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Compatibility of the Provisions Relating to the Protection of Investments Contained in the Energy Charter Treaty with EU Legislation

(Case Study Komstroy LLC v. Republic of Moldova)

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Abstract: *On September 21, 2021, the decision of the Court of Justice of the European Union (CJEU) rendered its verdict in Komstroy v. Moldova. In this case the Court ruled that the dispute resolution mechanism provided for by the Energy Charter Treaty (TCE) [Article 26 paragraph (2) c)] cannot be applied to intra-EU disputes, as it is incompatible with European law on the matter. On the same occasion, it also found that an assignment of a claim resulting from an electricity supply contract does not constitute an "investment" within the meaning of the provisions of article 1 para. 6 and of article 26 para. 1 of the TCE.*

Keywords*: investment, arbitration, incompatibility, EU legislation*

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1. Introduction

With the expansion of the phenomenon of globalization and the ever-accelerating development of commercial exchanges, the number of treaties containing investment provisions has grown exponentially, from a few dozen in the mid-1950s to over 2,000 today. At the same time, at the global level, the accentuation of the phenomenon of regional economic integration was carried out through the emergence of political-economic integration bodies that give the member states the levers and mechanisms necessary for the development of the economic framework. This is achieved through the liberalization of trade in goods, services, the free movement of capital, of people and labor.

Of all these organizations, the best known and the one with the greatest global relevance is the European Union. Since its establishment, the Union has had as its objective the achievement of a closer cooperation between the member states than that resulting from traditional bilateral or multilateral relations or from membership in economic cooperation organizations. Based on a set of well-established rules, the European construction accentuated the degree and progressively the difference between what we today call a "common market" and a simple free trade area or an ordinary customs union.

The entry into force of the Treaty of Lisbon (2009) led to discussions on the issue of possible incompatibilities between an international treaty to which a member state became a party prior to accession and its obligations arising from European norms. One of the essential aspects on which the European Commission and the EU member states have failed to identify a common point of view on the topic was maintaining in force the treaties with an investment component concluded in the pre-accession phase and the issue of applicable jurisdiction in arbitral disputes. Disputes between investors and the host states became more difficult to manage result of the existence of a conflict between the provisions of European law and those contained in the investment treaties, represents

The only compromise solution that found, suitable for all parties involved, was the conclusion of an intergovernmental Treaty between the EU member states for the exit, from force, in a coordinated manner of the intra-EU investment treaties. On May 5, 2020, 23 member states, including Romania, signed the Agreement on the termination of bilateral investment treaties between EU member states. The Agreement will produce effects for each signatory state separately, only from the date of its ratification, and only in the relationship between the member states that, in turn, have ratified the Agreement.

2. Basis of the Dispute

Pursuant to a series of contracts entered into during 1999, Ukrenergo, a Ukrainian power producer, sold electricity to Energoalians, a Ukrainian distributor, which resold this electricity to Derimen, incorporated in the British Virgin Islands, which resold to in turn the respective electricity to Moldtranselectro, a Moldovan public enterprise, in order to export it to Moldova.

The volumes of electricity to be supplied were defined each month directly between Moldtranselectro and Ukrenergo. The same electricity was thus supplied by Ukrenergo to Moldtranselectro during the years 1999 and 2000, except for the months of May-July 1999, according to the "DAF Incoterms 1990" conditions, namely up to the border separating Ukraine from the Republic of Moldova, on the Ukrainian side.

Derimen fully paid to Energoalians the sums owed for the electricity thus purchased, while Moldtranselectro only partially paid the sums owed to Derimen for this electricity.

On May 30, 2000, Derimen assigned to Energoalians the claim it had against Moldtranselectro. Moldtranselectro only partially paid the debt to Energoalians, ceding the the rest of the debt.

Energoalians tried, unsuccessfully, to obtain payment of the balance of this debt, in the amount of 16.287.185, 94 (USD) (approximately 13,735,000 euros), by referring the case to Moldovan courts and subsequently, to the Ukrainian courts. Considering that certain behaviors of the Republic of Moldova in this context constituted serious violations of the obligations arising from the Energy Charter Treaty (ECT),[1] Energoalians initiated the ad hoc arbitration procedure provided for in Article 26 paragraph (4) letter (b) of this treaty. Through a decision delivered in Paris on October 25, 2013, the ad hoc arbitral tribunal set up to resolve this dispute found jurisdiction and, judging that the Republic of Moldova had violated its international commitments, ordered it to pay a sum of money to the Energoalians company under the ECT.[2]

The Paris Court of Appeal, mandated to enforce the arbitral award, submitted a preliminary question to the CJEU regarding the notion of "investment" as

[1] The Energy Charter Treaty, concluded in Lisbon on December 17, 2014. Text available at: https://lege5.ro/Gratuit/heydsmbw/tratatul-cartei-energiei-din-17121994?pid=23813291#p-23813291.
[2] CJEU judgment of September 2, 2021 in case C 741/19 (Republic of Moldova vs. Komstroy LLC) para. 8-20, available at: https://curia.europa.eu/juris/document/document.jsf;jsessionid=9DBEFD665CE2DFCC86767862E57F79D1?text=&docid=245528&pageIndex=0&doclang=RO&mode=lst&dir=&occ=first&part=1&cid=4416691.

defined in the Energy Charter Treaty. During the debates, the issue of the jurisdiction *ratione materiae* that the court would have had over the plaintiff's contractual rights was raised and, more precisely, whether the assignment for consideration of a claim arising from an electricity supply contract constitutes an "investment" based on ECT provisions.[1]

Although the dispute was between a non-EU investor and a non-EU member state, during the process, the European Commission and several EU member states raised the issue of the applicability of the provisions of the Charter to intra-EU disputes. In his reasoned opinion, Advocate General Szpunar brought into question the compatibility of arbitration based on the ECT with European legislation on the matter, especially with regard to disputes that present elements of intra-EU interest.

3. The reasoning applied by the Court

The jurisdiction of the CJEU over the dispute was contested, both by the applicant and by several member states. However, the Court claimed that it has jurisdiction in the case, based on Article 267 of the TFEU,[2] given that that the questions received referred to the notion of investment[3] and according to European regulations, this type of activity is part of common commercial policy, an area under the exclusive competence of the EU.[4]

Although the CJEU recognized that, in principle, it does not have jurisdiction to interpret the application of the provisions of a multilateral treaty in the context of extra-EU disputes, it nevertheless assigned jurisdiction for the following reasons:

- the EU's interest in the uniform interpretation of the provisions that are the subject of the dispute and,
- the fact that the seat of the arbitration was Paris, France, a circumstance that obliged the French courts to apply EU law, and the Court, in its capacity as guardian of the treaties, supervises compliance with EU law in accordance with Article 19 of the TEU.[5]

[1] Ibidem, para 20 &39 "Whether Article 26(1) ECT shall be interpreted in a sense that a debt arising from an electricity sales contract delivered to the border of the host State can be regarded as an investment made "in the area" of the host State, where no economic activity has actually been carried out on its territory".
[2] Ibidem, para 22.
[3] Ibidem, para 25.
[4] Ibidem, para 26.
[5] Ibidem, para 34.

The Court noted that, in order to answer the question, it first had to clarify which disputes can be submitted to arbitration under Article 26(2)(c) ECT.[1] Then, while admitting that the arbitral dispute brought to trial was an extra-EU dispute, the CJEU held:

- That this does not prevent its jurisdiction and,
- There cannot be a legal presumption that the provisions of art. 26 paragraph (2) letter (c) of the Energy Charter, according to which state-investor disputes can be settled by recourse to arbitration, would similarly apply to intra-EU disputes.[2]

Subsequently, the CJEU carefully followed its reasoning in the Achmea case, recalling the autonomy of the EU legal system and the need to preserve it, in particular by establishing a judicial system that ensures coherence and uniformity in the interpretation of EU law. Then, it examined whether the conditions established in Achmea are met for arbitration, as a means of resolving state-investor disputes, to be compatible with EU law.[3]

In the case of Article 26 TCE, the CJEU mentioned that:

- The arbitral tribunals established pursuant to Article 26 paragraph (6) of the TCE will be in a position to interpret or even apply EU legislation;
- Arbitral tribunals do not belong to the EU judicial system and cannot be considered as a court of a Member State within the meaning of Article 267 of the TFEU and
- Decisions rendered under Article 26 TEC are not subject to review by a court of a Member State capable of ensuring full compliance with EU

[1] ART 26 ECT„... if such disputes cannot be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution: (a) to the courts or administrative tribunals of the Contracting Party party to the dispute; (b) in accordance with any applicable, previously agreed dispute settlement procedure; or (c) in accordance with the following paragraphs of this Article.", disponibil la https://www.energychartertreaty.org/provisions/article-26-settlement-of-disputes-between-an-investor-and-a-contracting-party/262.

[2] Komstroy LLC v. Republica Moldova**,** para. 41.

[3] CJEU Decision of 18 March 2018 in the case C 284/16 (Achmea BV v. Slovakia). In short, the Court's held the following: the existence of the arbitration clause in a bilateral treaty for the protection and promotion of investments would lead to: i) denying the Court's exclusive right to rule on issues related to the interpretation of EU law (art. .276 TFEU); ii) would violate the obligation assumed by the member states not to submit a dispute regarding the interpretation or application of the fundamental treaties to a different solution than those provided for by them (art. 344 TFEU), available at https://curia.europa.eu/juris/document/document.jsf?text=&docid=199968&doclang=Ro ; see also Carmen Tamara Ungureanu "European Private International Law in International Trade Reports" Hamangiu publishing house, Bucharest, 2021, pp.230-236.

law and guaranteeing that, if necessary, questions of EU law can be referred to the CJEU for a preliminary ruling.[1]

Turning then to the original question of the French court, the CJEU considered that "the assignment for consideration [...] of a claim arising from an electricity supply contract, [...] does not constitute an "investment" within the meaning of [articles 1 (6) and 26 (1) TCE."

The CJEU analysis focused on two issues related to the definition of "investment", as it appears in art. 1 paragraph (6) of the TCE, namely:

- If the debt assignment represents an "investment", as defined in the first paragraph of Article 1 paragraph (6) of the TCE, respectively: "any kind of asset, owned or controlled directly or indirectly by an investor" including one of the elements listed in letters a-f of art. 1;
- If the energy supply contract is an act related to the performance of an economic activity according to the provisions of part II of ECT (titled "Trade"), which includes articles 3 to 9 ECT.

To the first question, the Court's answer was negative: although the first condition (the existence of an "investor") is met, the asset in question does not constitute an investment according to the provisions of article 1 paragraph (6) letters (a-f). At the same time, the assignment of a claim resulting from an electricity sales contract cannot, in itself, be equated with carrying out an economic activity in the energy sector, in accordance with the provisions of art. 1. (f) of TCE. Moreover, the original litigation does not concern matters derived from an "investment", as this term is defined in art.1 TCE, since the contractual relationship refers only to the supply of electricity, not to its production, being therefore a commercial transaction that cannot constitute, in itself, an investment.[2]

4. Brief considerations on the Court's decision

First, the Court's Decision raises certain questions regarding its jurisdiction. Was the CJEU competent to rule on the validity of TCE arbitration in intra-EU disputes? It is important to note that, according to the current regulations, a preliminary question must concern the interpretation or validity of EU law,

[1] CJEU had on numerous occasions the opportunity to rule on the right of arbitral tribunals to formulate preliminary questions. In the cases of Handels- og Kontorfunktionoerernes Forbund v. Danmark, (109/88, EU:C: 1989:383) Ascendi Beiras Litoral e Alta& Auto Estradas das Beiras Litoral e Alta v. Autoridade Tributária e Aduaneira (C-377/13, EU: C:2014:1754), Merck v. Canada (C-555/13, EU:C:2014:92) the Court accepted the preliminary references formulated by the respective arbitral tribunals.

[2] Komstroy LLC v. Republica Moldova, para. 55-70.

applicable in the original case, the CJEU not being able to rule if EU law is not applicable to the main case.[1] On the other hand, as can be easily observed, in the present situation:

- the question addressed to the CJEU did not refer to an intra-EU dispute, and EU legislation is not directly applicable in the case and,
- the arbitration dispute does not involve elements that harm the public policies of the EU.

Another issue, equally important, concerns the reaction of the arbitral tribunals tasked with resolving disputes based on the provisions of the Energy Charter. Even after the CJEU decision in the Achmea case, several arbitral tribunals refused to recognize its effects on intra-EU arbitrations, leading to the need to negotiate a treaty to terminate intra-EU investment agreements.[2] Considering the similarities in the reasoning of the CJEU, we could expect that the tribunals constituted in intra-EU ECT arbitrations would react in the same way, a fact explained by the existence of two distinct jurisdictions – International Law and European law.

A third issue that arises in practice is the recognition outside the European Union of arbitral awards made by arbitral tribunals on the basis of the Energy Charter Treaty, respectively of those relating to intra-EU disputes. According to the current regulations, the investor can demand the compulsory enforcement of the arbitral award, either based on the ICSID Convention (1965)[3] or based on the New York Convention of 1958. According to their provisions, although the recognition of the arbitral award is mandatory, its enforcement it remains at the discretion of the state in which this is requested. Although non-EU states parties may invoke arguments of public order not to enforce an arbitral award bearing on an intra-EU dispute, there is also the possibility that some courts in ICSID member states, approached with a request for enforcement, approve its implementation.

With regard to recognition within the European Union, from the perspective of EU primacy, it is very likely that the approach of the courts of the EU

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[1] https://eur-lex.europa.eu/legal-content/RO/TXT/?uri=LEGISSUM%3Al14552.

[2] See *Vattenfall AB and others v. Germany* ICSID Case no. ARB/12/12. The arbitral tribunal did not take into account the arguments of the European Commission, derived from the CJEU Decision in the Achmea case, considering that the European Union, as a signatory of the Energy Charter, had to foresee the possibility of initiating an intra-EU dispute based on the provisions of the Charter - https://www.italaw.com/sites/default/files/case-documents/italaw9916.pdf;
See also *Georg Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia,* ICSID Case no. ARB/12/39, disponibil la adresa https://www.italaw.com/sites/default/files/case-documents/italaw9887.pdf.

[3] Convention for the settlement of disputes relative to investments between states and nationals of other states from, signed in Washington, on March 18, 1965-art. 55 (Immunity from jurisdiction of states).

member states will be in the sense of refusing to recognize the arbitral award, thus creating legal uncertainty that could only be resolved with the establishment of the future EU Investment Court.

5. Conclusions

The case presented above perfectly illustrates the dilemma that currently exists at the level of the European Union regarding the way of applying some obligations assumed at the international level, but which come into conflict with the European regulations in the matter. If, with regard to the situation of bilateral investment treaties concluded between member states, a solution has been identified through the negotiation and signing of an intergovernmental treaty to terminate all intra-EU agreements. However, with regard to multilateral treaties whose provisions contravene EU law, specifically the manner in which the obligations undertaken are applied in the territory of the European Union, the debate remains wide open.

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