Komstroy: the beginning of the end for the Energy Charter Treaty?

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On 2 November 2021, the ACELG will hold a webinar on the ECJ's decision in Komstroy *and the future of the Energy Charter Treaty. Please check the 'NADE' section on the ELB for more information.*

Earlier this month, the Court of Justice handed down its judgment in *Komstroy*. The judgment was the latest on the relationship between EU law and international investment law following earlier cases such as *Achmea* (discussed here) and *Opinion 1/17* (discussed here) where the Court demarked the limits under which international investment tribunals can legally operate under EU law. *Komstroy* added explicitly (and rather predictably) that there is no place for intra-EU arbitration proceedings under the Energy Charter Treaty (ECT), a multilateral agreement to which the EU, its Member States (apart from Italy which withdrew in 2016) and third states are parties. Within the EU such disputes must be resolved by the independent judiciary consisting of the EU and Member State courts and

not by external quasi-judicial bodies.

In the words of the ECJ (para 66): The dispute settlement mechanism in 'Article 26(2)(c) ECT must be interpreted as not being applicable to disputes between a Member State and an investor of another Member State concerning an investment made by the latter in the first Member State.'

The investment arbitration industry equally predictably reacted strongly and negatively to the ruling. After all, intra-EU investment arbitration proceedings are a rather lucrative business model. The judgment has been described as 'bafling' reinforcing 'discrimination', and comprising of 'scant and inconsistent reasoning […] based on political considerations rather than a sound and reasoned interpretation of the law'. At the same time, the industry is offering its clients the remarkable view that the judgment does not matter at all for intra-EU investment arbitration proceedings. Investment lawyers are claiming that the judgment 'should have no bearing on an ECT tribunal's jurisdiction' and point to the fact that since *Achmea* 40 arbitration courts have rejected challenges to their jurisdiction 'and will continue to declare them irrelevant in the future'.

This self-serving and ill-advised commentary calls for a few comments itself. We hence first discuss why continuing with intra-EU arbitration despite its illegality under EU law is highly problematic. We then set out why the ECT increasingly manoeuvers States in an impasse, where they cannot meet their climate related international obligations. Finally, we examine why the ECT itself stands in tension with EU law.

Continuing with intra-EU arbitration is a bad idea for everyone except the investment arbitration industry

EU Member States have to comply with EU law and continuing with the application of intra-EU BITs would result in Member States failing to fulfill their obligations under the EU Treaties. This means that:

- First, Member States are obliged to terminate all existing intra-EU investment agreements.
- Second, Member States are obliged to challenge jurisdiction of any tribunal requested by an investor in an intra-EU dispute as EU law precludes the applicability of these agreements.
- Third, Member States are legally bound to deny payment of such awards.
- Fourth, national courts of the EU Member States are legally bound not to enforce such awards.

All four points flows directly from the principle of sincere cooperation (Article 4(3) TEU), which demands Member States, as well as national courts in particular (settled case law; most fundamentally: Simmenthal [1978] EU:C:1978:49, para 24), to take all appropriate steps to eliminate incompatibilities with Union law, arising both from national law and their international obligations. The principle of primacy of EU law is both unconditional and absolute: it applies to all branches of government, to all law of the Member State (including international agreements to which they are party), and needs to be observed immediately.

In particular the fourth point directly flows from the ECJ's case law in *Achmea* and *Komstroy*.

However, it is also in line with the Court's earlier cases finding Member States in breach of a specific expression (Article 351(2) TFEU) of the general loyalty obligation (Article 4(3) TEU) for not renouncing or renegotiating their bilateral investment treaties (BITs) with third states. In these cases Member States still enjoyed the benefits of Article 351 TFEU because non-EU states were involved; the reasoning *a fortiori* applies to legal relations between Member States (see, Commission v Austria, C-205/06, 1–3 and 16–45; Commission v Sweden, Case C-249/06, EU:C:2009:119; Commission v Finland, Case C-118/07, EU:C:2009:715). The obligation to end the incompatibilities with EU law is moreover in line with the relevance of a properly functioning and independent national judiciary as the very essence of the rule of law and the functioning of the judicial dialogue

within the Union and a precondition for the principle of mutual trust (Portuguese Judges case, paras 31-37). In particular the latter case, in combination with the principle of loyalty, amounts to an obligation of the Member States to terminate all international agreements that undermine the core principles on which the EU legal order is built (judicial cooperation, rule of law, mutual trust).

It should be added that Member States have also politically and legally committed to terminate existing intra-EU investment agreements in a general agreement for the termination of Bilateral Investment Treaties between the EU Member States, albeit with the disclaimer that 'the Agreement does not cover intra-EU proceedings on the basis of Article 26 of the ECT. The European Union and its Member States will deal with this matter at a later stage' (recital 10). *Komstroy* clarifies in this regard that the ECT must be seen as a bundle of bilateral obligations and that therefore EU law precludes the ECT from imposing obligations on Member States as between themselves (paras. 64-65).

In this light, the reaction of the investment arbitration industry to continue with intra-EU claims and investment proceedings is remarkable. The industry appears convinced that arbitrators will continue to claim jurisdiction over intra-EU disputes and that therefore claims can still be brought by investors.

Encouraging such legally treacherous (and very expensive) arbitration is simply irresponsible. The arbitration industry can offer little reassurance as to whether its clients might see any money at the end of the day. *Achmea* is crystal clear: enforcement of awards can no longer happen in the EU. National courts are bound to follow this ruling. That is to say: when Member States comply with EU law and refuse to pay any award against them, litigating investors are likely looking to see whether the Member State in question has any assets outside of the EU. In other words, when no court inside the 27 EU Member States recognizes the – under EU law illegal – arbitration award the litigating investor may turn to the booming business of hunting down money outside the EU. One can only imagine the damage that this does to the trust of citizens in national and international institutions and

equality before the law.

The potential protracted legal battles with highly unsure outcomes are – one cannot refrain from adding – above all immensely profitable to the investment arbitration industry itself. Writing hundreds of pages on an award (e.g., on jurisdiction) generally pockets investment arbitrators some 3000 dollars per day (excluding expenses) under ICSID rules alone. Legal fees for the lawyers representing the Member States and investors can reach tens of millions of euros. International investment law, then, perfectly illustrates a point that Charles Dickens made with regard to English law in *Bleak House*:

'The one great principle of the English law is, to make business for itself. There is no other principle distinctly, certainly, and consistently maintained through all its narrow turnings. Viewed by this light it becomes a coherent scheme, and not the monstrous maze the laity are apt to think it. Let them but once clearly perceive that its grand principle is to make business for itself at their expense, and surely they will cease to grumble.'

Continuing with the Energy Charter Treaty at all is a bad idea…

The ECT is an international treaty that was adopted in the 1990s with the purpose of protecting investment in the newly-independent fossil-rich former-Soviet states, which did not have a tradition of democracy, separation of powers and independent judiciaries. Since then, however, the ECT has become a tool used by the fossil fuel industry to delay and hinder much-needed democratically-adopted climate action (see recently and both scientifically and politically authoritatively the 6th report of the International Panel on Climate Change) by States. By relying on the investor state dispute settlement (ISDS) mechanism under the ECT the fossil fuel industry has regularly successfully been able to bypass the domestic constitutionally embedded courts, asking for billions in compensation for 'expected' profits in the face of – in light of widespread climate science, long-looming – decisions to phase out fossil fuels.

With increasing climate action, including actions triggered by successful climate litigation

(see e.g. the Netherlands, Ireland, France, and Germany), States are more and more exposed to such claims for damages. These arbitration claims create a risk of great costs that policy-makers cannot avoid taking into account when taking climate action. States like the Netherlands are squeezed between a rock and a hard place. On the one hand, they have been legally obliged to take climate action (Dutch Supreme Court, Urgenda, 2019) and on the other they face multi-billion-euro claims in arbitration by fossil giants like RWE and Uniper. Needless to add that this was never the intention of the ECT and that the ECT in this way puts factual financial pressure on States to breach their international obligations under the 2015 Paris Agreement.

The investment arbitration industry claims that giving investors an additional right to sue governments for tax payer money is necessary for achieving climate change goals. Investment lawyers often cite ISDS-cases related to private investments in renewable energy. Yet, such claims are based on assumptions that lack evidence. What is more, in relation to existing awards related to renewables investments, no condition was attached to the awards that the tax payer money should go to protecting the environment. Quite to the contrary, it made it more difficult for these states to realize renewables projects as less funds were available and it discouraged them to undertake such projects. Yet, tax payer money is more necessary than ever to achieve climate change goals and invest in energy infrastructure projects in order to achieve the energy transition. The last thing we need is to encourage those investors that are willing to engage in the extra-judicial legal arm-wrestling that is ISDS.

… **and questionable under EU law!**

While *Komstroy* make it crystal clear that the Energy Charter Treaty is not applicable to intra-EU disputes, the judgment does not answer the question whether the ECT as applied to disputes between the EU or Member States on the one hand and investors from outside de EU on the other is compatible with EU law.

All international agreements concluded by the EU and its Member States must be

compatible with the EU Treaties. *Opinion 1/17* has set out the conditions under which agreements containing investment tribunals can be found compatible with EU law. The ECJ held in this opinion that the investment court system (ICS) as introduced under CETA was compatible with EU law. Before Opinion 1/17, one core reason (in addition to several others) to reject the compatibility of external (quasi-)judicial bodies with EU law has been that these bodies undermined the autonomy of EU law and the authority of the ECJ by being able to give binding interpretations of EU law. For this reason, CETA took a four-pronged separation approach: first, the CETA tribunal cannot determine the legality of EU law; second, it treats EU law as fact; third, it follows the prevailing interpretation of the ECJ; and fourth, the EU/ECJ is not bound by the tribunal's decision. Point one and two are meant to normatively disconnect EU law and the ECJ from the decisions of the ICS under CETA – whether these provisions achieve such a disconnection is a different question. Point three aims at lowering the likelihood of substantive differences in interpretation. Point four aims at excluding challenges based on decisions of the ICS.

While a general clause provides that the arbitration tribunal established under the ECT should 'decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law' the ECT does not offer the separation guarantees of CETA. It is not specifically tailored to meet the EU's autonomy concerns and arguably would not meet the ECJ's concerns if it was put to the test. With the legality of the ECT under EU law being doubtful more in general, perhaps the Commission, the Council and the Member States should take seriously the recent petition, signed by 1 million EU citizens already, aiming to end the ECT. This would avoid further protracted legal battles in the future and be a positive step in the fight against climate change.

TOPICS:
ENERGY LAW / EU CONSTITUTIONAL LAW / EXTERNAL RELATIONS / INTERNATIONAL INVESTMENT LAW

3 COMMENTS

LEAVE A REPLY

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