Case C-741/19: The CJEU decides that intra-EU ECT arbitration is incompatible with EU law and interprets the definition of "investment" in the ECT

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On 2 September 2021, in its judgment in Case C-741/19, *Republic of Moldova* v. *Komstroy LLC*, the Court of Justice of the European Union ("CJEU") decided that intra-EU arbitration under the Energy Charter Treaty ("ECT") is incompatible with EU law. It also gave a restrictive interpretation to the definition of "investment" in the ECT.

The CJEU was seized by a request for a preliminary ruling from the Paris Court of Appeal which was hearing an action to annul the arbitral award which had been rendered by an ECT tribunal established to hear a dispute between the Republic of Moldova and Energoalians, a Ukrainian distributor.

Despite the fact that the underlying award involved the application of the ECT to a dispute between an investor from a non-EU country (Ukraine) and another non-EU country (Moldova), the CJEU nonetheless confirmed its jurisdiction to interpret the ECT. Moreover, notwithstanding that the dispute did not involve an investor of one EU Member State acting against another EU Member State regarding an investment made by the former in the latter (an "intra-EU dispute"), the CJEU found that Article 26(2)(c) of the ECT must be interpreted as being inapplicable to intra-EU disputes. It adopted a reasoning similar to that developed in its 2018 *Achmea* judgment (see our client alert). In doing so, the CJEU also reached the same conclusion as Advocate General Szpunar in his Opinion and appeared to pre-empt the question of the compatibility of the draft modernised ECT with the EU Treaties, currently pending before the CJEU in Opinion 1/20.

Of the three questions referred by the French court, the CJEU limited its analysis to the first question. It interpreted the term "investment" as excluding "the acquisition, by an undertaking of a Contracting Party to [the ECT], of a claim arising from a contract for the supply of electricity, which is not connected with an investment, held by an undertaking of a third State against a public undertaking of another Contracting Party to that treaty".

Factual background

Energoalians, a Ukrainian electricity supplier, sought to recover debts of around EUR 13.7 million from Moldtranselectro, a Moldovan State-owned enterprise. The money was due as a result of a contract for the provision of electricity (by a company with its seat in the British Virgin Islands which are not a party to the ECT) on the Ukrainian side of the Moldovan-Ukrainian border in 1999 and 2000.

After failing to obtain relief before either the Moldovan or Ukrainian courts, Energoalians resorted to investor-State arbitration under Article 26 of the ECT, claiming that Moldova had breached its obligations under the ECT. An *ad hoc* arbitral tribunal seated in Paris (France) was established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). In its award of 25 October 2013, the ECT tribunal held that Moldova had failed to comply with the ECT and required it to pay the debt to Energoalians.

The Republic of Moldova filed an action for annulment of the arbitral award before the Court of Appeal of Paris, arguing that the tribunal lacked jurisdiction. The Court of Appeal of Paris agreed and annulled the award. Subsequently, following an appeal brought by Energoalians' successor company Komstroy, the French Cour de Cassation found that the Court of Appeal had misinterpreted the term "investment" and referred the case back to the Court of Appeal. The latter then considered it necessary to seek a preliminary ruling from the CJEU on three questions relating to the interpretation of the term "investment" in the ECT:

1. Must Article 1(6) of the ECT be interpreted as meaning that a claim which arose from a contract for the sale of electricity and which did not involve any economic contribution on the part of the investor in the host State can constitute an "investment" within the meaning of that article?

2. Must Article 26(1) of the ECT be interpreted as meaning that the acquisition, by an investor of a Contracting Party, of a claim established by an economic operator which is not from one of the States that are Contracting Parties to that treaty constitutes an investment?

3. Must Article 26(1) of the ECT be interpreted as meaning that a claim held by an investor, which arose from a contract for the sale of electricity supplied at the border of the host State, can constitute an investment made in the area of another Contracting Party, in the case where the investor does not carry out any economic activity in the territory of that latter Contracting Party?

The CJEU confirms its jurisdiction to answer the preliminary questions

The CJEU first assessed whether it had jurisdiction to answer the questions, taking into account that the underlying dispute concerned a third State and an investor of another third State. The Council, three EU Member States and Komstroy had argued that the CJEU lacked jurisdiction because such a dispute did not fall within the scope of EU law.

The CJEU disagreed. The starting point for the CJEU's extensive analysis of this question was the well-established case-law, according to which the CJEU has jurisdiction to interpret international agreements concluded by the European Union. The fact that an agreement is mixed (meaning that it was concluded by the European Union and the EU Member States) did not exclude that jurisdiction. Thus, in principle, the CJEU enjoys jurisdiction to interpret a mixed international agreement, such as the ECT.

Next, the CJEU recognised a limitation to that jurisdiction in cases where the interpretation of an international agreement, and especially its application to a dispute, arises in the context of a dispute that is not covered by EU law. However, that limitation was not an obstacle in the present case. *First*, because the provisions of the ECT may also apply to situations falling within the scope of EU law, there is an EU interest in the uniform interpretation of the ECT "to forestall future differences of interpretation". The CJEU offered the example of the same interpretive questions arising before an EU Member State court (either a court of the seat of arbitration or the courts of the respondent EU Member State) which is asked to consider an action to set aside an award concerning a dispute between an investor of a third country and an EU Member State. *Second*, in the present circumstances, the parties' choice of Paris as the seat of arbitration meant that French law became applicable to the dispute "under the conditions and within the limits laid down by that law". As a result, EU law also became applicable because the French courts must comply with EU law. Moreover, if those courts consider that there is a need for a preliminary ruling on questions concerning EU law, the CJEU must, in principle, give such a ruling. *Third*, the CJEU distinguished this case from previous cases in which it had ruled that the fact that the request for a preliminary ruling emanated from a court or

tribunal of a Member State was insufficient to conclude that the CJEU had jurisdiction to interpret the Agreement on the European Economic Area (EEA Agreement). The distinguishing factor was that those cases concerned the application of the EEA Agreement to situations falling outside the EU legal order because they related to a period prior to the EU accession of the States where the referring courts were located.

The CJEU considers that the arbitration clause in Article 26(2)(c) of the ECT does not apply to intra-EU disputes

Notwithstanding that the underlying dispute was *not* an intra-EU dispute and that the procedure in Opinion 1/20 is ongoing, the CJEU considered that Article 26(2)(c) of the ECT cannot apply to intra-EU disputes.

The relevance of addressing that question was explained as follows. *First*, several EU Member States intervening in the proceedings apparently raised this issue. *Second*, given that the term "investment" (on which the questions referred had focused) also appeared in Article 26 of the ECT and thus determined the type of dispute that may be subjected to arbitration, the CJEU deemed it necessary to "specify which disputes between one Contracting Party and an investor of another Contracting Party concerning an investment made by the latter in the area of the former" could be subjected to arbitration. *Third*, referring to its assessment of its jurisdiction in the present proceedings to interpret the ECT, the CJEU stressed that Article 26(2)(c) of the ECT is designed to apply also to a dispute between an investor from one EU Member State and another EU Member State.

In relation to the substance of the CJEU's decision, this was entirely predictable (even without the Advocate General's Opinion). The CJEU applied, in essence, the same reasoning developed in its *Achmea* judgment which concerned intra-EU arbitration under bilateral investment agreements concluded between two EU Member States.

As in *Achmea*, the CJEU focused its analysis on the need to protect the autonomy of the EU legal order (which results from the European Union's unique constitutional framework) and the central role of the preliminary ruling procedure in safeguarding the uniform interpretation of EU law. In a three-step analysis, the CJEU assessed whether the arbitration clause in the ECT undermines these principles.

First, the CJEU focused on the applicable law clause in Article 26(6) of the ECT. That clause states that an arbitral tribunal must decide the issues in dispute "in accordance with [the ECT] and principles of international law". Given that the ECT itself is an act of EU law, that tribunal must interpret and apply EU law.

Second, the CJEU determined that an arbitral tribunal, which does not form part of the EU Member States' judicial system, is not a court or tribunal of an EU Member State within the meaning of Article 267 of the Treaty on the Functioning of the European Union (TFEU). As it result, it may not refer questions to the CJEU for a preliminary ruling.

Third, if an arbitral tribunal itself may not refer questions to the CJEU, the CJEU examined whether the full effectiveness of EU law could be guaranteed by subjecting the award to review by the courts of the EU Member State. Taking into account that French law (as the *lex fori*) envisaged only a limited review of the award (including of the tribunal's jurisdiction), there was a risk that the ECT excludes the full effectiveness of EU law (through the use of the preliminary ruling procedure) in a dispute between an investor of one EU

Member State and another EU Member State that is heard by a tribunal applying EU law. The CJEU also repeated that ECT arbitration under Article 26 is different from commercial arbitration. The distinction relates to the fact that commercial arbitration relies on the consent of the parties whereas ECT arbitration is based on a decision of the EU Member States (and the European Union) to remove certain disputes from the jurisdiction of their own courts and on the remedies which they can provide.

As a result, the CJEU considered that Article 26(2)(c) of the ECT cannot be applied to disputes between an EU Member State and an investor of another EU Member State.

The supply of electricity itself does not constitute an "investment"

The CJEU found that an "investment", within the meaning of Article 1(6), first sentence, of the ECT, must meet two cumulative conditions. It must, *first*, constitute an "asset, owned or controlled directly or indirectly by an investor" and, *second*, that asset must fall into one of the categories listed in Article 1(6) which the CJEU understood to be an exhaustive list. The category in paragraph (c) covers "claims to money and claims to performance pursuant to [a] contract having an economic value and associated with an Investment". Paragraph (f) refers to "any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector".

The CJEU accepted that the debt arising out of a contract for the supply of electricity constitutes an asset directly held by an investor. The fact that Komstroy had acquired the debt from a company established in the British Virgin Islands (which are not party to the ECT) was irrelevant.

However, the CJEU was unable to identify a category of "investment" under Article 1(6) that could apply to the case at hand. In particular, it found that a "mere supply contract is a commercial transaction which cannot, in itself, constitute an 'investment' within the meaning of Article 1(6) ECT, irrespective of whether an economic contribution is necessary in order for a given transaction to constitute an investment".

In addition, the CJEU found that the concept of investment also involves "the immobilisation of resources abroad which, in general, cannot easily be repatriated in the event of a dispute". According to the CJEU, any other interpretation of that provision would amount to depriving of meaning the clear distinction between the ECT provisions relating to "Investment" (Part III of the ECT) and the provisions relating to "Commerce" (Part II of the ECT).

Key take-aways

Wider grip of the CJEU on investment issues

The CJEU's reasoning on jurisdiction results in bringing a wider set of disputes within the scope of the CJEU's jurisdiction. The choice of the seat of arbitration in any EU Member State (and arguably also the fact that an investor seeks to enforce an arbitral award in any EU Member State) triggers the application of EU law because the courts of the *lex fori* must comply with EU law in exercising their jurisdiction, regardless of whether the dispute otherwise has a connection with the European Union.

Furthermore, where that connection can be made and the applicable law includes EU law (which includes an international agreement concluded by the European Union on the basis of which the arbitral tribunal was established), the CJEU has jurisdiction to interpret any relevant provision of that international agreement.

As the substantive part of the CJEU's judgment shows, this entails the risk that the CJEU interprets those agreements differently than the arbitral tribunals established under those agreements.

Even if the CJEU's reasons for accepting jurisdiction to determine the application of the ECT to intra-EU arbitration appear rather stretched, it seems clear that, in taking this approach, the CJEU was in fact driven by a concern to offer legal certainty in respect of a question which was already pending before it because of Belgium's request for an Opinion on this issue (Opinion 1/20). Following the *Achmea* judgment, there was considerable uncertainty surrounding the application of Article 26 of the ECT to intra-EU disputes, particularly against the background of the European Union's proposals to reform the ECT. Still, the CJEU's decision to consider this question in the context of a non intra-EU dispute – given the pending request for an Opinion on the same matter – might cause some EU Member States and EU institutions which did not intervene in Case C-741/19 to express concern that they had not been heard on the matter of extending the CJEU's control on questions of investment.

Arbitral tribunals are not bound by the CJEU's interpretation of the ECT but the impact of the judgment on pending and future proceedings is significant

The judgment of the CJEU makes clear that, as a matter of EU law, Article 26 of the ECT can no longer serve as a legal basis for the *ad hoc* arbitration of intra-EU investment disputes relating to the energy sector. It also confirms, regardless of any other EU link, the application of EU law to any ECT investment arbitration with a seat in an EU Member State (and possibly when enforcement is sought in one of the EU Member States).

The CJEU's interpretation of the ECT is binding on the EU Member States and their courts. However, that interpretation does not have the same effect for the other non-EU ECT Parties and their courts (seized on matters relating to the recognition or enforcement of ECT arbitral awards) as well as the arbitral tribunals which are established to consider the ECT itself. The latter might consider that the *Komstroy* judgment, similar to the *Achmea* judgment, operates exclusively within the EU legal order and, as long as the text of Article 26 of the ECT remains the same, does not affect their jurisdiction.

Yet, even if arbitral tribunals hearing intra-EU disputes ignore the *Komstroy* judgment or dismiss its relevance, recognition and enforcement of their awards in any of the EU Member States is doubtful. Although the CJEU, in Case C-333/19, might decide to clarify the scope of EU Member States' obligations under the International Centre for Settlement of Investment Disputes (ICSID) Convention as well as the impact of EU law on the enforcement of ISCID awards, it has not to date addressed these issues in a case where an arbitral award has been issued pursuant to the ICSID Convention and whether the *ad hoc* annulment review for which the ICSID Convention provides in relation to ICSID disputes might alter its assessment. The reasoning developed in this judgment, as well as the *Achmea* judgment, nonetheless suggests that the conclusion would likely remain the same, taking into account that the ICSID Convention's *ad hoc* annulment review does not offer an opportunity to ask the CJEU for a ruling on the meaning of EU law.

The post-Achmea solutions might be insufficient or unavailable to manage the consequences of the Komstroy judgment

Following the *Achmea* judgment, the EU Member States negotiated and concluded a plurilateral agreement. That agreement terminated the EU Member States' intra-EU BITs and addressed key

transitional issues regarding the status of pending intra-EU investment disputes and the initiation of new arbitral proceedings. However, it did not apply to the ECT.

The solutions offered by the plurilateral agreement – of which the effectiveness still needs to be tested in practice – cannot simply be transposed to the ECT. Third States are also a party to the ECT and the ECT limits the effects of any subsequent *inter se* agreement between two or more Parties, such as the European Union and some of its Member States (see, for example, Article 16 of the ECT). Furthermore, any amendment of the ECT or formal interpretation of Article 26 of the ECT depends not solely on the support of the European Union and its Member States but also requires other States' support. A modernisation process for amending the ECT is already underway. However, the applicability of Article 26 of the ECT to intra-EU disputes is currently not included in the Council's negotiation directives or the list of topics where modernisation is needed.

Another option is that the European Union and its Member States withdraw from the ECT. That solution would affect only future proceedings and, in any event, appears, at this stage, to be excessive. However, if attempts to modernise and "green" the ECT were to fail, the European Union and its Member States might, in any event, consider the option of withdrawal.

The CJEU's definition of "investment" strengthens the need for clarification of the scope of Article 1(6) of the ECT

In contrast to prior BIT jurisprudence on the definition of "investment", the CJEU has interpreted the list of categories of investments described under Article 1(6) of the ECT as being exhaustive. This reading of Article 1(6) might not be shared by other parties to the ECT or by arbitral tribunals established under the ECT. In fact, the European Commission itself appears to support a broader interpretation of Article 1(6) because, in the text that it proposed for the modernisation of the ECT, it supports the view that the categories listed in Article 1(6) of the ECT are only certain "forms that an investment may take" and it continues to use the verb "include" prior to the list of categories of investment. However, since the CJEU's decision is binding on the courts of EU Member States, there remains a real risk that where a court of an EU Member State is called upon to consider the definition of "investment" under the ECT (whether upon the set-aside or the enforcement of an arbitral award) it will now be required to apply the restrictive interpretation set out by the CJEU in its *Komstroy* judgment.

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