ECT Arbitration Update: Warning, Restrictions Ahead

6 July 2022

The availability of investor-State arbitration between European Union ("EU") investors and EU Member States under the Energy Charter Treaty ("ECT") has come under threat in recent years after the Court of Justice of the European Union ("CJEU") found such arbitrations to be incompatible with EU law in its in its *Achmea*, *Komstroy*, and *PL Holdings* judgments (as we reported here).[1]

Although ECT tribunals have since continued to uphold jurisdiction over intra-EU disputes, and investors have achieved a measure of success in enforcement outside the EU, this *status quo* is looking increasingly fragile in light of recent developments. The first-known instance of an ECT tribunal declining jurisdiction over an intra-EU dispute on *Achmea*-based grounds, and ECT modernization efforts that narrow the scope of intra-EU investment protection, both portend even greater uncertainty as to the future of intra-EU ECT arbitration.

First Tribunal Declines Jurisdiction on *Achmea*-Related Grounds. On 16 June 2022, a Stockholm-seated tribunal in *Green Power v. Spain*[2] unanimously found that it did not have jurisdiction to hear two Danish investors' claims against Spain, on the basis that intra-EU ECT arbitration is incompatible with EU law. *Green Power* is the first-known award upholding a jurisdictional objection based on the CJEU's *Achmea* and *Komstroy* judgments.

Although the tribunal found that the plain terms of Spain's consent to arbitrate under Article 26(3)(a) ECT were "unconditional" and were not limited "by any carve-out for intra-EU investor-State arbitration," it also found that to stop the analysis there would "ignore the complexities of this case."[3] The tribunal also considered that EU law was

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1 CJEU Judgment of 6 March 2018, *Slovak Republic) v. Achmea B.V.*, C-284/16; CJEU Judgment of 2 September 2021, *Republic of Moldova v. Komstroy*, C-741/19; *Republic of Poland v. PL Holdings Sàrl*, C-109/20, EU:C:2021:875.

2 *Green Power v. Spain* (SCC Case No. V 2016/135; "**Green Power**"), available here.

3 *Ibid*, para. 343.

relevant to the interpretation of Article 26 because, among other things, the seat of the arbitration was an EU Member State.[4]

It concluded that EU law precluded the tribunal from asserting jurisdiction for two main reasons:

- *First*, the Spanish renewables incentives regime at issue in this dispute fell under the EU State aid regime, was therefore within the European Commission's exclusive competence, and would "overstep[]" the tribunal's powers under the ECT.[5]

- *Second*, even if the dispute had not concerned State aid, the tribunal held that it would lack jurisdiction as a result of EU law's autonomy and primacy. Relying on *Achmea* and *Komstroy* to reason that intra-EU ECT arbitration undermined the consistency and uniformity of the interpretation of EU law, the tribunal concluded that EU law precluded Spain from validly consenting to intra-EU arbitration before a tribunal that would "of necessity [have] to interpret and apply the EU Treaties."[6]

Modernized ECT to Narrow Scope of Intra-EU Investment Protection. Just days after the *Green Power* award, the ECT Secretariat announced that an agreement in principle had been reached on the modernization of the ECT in ways that would significantly restrict its scope.

Consistent with the EU's policy shift announced in *Achmea* (and subsequently *Komstroy* and *PL Holdings*), the European Commission has sought to exclude intra-EU arbitration from the scope of the ECT. The modernization process has also unfolded against a background of calls for reform on the basis that the ECT undermines clean energy transition by permitting fossil fuel investors to challenge State regulations that are designed to meet Paris Agreement targets.

The agreement-in-principle, the text of which is confidential until August 2022, reflects both of these priorities:

- *First*, the amended ECT will preclude intra-EU arbitration by carving out the availability of arbitration to resolve disputes where the relevant Contracting Parties are part of a regional economic integration organization, such as the EU.

- *Second*, an optional carve-out would exclude existing and future fossil fuel-related investments from the ECT. The EU and the UK have already opted into the carve-

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4 *Ibid*, para. 412.

5 *Ibid*, para. 454.

6 *Ibid*, para. 477.

out, and a new flexibility mechanism will allow other ECT Contracting Parties to do the same.[7]

- Finally, new definitions of covered investors and investments and amendments to the ECT's substantive standards, designed to accord greater deference to a State's right to regulate, may further restrict the ECT's protections.

What Next? These developments are unsurprising in the context of the EU's years-long policy shift, the sheer number of *Achmea*-based jurisdictional objections being raised in intra-EU treaty arbitrations, and the likelihood that EU Member State courts will set aside intra-EU awards seated in their jurisdictions (on which we reported here).

In the short term, the *Green Power* award is unlikely to result in a significant shift in arbitral jurisprudence on the validity of intra-EU arbitration agreements, although it will no doubt create additional risk. Over 60 (known) tribunal decisions to date have uniformly rejected similar *Achmea*-based jurisdictional challenges, including several decisions under the ECT and at least one decision since *Komstroy*.[8]

Moreover, the fact that the *Green Power* arbitration was seated in a Member State appears to have weighed heavily in the tribunal's analysis. As we reported here, investors considering intra-EU claims will no doubt seek to minimize risk by seating their arbitrations outside the EU or choosing ICSID arbitration, where available. The most pressing question for investors remains the prospect of enforcement of any intra-EU award outside the EU.

The amendment of the ECT, on the other hand, and especially its sectoral exclusions and restricted jurisdictional scope will have a longer-term impact. Although sunset and transitional provisions for fossil fuel investments may continue coverage for a short period of time, in the longer term investors should expect that the ECT will cease to be a safe haven for intra-EU or fossil fuel investments.

Whatever the future holds, investment structuring and other means of maximizing treaty protections will remain of paramount importance for investors in the EU and in certain industrial sectors.

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[7] The carve-out will apply to existing investments in fossil fuels after 10 years from the entry into force of the relevant provisions and to new investments made after 15 August 2023 as of that date. The ECT Secretariat's announcement can be found here.

[8] *See, e.g., Sevilla Beheer B.V. and others v. Kingdom of Spain*, ICSID Case No. ARB/16/27, Decision on Jurisdiction, Liability and the Principles of Quantum, 11 February 2022, para. 629, available here.

Please do not hesitate to contact us with any questions.

NEW YORK

Ina C. Popova
New York, Paris
ipopova@debevoise.com

David W. Rivkin
New York, London
dwrivkin@debevoise.com

Christel Y. Tham
New York
cytham@debevoise.com

LONDON

Tony Dymond
London
tdymond@debevoise.com

Lord Goldsmith QC
London, Paris
phgoldsm@debevoise.com

Samantha J. Rowe
London, Paris
sjrowe@debevoise.com

Patrick Taylor
London, Paris
ptaylor@debevoise.com

Amina Afifi
London
aafifi@debevoise.com