

## **Modernisation of the ECT: Championed by the EU, Derailed by Member States**

Although the adoption of the modernised text of the Energy Charter Treaty (“**ECT**”) was scheduled for 22 November 2022, dissatisfaction among EU Member States has derailed the proposed revision of the treaty. While the European Commission was the original driving force behind the modernisation of the ECT and continued to champion reform of the regime, in recent months a growing number of EU Member States have decided to pursue withdrawal from the ECT, despite agreement in principle having been reached on the amendments in June 2022. France, Poland, Germany, Spain, the Netherlands, Slovenia and Luxembourg have already announced their withdrawal. Not surprisingly, on 18 November 2022, the Council did not receive the required majority support for approval of the modernised text of the ECT and, as a result, at the request of the European Commission, the adoption of the amended ECT was removed from the agenda of the Energy Charter Conference and rescheduled to April 2023. With the European Parliament now calling for a coordinated exit from the ECT by EU Member States, the future of the revised ECT looks uncertain.

### **Modernisation of the ECT**

The ECT, in force since 1998, provides a framework for energy cooperation between its 53 Contracting Parties, including the European Union, Euratom and all EU Member States, except for Italy. The protection of foreign investments through investor-State dispute settlement (“**ISDS**”) is one of the core pillars of the ECT. With a view to updating the regime, in 2017, the Energy Charter Conference launched a discussion on the potential modernisation of the ECT.

The European Union was at the forefront of these discussions, and sought to address a number of concerns as reflected in the Council’s [negotiating directives](#) to the European Commission. For example, the European Union aimed to ensure that the modernised ECT clarified and reaffirmed the Parties’ right to regulate, including to account for EU State aid rules. In light of the Court of Justice of the EU’s (“**CJEU**”) ruling that intra-EU ISDS under the ECT is incompatible with EU law (see [Case C-741/19 Komstroy](#), as confirmed in [Opinion 1/20](#)), the European Union also sought to address the so-called intra-EU arbitration issue through the ECT modernisation process.

The 15 rounds of negotiations resulted in an agreement in principle on the revised ECT announced on 24 June 2022. The major amendments include provisions recognising the Contracting Parties’ right to regulate for legitimate public interests and the flexibility clause allowing the Contracting Parties to carve out protection for fossil fuel investments in their territories. Importantly, the modernised ECT excludes intra-EU investor-State disputes from the ECT’s ISDS mechanism. Yet, the agreement in principle does not appear to satisfy at least some of EU Member States.

## **What went wrong?**

France, Poland, Germany, Spain, the Netherlands, Slovenia and Luxembourg have recently announced their intention to withdraw from the ECT (see also our client alert [here](#)). They appear to consider that the ECT is not in line with EU climate goals and commitments under the Paris Agreement, and that it hinders the fight against climate change by continuing to offer significant protection to investments in fossil fuels.

As a result of this significant dissatisfaction, on 18 November 2022, the Council failed to approve, by qualified majority, the modernised text and the European Commission subsequently requested that the adoption of the amended ECT, scheduled for 22 November 2022, be removed from the agenda of the Energy Charter Conference.

Subsequently, on 24 November 2022, the European Parliament passed a [resolution](#) outlining the concerns that have still not been addressed by the ECT modernisation, and called for a coordinated withdrawal from the ECT by the EU and its Member States. With a view to neutralise the ECT sunset clause (under which existing investments are protected for a period of 20 years post-termination), the European Parliament even suggested that the Commission should propose to partner countries an agreement allowing non-EU ECT parties willing to withdraw to neutralise the sunset clause on a reciprocal basis.

The central issue in the debate relates to the protection of fossil fuel investments. Whilst the modernised ECT includes an investment protection carve-out for new investments in fossil fuels, the modernised ECT has still been criticised for maintaining protection for existing fossil fuel investments for a period of at least 10 years. According to the ECT Secretariat's analysis, assuming that the ECT amendments had been adopted on 22 November 2022 (and provisional application was applied), existing investments in fossil fuels would continue to have ECT protection until approximately 15 August 2033. It would only be after 15 August 2033 that there would be no protection for fossil fuel investments within the EU.

## **Is coordinated withdrawal the solution?**

Political debate in the EU has shifted the focus of the ECT modernisation discussion squarely on to the issue of whether investments in fossil fuels should benefit from ECT protection. Having broadly determined that they should not enjoy such protection, EU Member States are now considering the most effective way to terminate their commitments in respect of fossil fuel investments as soon as possible. At present, there appears to be a binary option: withdraw from the ECT or modernise.

At first glance, withdrawal from the ECT would appear to be the easiest option (and most aligned with public opinion). However, in practice, withdrawal from the ECT by EU Member States will have limited immediate implications for existing investments. The ECT sunset clause, which cannot be waived unilaterally, ensures protection for existing investments for 20 years. This means that, even if a Member State issued its notice of withdrawal on 1 January 2023 and the withdrawal therefore took effect on 1 January 2024, existing fossil fuel investments would still be protected under the ECT until 1 January 2044.

While the European Parliament appears to believe that the only option for the European Union is a coordinated exit from the ECT, it is questionable whether this approach will really achieve the Parliament's desired purpose. In addition to the problem of the ECT's sunset clause (and the fact that, unless such clauses are terminated, they will extend ECT protection until approximately 2044), it is worth recalling that

some 1500 bilateral investment treaties concluded by EU Member States offering investment protection similar to that granted by the ECT remain in force, and will not be affected by the withdrawal. The EU Member States will not be able to terminate all investment protection commitments in relation to fossil fuels simply by withdrawing from the ECT.

In light of the prevailing mood in Europe, it is unclear whether this is really the end of ECT modernisation efforts. It has been announced that the Energy Charter Conference will hold an *ad hoc* meeting in April 2023 to finalise the discussion on the adoption of the amendments to the ECT. This gives time for the ECT Contracting Parties, including the European Union and its Member States, to consider whether the door to ECT modernisation should be closed forever or whether alternative novel solutions can still be implemented to revive the ECT.

### **Implications for ECT Disputing Parties**

Notwithstanding the recent announcements made by certain EU Member States, the immediate implications of recent developments are rather limited for investors and other disputing parties. The ECT at present remains in full force and effect, on its current terms. Even in relation to those Member States indicating an intention to withdraw, such withdrawal will only take effect 12 months after notice of withdrawal and investors will still have the right to bring claims in relation to their existing investments for a period of 20 years based upon the treaty's sunset provision.

There is, however, increasing uncertainty over the future of the ECT. Whilst it is still possible that the proposed amendments to the ECT will be adopted in April 2023 (bringing with them both new standards of treatment and carve-outs for certain investments), there is an equal prospect that the amendments will not be adopted and that the EU and its Member States will withdraw from the ECT. There is also a prospect that the EU and its Member States will seek to enter into a termination agreement attempting to terminate the effect of the ECT's sunset clause. There is even the possibility of wider withdrawals.

For those contemplating (or facing) claims under the ECT, developments over the next months will need to be considered carefully. Whilst it cannot be entirely predicted how the ECT regime will develop in the following months, it does seem clear that the treaty in its current form, as at today, is likely to offer better protection to investors than any amended treaty. Withdrawal by the EU and its Member States (and any attempt to kill off the ECT's sunset provision) is also likely to create jurisdictional complications. Those investors with claims under the ECT should therefore be seriously considering the benefits of commencing arbitration now, namely either before any amendments are adopted or before there is a more widespread exit from the ECT regime.

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