

# Arguments in favour of Energy Charter Treaty withdrawal

The ECT's contracting parties have engaged in negotiations of the modernisation of the ECT. The European Commission has been very active in the negotiations, trying to secure an outcome that would meet the objectives set in the mandate it received from the Council. However, **the outcomes of the negotiations do not make the new ECT desirable, nor necessary for several reasons. Instead, withdrawal from the ECT remains the most viable option for the EU and the Member States (MS).**

## Why the new ECT is not desirable, nor necessary

### ECT parties will continue to be at risk of arbitration if they adopt climate policy measures

- (1) While the new ECT may satisfy most EU law compatibility requirements set by the Court of Justice under Opinion 1/17, it still contains an **old-style investor-state dispute settlement (ISDS) system**, in total contradiction with the Commission established approach to include Investment Court System (ICS) in EU investment treaties. The unpredictability of the old ISDS mechanism **risks making all other reform efforts futile**.
- (2) The **protection of (uncertain) future profits** is in stark contrast with the protection of property rights, e.g. under EU law and the European Convention of Human Rights. Reforms to the method to evaluate compensation are limited and superficial. In particular, it does not prevent the use of forward-looking valuation techniques such as discounted cash flow methodology.

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- (3) Read in conjunction with **a wide definition of investment and broad substantive protections**, this leaves states open to extraordinary financial liabilities for their climate action. The use of more detailed treaty language or the inclusion of new exceptions and a right to regulate clause in the new ECT is in any case unlikely to significantly mitigate the risk of ISDS. According to **a recent study**, reforms aimed at rebalancing investment protection with host state policy space (exception for public health or environment for e.g.) have been dulled or reversed by investment arbitral tribunals. In the recent **Eco Oro decision**, the environmental exception was found “effectively irrelevant in investment arbitration” by the tribunal.

### The new ECT fails to align with EU and international climate objectives

- (1) The new treaty also **fails to align with EU and international climate objectives**, as it continues to protect fossil fuels investments in most contracting parties' jurisdiction indefinitely as well as in the EU for at least another decade (potentially until 2040). This means contracting parties will continue to be at risk of litigation if they adopt climate policy measures. The modernised ECT thus still has the potential to interfere with the objectives of the European Green Deal and the EU's international emission reduction commitments.
- (2) The new ECT also **extends protection to investments into controversial energy sources, including biomass, biofuels and synthetic fuels**. This increases litigation risks under the ECT and therefore removes the flexibility needed for future energy policy. The speed with which the energy transition must take place in light of the climate emergency requires regulatory space to adapt and adjust in a flexible manner. The discussion on the use of biomass for electricity generation is a good example of this.
- (3) This extension of scope to ammonia, synthetic fuels and hydrogen also **operates like a backdoor extension of investment protection for fossil fuels**, particularly in the case of fossil gas used to produce so-called blue and gray hydrogen.

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### Absence of clarity about when new rules will apply

- (1) According to Article 36 (1) (a) and Article 42 (4) ECT: **the entry into force of the new ECT** depends on (1) adoption at unanimity by the contracting parties present and voting at the next Charter Conference and (2) ratification by  $\frac{3}{4}$  of the contracting parties. History shows that this process can last indefinitely. The Comprehensive Economic and Trade Agreement is still not ratified and the last ratification of ECT trade amendments took 12 years. Beyond the internal EU procedural issues, there is also a great risk that the process will be slow or even fruitless in third countries. The low level of involvement in the modernisation process does not augur well in this respect. Some countries that are reluctant to change the treaty may have an interest in not ratifying the modernised version.
- (2) **Modifications of certain annexes** (Annex NI for e.g.) enter into force after having been adopted at unanimity by the contracting parties present and voting at the next Charter Conference in accordance with Article 36 (1) (d). Modifications are not amendments and thus do not require ratification. However, the ECT does not regulate when exactly such modification enters into force, and Annex NI introduces further confusion by adding that these changes would enter into force “no later than 2040”.
- (3) **Parties could agree to provisionally apply** the new ECT, or parts of it, pending its entry into force between the contracting parties concerned. Provisional application produces legal effects only among the Parties that agree to it. Even if parties agree to provisionally apply amendments *by default*, **any party remains free, at any time, to opt out of the provisional application of the entire, or parts of, the new ECT**. The consequences attached to stopping provisional application at a later stage are also unclear. This may create a complex patchwork of material, geographical, and temporal application of the new ECT.

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- (4) It is standard practice of the EU to provisionally apply parts of mixed trade agreements that fall within its area of competence. This means **the EU can provisionally apply the new ECT only in so far as foreign direct investment is concerned** (exclusive competence of the EU). Provisions applying to foreign indirect investments (competence of the MS) are therefore excluded from provisional application (see for e.g. CETA investment chapter), unless all the MS have agreed to it separately. Decisions on the provisional application of a mixed agreement in its entirety usually include a statement clarifying that MS have given their agreement with respect to their competences. **This would however signal a significant change in EU trade policy practice and set a dangerous precedent for democratic decision making for future agreements.** Although there is no legal requirement to involve the European Parliament prior to deciding on provisional application, it is usual practice that the Council votes on provisional application only after the European Parliament has given its consent to conclusion of the agreement.

### Adoption of the modernized ECT would resume the geographic expansion process

Contracting parties acceding to the treaty at a later stage might not be able to obtain the required support for a carve out of investment protection for fossil fuels equivalent to the one of the EU or the UK. To be able to do so they would require the unanimous support of all existing contracting parties present and voting at the Charter Conference. They will thus be facing a choice to “take it or leave it”.

## Why withdrawal is the cleanest option

- Leaving the treaty will remove a larger share of arbitration risks under the ECT, while the new treaty increases the stock of investments covered by the treaty and thus the risk of arbitration claims (see table page 6).
- A withdrawal would give states the regulatory flexibility they need, in particular in relation to the energy transition in order to adapt regulation for new, untested technologies and energy products.
- The EU and the MS have the possibility to leave the ECT unilaterally (Article 47 ECT). Withdrawal is effective 1 year after deposit of the notification.
- Withdrawal triggers the famous 'sunset clause' or 'survival' clause. That clause allows the treaty to continue to apply for another 20 year period to existing investment made before the decision to leave the treaty, but not to new or future investments made after the exit. The sunset clause is often raised as the major obstacle to withdrawal and to discredit the potentials of leaving the treaty.
- Because of the lengthy process of ratification (see above), the new ECT is likely to only enter into force at the same time or even after the legal effects under the sunset clause would end if the EU and the MS decide to leave now.
- Moreover, public international law allows a group of contracting parties to a multilateral treaty to modify the treaty among themselves. In other terms the modifications would only apply to those who participate in the modification. That is what is called an 'inter-se agreement'. Before leaving the Treaty, the EU and the MS could adopt **an inter se agreement** whereby they would modify the sunset clause and abolish it / extinguish its effects among themselves. The MS and the EU should open up this agreement to other contracting parties, as this would further decrease litigation risks.
- The argument that Article 16 ECT prevents the adoption of an inter-se agreement is legally unfounded. Indeed, Article 16 ECT provides that when ECT contracting parties are also parties to another treaty on the same subject matter, the regime most favourable to the investor prevails. This does not implicitly prohibit a modification (inter-se agreement) of the ECT abolishing the sunset clause (or intra-EU investment protection). ECT Article 16 concerns the relationship between coexisting treaties within the meaning of Vienna Convention on the Law of Treaties (VCLT) Article 30. Pursuant to VCLT Article 30, §5, rules on the precedence between coexisting treaties are without prejudice to modification.
- The amendment excluding arbitration under the new ECT for intra EU investments (REIO clause) is limited to EU countries, while an inter se agreement nullifying the legal effect of the sunset clause can be open to other contracting parties, thus further decreasing the risk of arbitration claims. This also means a coordinated withdrawal with inter se agreement offers therefore far more flexibility for willing states to take such a decision at a later stage.

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- The EU and MS are parties to the ECT in their own right. On the EU side, withdrawal involves procedure in Article 218 TFEU, parallel to the one for the conclusion of EU agreements. This means for the EU itself to leave, it requires a proposal by the Commission + adoption by QMV in the Council + consent by the European Parliament. In addition, the Court has made clear that the use of the EU's powers under the procedure of Article 218 TFEU cannot be made dependent on MS action or any common accord between the MS (Opinion 1/19 on the Istanbul Convention, para. 249).
- On the MS side, it would thus also require a separate notice from each MS according to their constitutional/legislative requirements.
- The ECT covers areas of exclusive competence. As a consequence, there are grounds to argue that MS should be legally (under EU law) required to withdraw from the ECT if the EU withdraws. In essence the EU withdrawal means that the EU is making it clear that it no longer wants to be bound over those areas over which it has exercised its competence: Member States will need to fill this gap and assume obligations in areas of exclusive competence of the EU for which they do not have the power. This means MS can no longer properly participate as parties to the ECT as they can simply not act in areas of exclusive competence without authorization from the EU.
- EU's withdrawal would become effective when this internal procedure is completed and the withdrawal is notified to the ECT depository (+ 1 year under Article 47 ECT).
- If the Commission does not obtain a QMV on its decision at the Council before 22nd of November because of a blocking minority, this means it cannot sign on the new ECT and is left with the old ECT. As a result, the Commission would have to propose a decision to leave the ECT, since **the EU and other MS should not remain party to an international treaty that is fundamentally incompatible with EU law.**

### Conclusion

A coordinated withdrawal and inter-se abolishing the sunset clause is the cleanest option to end the legal effects of the ECT to its maximum and potentially even terminate it. Adoption of the ECT, even with provisional application, leaves the door open to several uncertainties and risks, and prolongs the detrimental impacts on the adoption of legislation aiming at reducing emissions.

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- Indeed, a decision to withdraw by the EU and the MS in a coordinated manner would likely empty the treaty and its institutions of its meaning, thereby ending protection for existing and future fossil fuel investments. In other terms, EU and MS withdrawal would help leveraging for termination – i.e. if all contracting parties decide to terminate, the sunset clause would not apply, which means the ECT legal effects would end immediately upon termination and for all contracting parties.
- Leaving an investment treaty is not something unusual, states in the past have terminated BITs, and there is no evidence that investment agreements and ISDS lead to increased investment flows, neither in terms of quantity nor quality.
- Leaving the ECT would allow to start from scratch and design an investment governance framework that effectively supports the energy transition.
- Leaving the ECT before COP27 would show support for the achievement of the Paris Agreement's target.

| Investment protection in the case of withdrawal and inter-se abolishing sunset clause   | Investment protection under the new ECT  |
|---|--|
|   | Addition of ammonia, hydrogen, biomass, biogas, synthetic fuels and CCS (with few exceptions for the EU) (amendments to Art 1 (5) and changes to Annex EM I)   |
| No more protection of <i>new</i> investments in the EU and EU investment abroad, in all energy sectors  | No more protection for <i>new</i> investment after August 2023 in coal, oil, gas and only in the EU and UK, with significant exemptions for certain types of gas projects in the EU (Change to Annex NI Section B) |
| Existing investments remain protected for 20 years in relation to contracting parties that do not conclude an inter-se agreement neutralising the sunset clause | 10 years after the entry into force of the changes to the annex, or at the latest until 2040, no more protection for existing investment in the EU in coal, oil and gas (changes to Annex NI Section C)            |
| No more treaty protection of <i>existing</i> intra-EU investments (inter se agreement on sunset clause)   | No more arbitration for intra-EU disputes (amendment to Article 24), but ECT remains enforceable in EU and MS courts   |

