitral tribunals established on the basis of such treaties to the extent that they are incompatible with EU law.

Following the ECJ’s *Achmea* ruling, 22 Member States published on 15 January 2019 a Declaration on the legal consequences of the judgment.<sup>174</sup> The remaining Member States published two additional declarations: One expressing the views of Finland, Luxembourg, Malta, Slovenia and Sweden<sup>175</sup> and one expressing Hungary’s position.<sup>176</sup> All took the position that EU law and the ECJ’s position prevail in the event of conflict with *intra-se* agreements. The three declarations took a different position on the scope of the conflict. The 22 Member States plus Hungary took the position that all bilateral investment treaties concluded between Member States are incompatible with EU law and ‘thus inapplicable’.<sup>177</sup> The remaining 5 Member States by contrast took the more nuanced position that the inapplicability was limited to BITs with clauses ‘such as the one described in *Achmea*’.<sup>178</sup> At least the first position should apply *mutatis mutandis* to all intra-EU arbitration on the basis of the ECT.

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<sup>171</sup> European Commission, Communication from the European Commission to the Brussels, 19.7.2018 COM(2018) 547 final, 3.

<sup>172</sup> Ibid.

<sup>173</sup> Ibid.

<sup>174</sup> Declaration of the Member States of 15 January 2019 on the legal consequences of the *Achmea* judgment and on investment protection, [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/190117-bilateral-investment-treaties\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190117-bilateral-investment-treaties_en.pdf).

<sup>175</sup> Declaration of the Representatives of the Member States of 16 January 2019 on the enforcement of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union, <https://www.regeringen.se/48ee19/contentassets/d759689c0c804a9ea7af6b2de7320128/achmea-declaration.pdf>

<sup>176</sup> Declaration of the Representative of the Government of Hungary of 16 January 2019 on the legal consequences of the judgment of the Court of Justice in *Achmea* and on investment protection in the European Union, <https://www.kormany.hu/download/5/1b/81000/Hungarys%20Declaration%20on%20Achmea.pdf>.

<sup>177</sup> Declaration of the Member States of 15 January 2019, 1; Declaration of the Representative of the Government of Hungary of 16 January 2019, 1.

<sup>178</sup> Declaration of the Representatives of the Member States of 16 January 2019 (n 274), 1.

*Komstroy* does not leave any room for manoeuvre with regard to the incompatibility of intra-EU arbitration on the basis of the ECT, irrespective of under which arbitration system the tribunal is established. In addition, the majority of the Member States has acknowledged the primacy of EU law in the specific situation of a conflict with *intra-se* arbitration agreements. In other words, loyalty obliges the Member States to use all legal means in their power to avoid such a foreseeable and acknowledged conflict, including withdrawal from the ECT.

The case of extra-EU arbitration on the basis of the ECT is much less clear. No direct loyalty obligation for Member States appears to arise in this regard. However, if and when the EU institutions and the Member States address the incompatibility of the ECT with EU law in line with Section 3 below, they must aim to avoid circumvention of EU law through change of seat of the claimant or tribunal as discussed above.

#### *Conclusion on loyalty obligations*

As we have seen above, the ECT is at present the greatest current challenge to the ECJ's doctrine of autonomy. If we accept that the autonomy of EU law is its most defining essential characteristic, *i.e.*, if that autonomy was structurally undermined the EU could not exist as a legal entity with its own principles and objectives and EU law would not continue to enjoy primacy and direct effect, the duty of loyalty requires to avoid such a challenge with all legally available means.

It should be added that loyalty obligations in the context of external relations are more stringent than internally.<sup>179</sup> This is essentially the case because EU law, and above all its primacy, does not bind third states nor arbitral tribunals. The ECJ has gone very far in protecting EU law from future clashes on central issues. As explained above, the doctrine of the autonomy of EU law is essential to the functioning of the EU legal order. If it is foreseeable, as it is today, that the number of challenges under a given international agreement is likely to sharply increase, and if these challenges structurally undermine autonomy, the obligation of Member States to avoid such a challenge of an essential element of the functioning of the EU legal order is very far reaching. The ECJ has confirmed in the past that this may include renouncing or withdrawing from an international treaty.<sup>180</sup>

In addition, it has been established that arbitral tribunals have, as is not uncommon for legal bodies, interpreted expansively the protective scope of investment agreements and hence their own powers.<sup>181</sup> Several tribunals have more specifically displayed an 'outright hostility towards the EU

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<sup>179</sup> Case C246/07, *Commission v Sweden (PFOS)* [2010] EU:C:2009:589; Eckes, EU Loyalty, *Cambridge Journal of European Studies*, 2019.

<sup>180</sup> See the Bilateral Investment Treaty cases (Case C-205/06, *Commission v Austria* [2009] EU:C:2009:118; Case C-249/06, *Commission v Sweden* [2009] EU:C:2009:119; Case C-118/07, *Commission v Finland* [2009] EU:C:2009:715; see also *e.g.*, Case C-170/98, *Commission v Belgium* [1999] EU:C:1999:411; Case C-84/98, *Commission v Portugal* [2000] EU:C:2000:359; Case C-62/98, *Commission v Portugal* [2000] EU:C:2000:358.

<sup>181</sup> Gus Van Harten, 'Leaders in the Expansive and Restrictive Interpretation of Investment Treaties: A Descriptive Study of ISDS Awards to 2010' [2018] 29 *European Journal of International Law* 507; and Katherine Jonckheere, 'Practical Implications of an Expansive Interpretation of Umbrella Clauses in International Investment Law' [2015] 11 *South Carolina Journal of International Law and Business* 143.

legal order'.<sup>182</sup> Furthermore, the lack of *embeddedness* of ECT arbitral tribunals in any constitutional framework of the participating parties hampers their ability to take the common good and shared objectives, as defined by the relevant society, into account. This also directly affects the level of *social and normative legitimacy* that they benefit from. Jointly these considerations speak for a stringent interpretation of EU loyalty obligations in the case of the ECT.

By way of conclusion, EU loyalty obliges both the EU and the Member States to do all in their power to avoid a conflict with EU law. This includes an obligation to attempt amending the ECT, as well as, ultimately, an obligation to withdraw from the ECT, which is legally possible under the ECT. It also obliges them to use all legal means to avoid conflicts during the duration of the sunset clause (see Section 3 below).

### 3. Options to remedy incompatibility under public international law

#### 3.1 Political and legal pressures

The political and legal pressures on the EU to either reform the ECT or withdraw from it is high, both for sustainability reasons and because of the ECT's incompatibility with EU law.

##### *Legal conflicts*

After *Komstroy*, Member States are in the position that they either participate in intra-EU arbitration and hence breach their EU loyalty obligations or refuse to participate in intra-EU arbitration and breach their obligations under the ECT. This incompatibility is also likely to continue considering the fact that ECT tribunals cannot be expected to quickly change their predominant approach to EU law. They are likely to continue to exercise jurisdiction even after the ECJ has unambiguously stated in *Komstroy* that intra-EU arbitration established on the basis of the ECT is incompatible with EU law.

This results in a regime conflict. This brings amendment and withdrawal on the table as possible ways to end this conflict.

One relevant ECT arbitration case that may specifically expose tensions with EU law is the Nord Stream 2 pipeline case to which the EU is the respondent.<sup>183</sup> As Member States have done in many other cases, the EU, represented by the Commission, objected that the tribunal did not have jurisdiction. Yet, the tribunal decided to assess whether the claimant's case has merits. The point of contention is whether the EU by enacting Directive 2019/692 concerning common rules for the internal market in natural gas has breached its commitments under the ECT. Similarly, sanctions

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<sup>182</sup> Steffen Hindelang, 'Study on Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law' in Pieter Jan Kuijper, Ingolf Pernice, Steffen Hindelang, Michael Schwarz and Martin Reuling, *Investor-State Dispute Settlement (ISDS) Provisions in the EU's International Investment Agreements*. Volume 2 – Studies (European Parliament 2014) 69-71. See also: ICSID Case No. ARB/15/50, *Eskosol s.p.a. in liquidazione v. Italian Republic*, para 175 and the cited arbitral awards therein.

<sup>183</sup> See for all related, publicly available documents: <https://pca-cpa.org/en/cases/239/>.

against Russia restricting the import of fossil fuels<sup>184</sup> could result in highly political salient challenges on the basis of the ECT.

In addition, and more structurally, investors are pushing back. In 2019, the Netherlands adopted a general law prohibiting the use of coal for producing electricity. This law determines that the Netherlands' five coal-fuelled power plants must shut down in phases until 2030. RWE and Uniper commenced ICSID arbitration on 2 February 2021 and 30 April 2021, respectively, claiming compensation. In response, the Netherlands initiated two anti-arbitration injunctions before the German courts with the intention to block the ICSID arbitrations to proceed. Uniper then brought a counter-action before the arbitral tribunal claiming that the legal proceedings before the German courts violate Articles 26 (on the exclusivity of ICSID arbitration) and Article 41 (providing for the tribunal's competence to rule on its own jurisdiction) of the ICSID Convention.<sup>185</sup> Other actors in the fossil fuel industries are likely watching these cases closely to assess how relevant the ECT may prove to be as a means of slowing down the green transition.

### *Reconciling substantive obligations*

Under international law, states do not have a general obligation to reconcile the different treaty obligations into which they have entered. Hence, interpretative reconciliation is not required simply by the fact that all 53 Contracting Parties to the ECT are also Contracting Parties to the 2015 Paris Agreement and the processes taking place within the framework of that agreement.

Article 16 ECT stipulates the relations between the ECT and other Treaties. Most notably it only allows for other rules to prevail if they are more favourably to the investor or investment. The European Treaties operate on the assumption that EU law obligations, including international agreements which the EU has concluded, take primacy over the international law obligations of the Member States. This is, *e.g.*, expressed in Article 216 TFEU, binding the Member States to EU international agreements as a matter of EU law, and Article 352 TFEU, requiring Member States to do all possible to avoid conflict between international agreements that they have entered into before the EU was created or before they acceded to it. It is also apparent from the ECJ's case law on the Member States loyalty obligations.<sup>186</sup>

However, from the perspective of international law, the primacy of EU law and the connected obligation to give priority to EU law obligations over international law obligations does not matter. Article 27 VCLT, reproduced in the 1986 Convention on the law of treaties between States and international organisations or between international organisations, does not allow the EU to rely on its internal law as justification for its failure to perform a treaty. And, while Article 59 VCLT contains a *lex posterior* rule, *i.e.*, that a later treaty prevails over an earlier treaty, this provision does not apply in the present context. It is only applicable if the later treaty relates to the same subject matter than the earlier treaty. This identity of subject matter cannot be argued as regards the ECT and the 2015 Paris Agreement.

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<sup>184</sup> Council Regulation (EU) 2022/576 of 8 April 2022 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

<sup>185</sup> <https://www.iareporter.com/articles/uniper-seeks-to-halt-anti-arbitration-proceedings-before-german-courts-by-requesting-provisional-measures-from-newly-constituted-icsid-tribunal/>.

<sup>186</sup> See Section 2.9 above.

It should be added that, so far, no tribunal has considered international climate law when interpreting the ECT's investment protections.<sup>187</sup> This also highlights a deeper problem of increasing reliance on arbitration, which is both a result of the fragmentation of international law and further advances this fragmentation.

### *Political pressure*

Prominently, the European Parliament suggested adding the following provision to the European climate law:

Article 8a

The Union shall end protection of investments in fossil fuels in the context of the modernisation of the Energy Charter Treaty.

The final text adopted does not include this provision, but the suggestion unambiguously reflects the political position of the European Parliament. In addition, some Member States' governments have signalled their willingness to consider withdrawal. France for example openly pointed to the possibility to withdraw from the ECT.<sup>188</sup>

## **3.2 Amendment of the ECT**

### *Commission proposal for amendment*

As discussed above, the EU has made a text proposal to amend the ECT. The proposal of the European Commission aims to amend the definition of protected investments under the ECT to partially exclude investments associated with fossil-based energy sources, although a number of gas-related exceptions remain and a 10-year transition period to phase-out protection for existing investments.<sup>189</sup> Whether this would be in line with the ECT's signatories' commitments to reduce emissions under the Paris agreement is contested by civil society organisations.<sup>190</sup> Most contracting parties to the Paris agreement have adopted the required Nationally Determined Contributions (NDCs) and aim for significant reductions of emissions by 2030 and carbon neutrality by 2050.<sup>191</sup> This goal is only achievable if – amongst other significant steps – the energy sector is fundamentally reformed. In most countries, such a transition of the energy sector is also envisaged.<sup>192</sup>

The EU's text proposal, as discussed above, suggests introducing a footnote to Article 26 ECT that sets out a procedural separation clause drafted with CETA and Opinion 1/17 in mind. However, the Energy Charter Conference did not include Article 26 ECT in the list of topics that are part of the discussions on the modernization effort. Hence, the inclusion of this provision is unlikely. It also

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<sup>187</sup> CCC report, 2022.

<sup>188</sup> <https://www.euractiv.com/section/energy/news/france-puts-eu-withdrawal-from-energy-charter-treaty-on-the-table/>.

<sup>189</sup> See Section 1.4 above.

<sup>190</sup> See e.g., <https://caneurope.org/content/uploads/2022/03/ECT-reform-briefing-March-2022.pdf>.

<sup>191</sup> In addition, many NDCs are not compatible with the objective of the Paris Agreement to limit global warming to 1.5 degrees.

<sup>192</sup> E.g., in Germany: <https://www.bmwi.de/Redaktion/DE/Schlaglichter-der-Wirtschaftspolitik/2021/10/14-neues-klimaschutzgesetz.html>.



does not remedy other incompatibilities with EU law, such as the restrictions on the EU's regulatory autonomy. Most importantly, however, it does not envisage a general exclusion of intra-EU arbitration. This, because of the intricate relation of intra-EU and extra-EU arbitration based on the ECT, will continue to raise further problems.

In addition, as we have seen ending intra-EU arbitration is an obligation under EU law, flowing from the duty of EU loyalty. This duty also applies to the EU institutions. Assuming, as a matter of principle that ending intra-EU arbitration would not affect the non-EU parties to the ECT, it is not immediately obvious why they would be less likely to agree to such an amendment than to the amendment of substantive clauses of the ECT. In other words, the Commission's amendment proposal should clarify that intra-EU arbitration is excluded. Any such amendment of the ECT should be accompanied by an interpretative declaration by the EU and its Member States clarifying that any later relocation of the seat of an investor from an EU Member State to a non-EU Contracting Party of the ECT would not qualify their claims as extra-EU arbitration.<sup>193</sup>

Ultimately, the amendment of the ECT for all 53 parties would also require consent by all of the Contracting Parties present at the Energy Charter Conference. The amendment enters into force between Contracting Parties having ratified the amendments on the 90th day after deposit of the instruments of ratification of at least three fourths, or 41, Contracting Parties.

Politically, this process is considered highly uncertain and modernisation is hence considered by many as highly unlikely. The ECT Contracting Parties plan to reach a political agreement on a 'modernisation package' in June 2022. They would then vote to adopt the modernisation package at the Energy Charter Conference at least three months later, i.e., at the earliest in November 2022 (Art. 42(2) ECT).

If the modernisation package is adopted unanimously by the Contracting Parties present and voting in November 2022 (Art. 36(1)(a) ECT), it will be submitted by the Secretariat to the Contracting Parties for ratification (Art. 42(3) ECT; delay unknown). After this, the Contracting Parties start to ratify the modernisation package and deposit their ratification documents with the Depositary. The modernisation package enters into force between Contracting Parties having ratified the amendments on the 90th day after deposit of the instruments of ratification of at least three fourths, or 41, Contracting Parties.

For the EU, the adoption of a 'Modernised ECT' also entails a number of procedural requirements: (1) a qualified majority vote at the Council; (2) consent by the European Parliament; and (3) ratification by the Member States in accordance with their national procedures. As mentioned above, also on the EU side this may result in a lengthy process. Examples of ratification processes that have proven difficult are the Mauritius Transparency rules (pending since 2015), CETA (pending since 2016), and the last amendments to the ECT, which took 12 years.

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<sup>193</sup> See also below Section 3.7 for a combination of inter-se modification and an interpretative declaration excluding circumvention of the prohibition of intra-EU arbitration.

### 3.3 Withdrawal from the ECT

The ECT includes a right to withdrawal from the treaty, as is regulated in Article 47 ECT. Withdrawal is the ‘procedure initiated [...] by a State to terminate its legal engagements under a treaty,’<sup>194</sup> in this case based on a right created by the treaty, thus based on the earlier consent of the ECT parties (Art 54 VCLT). As Article 47 ECT stipulates that withdrawal from the ECT is possible by written notice to the depositary, taking effect one year after that notice. It puts an end to the participation of the withdrawing party or parties but without terminating the treaty itself. The treaty remains in force for and among the non-withdrawing parties.

The problem is that in the case of the ECT, withdrawal does not end the incompatibility with EU law. The so-called survival or sunset clause in Art 47(3) ECT continues the effects of the ECT for already made investments for 20 years beyond the date of withdrawal. While 20 years is an unusually long period of time the parties to an international treaty are free to protect the effects of a treaty for past investments for such a long time into the future.

The question is hence how could the effects of the sunset clause be either limited or altogether eliminated. Partial elimination between the withdrawing parties, e.g., the EU, the EU Member States, and any additional Contracting Parties to the ECT that may decide to withdraw, appears an immediate possibility. Pursuant to Article 41 VCLT, the withdrawing states may negotiate an agreement for so-called *inter-se modification* of the ECT among these particular parties.<sup>195</sup> Similarly, the combination of withdrawal and inter-se modification could eliminate intra-EU arbitration.

For completeness, on the EU side, withdrawal requires the Commission to make a proposal for a Council decision to withdraw from the ECT. The Council would then adopt the decision of withdrawal by qualified majority vote.

### 3.4 Making an additional interpretative declaration under Article 26(3)(b)(ii) ECT

The EU could update its declaration under Article 26(3)(b)(ii) ECT. Currently, the EU’s declaration, updated on 2 May 2019, deals with a range of issues, such as the ECJ’s status as a domestic court, notification obligations, and the fact that ICSID does not allow EU participation.<sup>196</sup> A future declaration could clearly state that intra-EU arbitration is contrary to EU law.

Article 26(3)(a) ECT makes the parties’ ‘unconditional consent to the submission of a dispute to international arbitration’ among other things ‘subject to’ subparagraph (b). ECT tribunals must hence take the declaration made ‘for the sake of transparency’ on the ‘policies, practices and

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<sup>194</sup> United Nations. (2003). Final clauses of multilateral treaties handbook, p. 109. <https://treaties.un.org/doc/source/publications/fc/english.pdf>.

<sup>195</sup> See also: Nathalie Bernasconi, Lukas Schaugg, Amandine Van den Berghe, Energy Charter Treaty reform: why withdrawal is an option, June 2021, <https://www.clientearth.org/latest/documents/energy-charter-treaty-reform-why-withdrawal-is-an-option/>.

<sup>196</sup> Statement submitted to the Energy Charter Treaty (ECT) Secretariat pursuant to Article 26(3)(b)(ii) of the ECT replacing the statement made on 17 November 1997 on behalf of the European Communities.

conditions’ into account. Whether this would lead to a different approach of ECT tribunals, in light of the above discussed and importantly Articles 27 and 46 VCLT, is a different question.

ECT contains explicit invitation to provide an interpretative declaration ‘no later than the deposit’. However, this does not necessarily exclude a later interpretative declaration. The limitation lies in the substance of the interpretative declaration. In principle, such a unilateral declaration may not change the content or purpose of the treaty regime. If it did, this would amount to making a reservation (Art 19 VCLT), which cannot be made at a later time than that of expression of consent to be bound to a treaty, or a clandestine hard-core readjustment of the normative content of the treaty in relation to the Contracting Party making the declaration.

A declaration bringing the EU’s and its Member States’ obligations in line with the ECJ’s *Komstroy* decision would amount to an attempt at unilaterally changing the normative content of the treaty. It might be seen as going against the core principle of *pacta sunt servanda* in Article 26 VCLT. It might also be considered undermining the rules of Article 40 and 41 VCLT as clearly circumscribed rules for later consent-based amendment of a treaty.

Nonetheless, the EU and its Member States should make such a declaration, ‘for the sake of transparency’ in order to clearly set out that the intra-EU arbitration is contrary to EU law. Such a declaration should also explicate that the notion of intra-EU arbitration applies to all arbitration brought against a Member State that at the time of the investment had their seat in another EU Member States. A later change of seat of the company, in order to circumvent *Komstroy* should be explicitly excluded.

### **3.5 The Choice between amendment and withdrawal**

Mainly because of the sunset clause, the Commission has so far advocated amendment rather than withdrawal; yet, it has also acknowledged, when pressed by the European Parliament, that ‘[i]f core EU objectives, including the alignment with the Paris Agreement, are not attained within a reasonable timeframe, the Commission may consider proposing other options, including the withdrawal from the ECT.’<sup>197</sup>

If the objective is to end the conflict with EU law, amending the ECT, as opposed to withdrawing from it, has the advantage of changing the legal situation at the moment that the amendment enters into force. However, in light of the high hurdles for adopting the modernised text, in combination with the delay resulting from the necessary ratification process, it seems highly likely that any amendment procedure, if successful at all, would take many years. For all that time, the current ECT would remain applicable. Also, pursuing amendment remains for all that time a path of uncertain success. Ultimately, if the modernisation efforts fail, the EU and its Member States would have to resort to other means, only with a highly costly and – in light of the certainty of the increasing impacts of the climate emergency – highly undesirable delay. Furthermore, the

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<sup>197</sup> Parliamentary questions, Answer given by Executive Vice-President Dombrovskis on behalf of the European Commission, 2 December 2020, available at [https://www.europarl.europa.eu/doceo/document/P-9-2020-005555-ASW\\_EN.html](https://www.europarl.europa.eu/doceo/document/P-9-2020-005555-ASW_EN.html).

Commission's proposal to amend the ECT allows the protection of existing fossil fuel investment for another decade.<sup>198</sup>

Withdrawal, by contrast, in principle triggers the 20-year sunset clause in Article 47(3) ECT, which would likely lead to numerous additional disputes, including arbitration instigated by the fossil fuel industries. Yet, it is not only a strong political signal. It also ends the protection of existing investments in any event 20 years after the withdrawal takes effect and ends all protection of new investments. In addition, international law offers the possibility to limit or at least partially eliminate the effects of the sunset clause, *i.e.*, exclude it in relation to intra-EU arbitration.

### **3.6 *Inter-se* modification within the meaning of Article 41 VCLT**

The ECT is a mixed agreement. The EU and all Member States, with the exception of Italy are parties to the ECT. They are all full parties and, under international law, obliged to comply with the ECT as a whole. They may all be held liable under international law for all obligations under the ECT.

As explained above, the ECT contains a dispute settlement clause in Article 26 ECT, allowing investors from one Contracting Party to bring arbitration against another Contracting Party.

This justifies *inter-se* modification of the ECT on agreements between the EU Member States and the EU itself in the sense of Article 41 VCLT. This is, if you will, the bright flipside of the ambiguity of mixed agreements. Or, to put it differently, the EU's hybrid status of an international organisation with a domestic, constitutionalised legal order and the ambition to be a (state-like) effective international actor, in combination with the EU Member States as international actors with particular EU law obligations, allow the EU and its Member States as Contracting Parties to the ECT in their own rights to act as separate treaty parties under the VCLT.

The EU, the EU Member States, and any non-EU States withdrawing with them, could hence modify the ECT between themselves in line with Article 41(1)(b) VCLT as parties of a multilateral treaty.

#### Article 41 VCLT

Agreements to modify multilateral treaties between certain of the parties only

1. Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if:

(a) the possibility of such a modification is provided for by the treaty; or (b) the modification in question is not prohibited by the treaty and: (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations; (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole.

2. Unless in a case falling under paragraph 1(a) the treaty otherwise provides, the parties in question shall notify the other parties of their intention to conclude the agreement and of the modification to the treaty for which it provides.

While the ECT does not specifically provide for such an *inter-se* modification (Art 41(1)(a) VCLT), it does not prohibit it either (Art 41(1)(b) VCLT). Hence, as long as such modification does not affect the right of the remaining parties to the ECT (Art 41(1)(a)(i) VCLT) and does not stand in

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<sup>198</sup> See section 1.4 above.

conflict with the purpose of the treaty as a whole (Art 41(1)(a)(ii) VCLT), an *inter-se* modification is possible under international law.

This inter-se modification would have to address at least two points:

- i. It would have to explicitly exclude the possibility of multinationals avoiding the effects of the inter-se modification treaty by moving their seat from an EU Member States to a non-EU state.
- ii. It would have to address the position of Italy, as the only EU Member States that is no longer a party to the ECT, but that is still subject to the effects of the ECT as protected under the sunset clause.

As to 1): As indicated above, the line between intra-EU and extra-EU arbitration is not static and any firm exclusion of intra-EU arbitration may incentivise companies to move their seat outside of the EU. However, Article 41(1)(b)(i) VCLT protecting the ‘enjoyment by the other parties of their rights under the treaty’ only applies to the Contracting Parties to the international treaty. It does not apply to natural or legal persons. It is hence coherent and necessary to include an interpretative declaration to accompany the modification, explaining that investors are excluded from extra-EU arbitration that were, at the time of their investment, which must necessarily be before withdrawal of the EU and its Member States, seated in one of the withdrawing parties and that then moved their seat to a remaining party from the rights as protected by the sunset clause in combination with Article 41 VCLT. In other words, a combination of withdrawal and an *inter-se* modification of the ECT would be able to terminate all rights of investors that at the time of their investment were seated within the EU or a withdrawing third state that agrees to the *inter-se* modification of the ECT.

As to 2): Italy would have to join the agreement for inter-se modification in order to benefit from the partial elimination of the effects of the sunset clause -i.e. the blocking of intra-EU arbitration-, since Italy is at present still subject to the effect of the sunset clause with regard to all Contracting Parties of the ECT.

Since the case law of the ECJ does not qualify as such a modification because the primacy of EU law obligations over international law obligations is not accepted under international law, further explicit and formal steps should be taken in this direction. This modification has become more urgent and necessary, both in light of the growing likelihood of conflict and the EU’s exclusive competence over investment protection under the Lisbon Treaty, which was signed in 2007 and entered into force in 2009.

An additional issue is whether the EU and its Member States are legally able to either limit or eliminate the effects of the sunset clause for *all arbitration*. This remains a highly salient aspect in light of arbitration brought by investors that were, at the time of their investment, which must necessarily be before withdrawal of the EU and its Member States, seated in a remaining contracting party to the ECT.

The limitation or elimination of the effects of the sunset clause for extra-EU arbitration on the basis of the ECT would necessarily affect the rights of the remaining, *i.e.* non-EU and not withdrawing, parties to the ECT. Hence, it would not meet the requirement in Article 41(1)(a)(i) VCLT for companies that were, at the time of their investment, which must necessarily be before withdrawal of the EU and its Member States, already seated in a remaining Contracting Party to the ECT.

### 3.7 Changing legal and factual landscape

While States do not have a general obligation to reconcile their obligations under different treaties, Article 26(6) ECT stipulates that arbitral tribunals established on the basis of the ECT ‘shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law’.

Without amendment or withdrawal, the EU and the EU Member States (except Italy) remain bound by the ECT. However, the reading of what ECT tribunals may consider to be protected under the FET standard within the meaning of Article 10(1) ECT as ‘legitimate expectations’ of investors should nonetheless change over time.

Most tribunals have held that investors must conduct some level of due diligence to claim legitimate expectations of legal stability.<sup>199</sup> If regulatory changes were foreseeable at the time of investment these changes have been held not to breach the fair and equitable treatment standard.

This is where the international and national legal commitments to reduce emissions come in, as well as (strategic) climate litigation.<sup>200</sup> At the very latest since the 2015 Paris agreement, the fossil fuel industries can hardly argue that they were not aware of the likelihood that domestic regulation could interfere with their business, considering that fossil fuels are the dominant cause of the climate crisis. In addition, more and more domestic courts around the world have recognised the climate crisis as triggering, in combination with different legal obligations, legal consequences that ECT tribunals must consider as fact when they establish legitimate expectations within the meaning of FET in Article 10(1) ECT.

### 3.8 Obligations of the Member States after EU withdrawal

If the EU were to withdraw from the ECT, EU Member States as parties to the ECT are under an obligation under EU law to do so as well. While under public international law the ECT remains binding on EU Member States when they remain a party to the ECT, these EU Member States no longer have the competence under EU law to remain a party to the ECT. This is because since the entry into force of the Lisbon Treaty, the EU holds exclusive competence for foreign direct investment (FDI) pursuant Article 207 TFEU. *Opinion 2/15* clarified that the EU’s exclusive competence over foreign direct investment concerns the competence to negotiate and conclude agreements that contain provisions on the protection of foreign direct investment post-establishment, such as the ‘fair and equitable treatment’ standard and the expropriation standards.<sup>201</sup>

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<sup>199</sup> CCC report, 2022.

<sup>200</sup> Eckes, *Verfassungsblog*, 2021.

<sup>201</sup> *Opinion 2/15*, paras. 78-110.

As a result, Member States no longer have the competence to conclude or maintain agreements that cover foreign direct investment as they are operating in an area of EU exclusive competence.<sup>202</sup>

The ECT covers provisions that protect foreign direct investment after the admission phase and therefore such provisions, since the entry into force of the Treaty of Lisbon, fall squarely within EU exclusive competence. As a result, they no longer have the competence under EU law to remain a Party to the agreement as this would result in them exercising a competence that they no longer have.

The EU's Grandfathering Regulation (Regulation 1219/2012) does not change the fact that EU Member States have lost competence under EU law to remain party to the ECT without the EU.<sup>203</sup>

The Grandfathering Regulation was specifically adopted to allow Member States to maintain their existing bilateral investment agreements and to negotiate new bilateral investment agreements under supervision of the Commission even if such agreements fall in large part under EU exclusive competence. The Regulation thereby is an example where the EU empowers the Member States to exercise powers in areas of the EU exclusive competence.<sup>204</sup>

The Regulation establishes a mechanism by which Member States must notify existing bilateral investment agreements and only notified existing agreements can, under the Grandfathering Regulation, be maintained. Article 2 specifies that Member States had until 8 February 2013 to make such a notification. No Member State has notified the ECT under the Grandfathering Regulation.<sup>205</sup> This is not surprising given that until the EU withdraws no competence issues for Member States arise given that it is the EU that is exercising its powers over those parts of ECT for which it is competent. Moreover, the subject-matter of the Grandfathering Regulation is *bilateral* investment agreements and not a multilateral treaty to which the EU itself is a party.

EU Member States that acceded to the EU after they became party to the ECT benefit from Article 351 TFEU. The first paragraph protects third country rights under an agreement concluded by a Member State before accession to the EU. EU law cannot affect such rights and the corresponding obligations of Member States. However, even these Member States are, under the second paragraph of Article 351 TFEU, under an obligation to 'take all appropriate steps to eliminate the incompatibilities'. The Court has maintained that Member States are obliged to withdraw from an international agreement if the agreement so permits and where other steps such as renegotiation have failed.<sup>206</sup>

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<sup>202</sup> Article 2 (1) TFEU

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<sup>204</sup> Article 2 (1) TFEU

<sup>205</sup> List of the bilateral investment agreements referred to in Article 4(1) of Regulation (EU) No 1219/2012 of the European Parliament and of the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries [2012 ] OJ L 142/1

<sup>206</sup> Case C-62/98 *Commission v Portugal* ECLI:EU:C:2000:358, paras. 32-34

## 4. Challenges to the validity of the ratification decision under EU law

### 4.1 Preliminary reference on the validity of the Council decision to conclude the ECT

#### *General*

In *Western Sahara* the European Court of Justice confirmed that it has jurisdiction

‘both in the context of an action for annulment and in that of a request for a preliminary ruling to assess whether an international agreement concluded by the European Union is compatible with the Treaties [...] and with the rules of international law which, in accordance with the Treaties, are binding on the Union.’<sup>207</sup>

Thus, review of legality of an international agreement binding on the EU is generally possible both through a direct action for annulment on the basis of Article 263 TFEU and through an indirect action in the form of a preliminary reference made by a court of a Member State through Article 267 TFEU. In fact, in *Front Polisario* the General Court annulled in an action for annulment Council decisions concluding fisheries and trade agreements with Morocco.<sup>208</sup>

The review of the validity of an international agreement is understood by the Court as relating to the EU act approving the conclusion of that international agreement, because such an international agreement concluded by the Union is also binding on non-member States that are parties to such an agreement.<sup>209</sup> Nonetheless, such a review may also concern ‘the legality of that act in the light of the actual content of the international agreement at issue.’<sup>210</sup>

#### *Time limits*

However, the Council and Commission decisions concluding the ECT and its Trade amendment on behalf of the EU date back to 23 September 1997 and 13 July 2001 respectively.<sup>211</sup> Accordingly, the time-limit contained in Article 263 TFEU has passed and a direct action for annulment would be inadmissible.<sup>212</sup> On the other hand, a preliminary reference on the validity of an international agreement made by a court of a Member State in accordance with Article 267 TFEU is still possible.<sup>213</sup> This procedure does not contain any time-limits and procedural questions such as that of standing of applicants are usually entirely decided by national law.<sup>214</sup>

#### *Requirements for a preliminary ruling on the validity of an international agreement –*

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<sup>207</sup> Case C-266/16, *Western Sahara Campaign UK* ECLI:EU:C:2018:118, para. 48

<sup>208</sup> Judgments in Case T-279/19 and in Joined Cases T-344/19 and T-356/19 *Front Polisario v Council* ECLI:EU:T:2021:639 and ECLI:EU:T:2021:640

<sup>209</sup> Case C-266/16, *Western Sahara Campaign UK*, para. 49-50

<sup>210</sup> *Ibid.*, para. 51

<sup>211</sup> See above (9)

<sup>212</sup> In the event the ECT would be amended, the Council decision concluding the modernized ECT can be challenged within a two-month period under the conditions set out in Article 263 TFEU. Only privileged applicants (Member States, the European Parliament, the Commission and the Council) would be in the position to do so.

<sup>213</sup> In the event the ECT would be amended, a preliminary reference on the validity of the Council decision concluding the ECT is possible as soon as such a Council decision is taken.

<sup>214</sup> Joined Cases 21-24/72 *International Fruit and Others* ECLI:EU:C:1972:115, para. 5; Case C-366/10 *Air Transport Association of America and Others* ECLI:EU:C:2011:864.



- A national court does not itself have jurisdiction to invalidate the Council and Commission decisions concluding the ECT and the trade amendment. This decision is within the exclusive jurisdiction of the Court of Justice.<sup>215</sup>
- On the other hand, a national court may decide that such acts of EU law are valid.<sup>216</sup>
- A party seeking to challenge the validity of the ECT before a court of a Member State therefore does not have a right to a preliminary reference on the validity of the ECT under EU law to the Court of Justice under Article 267 TFEU. The decision to make such a reference is one of the national courts. The party alleging invalidity therefore needs to convince the national court that a preliminary reference is necessary. In such a case, if a national court considers the arguments raised by a party for the invalidity of an international agreement to be well-founded and considers there is real doubt as to the validity of the international agreement, it should stay the proceedings and refer this question to the Court of Justice.<sup>217</sup>
- In general, it is the national court's responsibility to decide on the relevance of a reference to the Court of Justice.<sup>218</sup> As a consequence, in principle, the Court of Justice is bound to give a ruling. However, this presumption of relevance is constrained by the purpose of the preliminary reference procedure, which is not enable the Court of Justice to give advisory opinions on general or hypothetical questions, but must assist in the administration of justice in the Member States.<sup>219</sup> Therefore, the Court of Justice may decline to give a ruling in hypothetical cases, in cases where questions are not sufficiently clearly articulated, where the facts are not sufficiently clear to the Court of Justice, or where the questions raised are not relevant to the resolution of the dispute.<sup>220</sup>

As a consequence, it is possible for individuals to challenge the validity of the ECT on the basis of incompatibility with EU law before national courts. In proceedings before a national court, however, such a party must convince the national court that a preliminary reference to the Court of Justice is necessary. It must convince the national court that its arguments are well-founded and that there is a real doubt as to the validity of the international agreement. Such an answer to the question of validity must moreover be relevant to the resolution of the dispute before the national court.

*Consequences under international law* – There is no precedent for the annulment of an EU decision concluding an international agreement. However, as a general rule, the invalidity of such an internal act does not affect the validity under international law of the international agreement.<sup>221</sup> The EU and the Member States would continue to be bound to the agreement under international law. However, given invalidity of the international agreement within the EU legal order, it will not have any legal force within the EU legal order. This may result in the EU having difficulties fulfilling its

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<sup>215</sup> Case 314/85, *Foto-Frost v Hauptzollamt Lübeck-Ost* ECLI:EU:C:1987:452, paras. 15-17; in exceptional circumstances, national courts may nonetheless grant interim relief, see Case C-465/93, *Atlanta Fruchthandels-gesellschaft* ECLI:EU:C:1995:369 paras. 29-33.

<sup>216</sup> *Foto-Frost*, para. 14

<sup>217</sup> Case C-344/04 *International Air Transport* ECLI:EU:C:2006:10, para. 32.

<sup>218</sup> Case 83/78 *Pigs Marketing Board v Redmond* ECLI:EU:C:1978:214, para. 25

<sup>219</sup> Case 244/80 *Foglia v Novello II* ECLI:EU:C:1981:302, para. 18.

<sup>220</sup> Paul Craig & Gráinne de Búrca, *EU Law: text, cases and materials* (6<sup>th</sup> edn, Oxford 2015) pages 490-494 Koen Lenaerts, Iğace Maselis and Kathleen Gutman, *EU Procedural Law* (Oxford University Press 2014) at 3.31-3.41

<sup>221</sup> Articles 27 and 46 VCLT.

obligations under international law. As a result, a declaration by the Court of Justice of invalidity of the Council and Commission decisions will compel the EU institutions to remedy the incompatibility of the ECT under EU law by either seeking amendment or withdrawal from the ECT (see *infra* under 3.1 and 3.2).

#### 4.2 Request for an Opinion on a future modernized ECT

Under Article 218 (11) TFEU, a Member State, the European Parliament, the Council or the Commission may request an Opinion of the ECJ on the compatibility of an ‘envisaged’ EU international agreement. The reason for the existence of this Treaty procedure is to prevent complications which would result from legal disputes concerning the compatibility with the Treaties of international agreements binding upon the European Union.<sup>222</sup> Requesting an Opinion therefore also has benefits for the EU’s international partners. By making a request for an Opinion, therefore, these three institutions or the Member States can avoid legal and political difficulties with the EU’s international partners if the modernized ECT were found to be incompatible with EU law. It has been used increasingly in the past decades by EU institutions and Member States alike.<sup>223</sup> Indeed, Belgium has already made such a request for an Opinion in relation to the modernised ECT in relation to the application of Article 26 ECT to intra-EU disputes.

The Court can only issue Opinions in relation to an ‘envisaged agreement’. This means that neither agreements in force, nor initiatives for an international agreement that are still in their infancy can be part of an Opinion. The Court has made clear that it needs ‘sufficient information on the actual content of the agreement’ in order to be able to deliver an Opinion on an ‘envisaged agreement’.<sup>224</sup> In that sense, the Court needs a draft text of the relevant provisions of the agreement in order to be able to deliver an Opinion on the compatibility of an international agreement with EU law.

#### Conclusion

The ECT was negotiated in the early 1990s and entered into force in 1998. As such, it contains one of the strongest investment provisions and dispute settlement provisions ever negotiated, limited to one albeit highly significant sector (the energy sector). In terms of numbers, it remains by far the most popular investment agreement used by investors to settle disputes with states. Unlike other investment agreements from this era, the EU itself is party to the ECT. This makes the ECT from the perspective of EU law an outlier: it was negotiated long before the EU gained competence over foreign direct investment under its common commercial policy and long before the EU sought to develop its own investment law policy and reform of the system of international investment law. It was also negotiated before the case-law of the Court of Justice clarified the boundaries for the EU’s submission to international dispute settlement systems, including ISDS. Not only from a policy perspective, but also from the perspective of its compatibility with EU law the ECT is therefore outdated.

This study concludes that the ECT is incompatible with EU law for the following reasons:

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<sup>222</sup> *Opinion 1/75* ECLI:EU:C:1975:145.

<sup>223</sup> M Cremona, ‘The Opinion procedure under Article 218(11) TFEU: Reflections in the light of Opinion 1/17’ 4 (1) *Europe in the World: A Law Review*.

<sup>224</sup> *Opinion 1/09* ECLI:EU:C:2011:123 para.49-52; *Opinion 2/94* ECLI:EU:C:1996:140, para. 20.

- *Autonomy of EU law* – The EU can only be party to an international agreement that provides for international dispute settlement binding on the EU if there is no adverse effect on the EU legal order. This means that the investment tribunals established on the basis of the ECT cannot have jurisdiction to interpret and apply rules of EU law other than the provisions in the ECT itself.

However, in *Komstroy*, the ECJ already clarified that tribunals set up under Article 26 ECT are ‘required to interpret, and even apply, EU law’.<sup>225</sup> Moreover, the safeguards introduced in CETA that the Court assessed in *Opinion 1/17* are not part of the ECT. The ECT does not stipulate that EU law can only be taken into account as a matter of fact or that the tribunals must follow the prevailing interpretation of EU law given by the Court of Justice or the EU institutions. Nor does the ECT specify that domestic courts, including courts of the Member States, are not bound to the interpretation given of EU law by these tribunals.

- *Regulatory autonomy of the EU* – Importantly, in *Opinion 1/17*, the Court introduced an additional element to the concept of autonomy of EU law. The EU cannot conclude international agreements that contain dispute settlement provisions if such tribunals would be able to significantly affect the independence of the EU institutions involved in the legislative process. The ECT contains the same problematic features as the CETA assessed in *Opinion 1/17*: a broad definition of investment, compulsory jurisdiction for tribunals, measures of general application may be challenged, and binding nature of awards. However, unlike the CETA, the ECT as it stands today does not contain any of the safeguards introduced in CETA to preserve the regulatory autonomy of the EU.

The text proposal of the EU of May 2020 does not fully remedy these incompatibilities. It does introduce several similar safeguards to that of the CETA that seek to preserve the regulatory autonomy of the EU, but it does not introduce all such safeguards and it does so in relation to a different agreement. The text proposal of the EU of May 2020 therefore is not guaranteed to be compatible and can be best subjected to an Opinion of the Court under Article 218 (11) TFEU in particular if the EU’s text proposals are not fully accepted by the other parties to the ECT. Any deviation from the standards set in CETA and accepted by the Court in subsequent negotiations increase the risk of incompatibility. The EU’s text proposal on preserving the jurisdictional autonomy of EU law by protecting the EU courts’ jurisdiction to interpret and apply EU law, moreover, falls outside the scope of the current negotiations for modernisation of the ECT. It is therefore highly uncertain whether this crucial text proposal will be part of any final draft text. In addition, the EU’s text proposal does not address intra-EU arbitration. This stands in contrast with the list of issues identified by the Energy Charter Conference in November 2018 to form part of the modernisation discussions, which included a reference ‘to consider which ECT provisions (if any) should not apply among members of a REIO’.<sup>226</sup> However, the effects of extra-EU arbitration on intra-EU arbitration and the continuous possibility to pursue intra-EU arbitration outside of the EU are all aspects that raise questions about the compatibility with EU law even of a modernised ECT.

More generally, the lengthy and uncertain process of amendment make all the EU text proposal of May 2020 a questionable option at this stage. These proposals nonetheless make one point abundantly clear: they underline EU legal flaws that exist in the ECT as it currently is in force.

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<sup>225</sup> Case C-741/19, *République de Moldavie v Komstroy LLC* ECLI:EU:C:2021:655, para. 50

<sup>226</sup> Decision of the Energy Charter Conference, Brussels, 27 November 2018 (CCDEC 2018 21 NOT), available at: [https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201821\\_-\\_NOT\\_Report\\_by\\_the\\_Chair\\_of\\_Subgroup\\_on\\_Modernisation.pdf](https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201821_-_NOT_Report_by_the_Chair_of_Subgroup_on_Modernisation.pdf).



The fact that the EU and 26 Member States are party to an international agreement that is incompatible with its own constitutional framework, the EU legal order, is a significant problem. The EU institutions and the Member States are bound by the EU Treaties and will have to take the necessary steps to remedy such incompatibility. Even if they chose to ignore incompatibility in the absence of a judgment to that extent from the Court of Justice, a challenge through a preliminary ruling on the validity of the Council decision concluding the ECT will mean that both the EU institutions and the Member States may be forced to take action after all.

The options under international legal to remedy this incompatibility come down to general amendment, withdrawal from the ECT, inter-se modification, and/or making an additional declaration to the ECT. Of these options the combination of withdrawal, inter-se modification, eliminating the effects of the sunset clause between the withdrawing parties, and an attached interpretative declaration that avoids circumvention of the inter-se modification through relocation to a not withdrawing, non-EU Contracting Party to the ECT appears in this respect the most promising way forward for the EU and the Member States to avoid regime conflict with the ECT.