

Moldova v. Komstroy and the Future of Intra-EU Investment Arbitration under the Energy Charter Treaty: What Does the ECT's Negotiating History Tell Us?

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Intra-EU investment agreements and arbitration have been a highly divisive issue in European policy circles for decades. The European Commission has been forcefully pushing for the termination of these agreements since the early 2000s. It criticised inter alia that intra-EU investment agreements and arbitration undermine the European legal order and create inequality among European investors within the Single Market. Many Member States and law firms, in turn, rejected these legal concerns and praised intra-EU investment agreements and arbitration as policy tools to protect European investors against mistreatment in Member States with flawed legal systems and – contested in the economics literature (for an overview see Bonnitcha et al. 2017, pp. 192-193) – to promote investment and economic development in struggling EU economies.

The Court of Justice of the European Union's (CJEU) *Achmea* ruling (C-284/16, 2018), partially, resolved this long-standing debate in that it found intra-EU

investment agreements and arbitration provisions to be incompatible with the EU law principle of mutual trust and autonomy of the European legal order (see blog coverage here). In August 2020, Member States – many somewhat unwillingly – concluded an agreement on the termination of their 190 intra-EU investment agreements in order to comply with the CJEU ruling. Intra-EU investment arbitration, nonetheless, remains possible under the Energy Charter Treaty (ECT). As of late 2020, the ECT has been invoked in 43 extra-EU investment disputes but also in 83 often high-value intra-EU investment disputes. The ECT is not directly affected by the *Achmea* ruling as it is not a pure intra-EU agreement among Member States only but a plurilateral energy trade and investment agreement that the EU and its Member States concluded as a ‘mixed’ agreement with a sizeable number of third countries. The EU herself is bound by the ECT under public international law. Ever since the publication of the *Achmea* ruling, scholars have thus been debating its ramifications for intra-EU investment arbitration under the ECT.

Moldova v Komstroy: The AG Opinion

These discussions entered a new important phase with the publication of the opinion of the Advocate General Szpunar in *Moldova v Komstroy* (C-741/19) in March 2021. In this complex opinion, the Advocate General inter alia assesses the compatibility of Art. 26 ECT, which deals with dispute resolution and notably investment arbitration, with the European legal order. Following the CJEU’s reasoning in the *Achmea* ruling, Advocate General Szpunar concludes that Art. 26 is in all likelihood incompatible with the European legal order in that it undermines its autonomy. The Advocate General explicitly invites the CJEU to take up this opportunity to finally evaluate the compatibility of intra-EU investment arbitration under the ECT and to conclude this long-standing debate.

The Negotiating History of the ECT: Why Mixed Ratification without Disconnection Clause?

The time is thus ripe to take a look at the negotiating history of the ECT (1990-98) and address a number of salient questions in view of the upcoming CJEU ruling: What was the original purpose of the ECT? Why did the EU and Member States

conclude this treaty as a 'mixed' agreement arguably providing for its intra-EU application today? Why did they not include a disconnection clause to shield intra-EU relations from the ECT? And what does all that mean for reform options to modernise the ECT? I will address these questions in turn below. A more detailed account of the ECT negotiating history and its implications for intra-EU investment arbitration can be found in my recent article in the *Journal of International Economic Law*.

The EU and her Member States conceived the ECT project in 1990 to promote political-economic integration between Western Europe and the Soviet bloc in Central and Eastern Europe and Eurasia. The ECT project indeed echoed the very founding idea of the European Coal and Steel Community to foster peace and friendship among historically antagonistic states through energy cooperation and economic integration. While the EU and Member States were hoping to turn their Eastern neighbours into stable and peaceful democracies and improve access to Soviet energy resources and markets, the Soviet Union and Central and Eastern European countries were hoping to attract badly needed foreign direct investment, hard currency through energy exports and Western know-how to stabilise their faltering economies. To attain these objectives, Western and Eastern European policy-makers agreed that the ECT should contain *inter alia* rules on energy trade, investment liberalisation and provisions on investment protection and arbitration. The EU and its Member States thus approached the ECT negotiations with an outward-looking perspective – much like the EU negotiates trade and investment agreements with Australia, India or China nowadays – and indeed negotiated with a 'single voice' vis-à-vis notably the Soviet Union and then Russia. Individual Member States only exceptionally took the floor and left negotiating mostly to the European Commission and Council Presidency.

Why then did the EU and Member States conclude the ECT as a 'mixed' agreement, which arguably provides for its intra-EU applicability nowadays? This answer lies in the EU-internal allocation of competences and ECT negotiating dynamics. While the EU manifestly sought to appear as a cohesive unitary international actor vis-à-vis the Soviet Union and its Eastern neighbours, it was nonetheless clear that both the EU and the individual Member States would have to accede and ratify the ECT. The EU held an exclusive competence over trade as well as shared and fringe competences over capital movements, energy, transport and environmental matters. The Member States, in turn, remained competent over

foreign direct investment, investment protection, services trade and alike. The breadth of the ECT thus made a 'mixed' ratification unavoidable – notably in that the allocation of competences in foreign economic relations was a highly sensitive topic in the early 1990s as CJEU Opinion 1/94 illustrates.

To avoid any misconceptions, the EU delegation insisted that the ECT should not govern intra-EU trade and investment relations. It proposed a disconnection clause that clarified that in as far as applicable European law rather than the ECT should govern intra-EU trade and investment relations. This draft disconnection clause, however, at some point disappeared from the negotiating documents and did not become part of the final ECT text. Why is that? Here we enter the realm of speculation though some informed guesses are possible. Towards the end of the core negotiations in 1993/94, the US, EU and Russia zeroed in on a number of challenging negotiating items. The USA demanded an ECT carve-out for her federal states. The EU, in turn, insisted on disconnection and Regional Economic Integration Organisation (REIO) clauses. Russia, finally, started growing weary of the ECT's ramification for its energy sector and sovereignty and demanded a lengthy transition period to gain more experience with Western economic law and schedule its final investment liberalisation commitments. Each of these demands was met with considerable hesitation from the other parties. Discussions got so tense that the USA ultimately walked away from the negotiations. These developments created a sense of urgency among EU negotiators to avoid that Russia would follow suit. It seems possible that the EU thus dropped its demand for disconnection clause to speed up the conclusion of the negotiations and probably assumed that it was unlikely for the ECT to get successfully invoked in intra-EU relations and disputes. One should indeed recall here that investors had filed only a handful of disputes in the first half of the 1990s.

Concluding Remarks: What Way Forward?

These observations are noteworthy. While we do not know with certainty why the EU dropped its demand for disconnection clause, we do know that the EU initially proposed such a clause and that the ECT parties considered it but that the final treaty text does not contain one. The European Commission's recent claim that the ECT contains an 'implicit' disconnection clause and cannot be applied in intra-EU disputes is thus unconvincing against the background of the *travaux préparatoires*.

It is unclear how the CJEU will tailor these observations into its legal assessment in *Moldova v Komstroy* or indeed Belgium's recent request for Opinion 1/20 on the modernisation of the ECT. After all, the CJEU's reasoning in *Achmea* leaves little doubt that intra-EU arbitration is incompatible with the European legal order. Nonetheless, the EU has manifestly entered into a public international law commitment to that effect. The situation is certainly complex from a legal point of view.

From a political point of view, the situation looks somewhat clearer. The EU will need to take action to stop the intra-EU applicability of the ECT in that it is legally and politically unsustainable. To that end, the EU and Member States could either terminate their ECT membership. Or they could seek the inclusion of a disconnection clause as part of ongoing ECT modernisation negotiations. The second option may seem more appealing to many European policy-makers and lawyers. Though, two important caveats apply. First, third countries may oppose such a disconnection clause. Second, a reformed ECT with arbitration provision in all likelihood will need to undergo mixed ratification due to the CJEU's findings in Opinion 1/15. Many Member State parliaments and the European Parliament may have little appetite to ratify an agreement with conventional investor-to-state dispute settlement (ISDS) provisions and insist on replacing conventional ISDS with the EU's new Investment Court System. Yet, convincing all ECT parties of the Investment Court System may show difficult. Finally, it needs mentioning that Russia stopped provisionally applying the ECT in 2009. From the EU's point of view the ECT thus lost its historic *raison d' être*, which was to embed Russia into a rules-based regional energy framework. Instead, in the context of Brexit and the clampdown on intra-EU investment arbitration, the UK is likely to turn into a hub for energy investments and disputes against the EU and Member States putting additional strain on already delicate post-Brexit relations. In sum, the question arises whether the balance of costs and benefits under the ECT is still positive from the EU's perspective. *Moldova v Komstroy* may turn out to be a moment of reckoning for the EU and ECT.