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Exodus From The Energy Charter Treaty – What is Left of Europe's Protections for Investors?

Minding Your Business on **January 16, 2024**

As of January 2024, France, Germany and Poland have officially withdrawn from the Energy Charter Treaty (ECT). Their decision to withdraw from the treaty follows a recent European Commission proposal for a mass exodus from the ECT by EU member states, which effectively will limit protections granted by the treaty previously enjoyed by direct investors and asset managers with portfolio companies in the energy sector.

What is the ECT?

The ECT came into force in 1998. The treaty is designed to provide a framework for energy cooperation and promote energy security through open and competitive energy markets. Under Article 26, investors that are nationals of an ECT signatory state can bring claims against another ECT signatory state for violation of its obligations to promote and protect energy-related investments (*see* ECT Section III).

To this date, the ECT counts 50 members including the European Union and Euratom. The United States is not a member of the ECT.

Who is withdrawing from the ECT?

After Russia's withdrawal from the ECT in 2009 and Italy's exit in 2016, several countries followed suit. In 2022, Spain, the Netherlands, and Slovenia announced their intention to leave the ECT. Denmark, on April 13, 2023, became the eighth country to officially announce its withdrawal from the ECT. On July 7, 2023, the European Commission proposed the withdrawal of the EU and its member states. Shortly thereafter, on July 21, 2023, Portugal, became the first country to echo the European Commission's proposal by indicating it was considering withdrawing from the treaty. Further withdrawals are scheduled for 2024. France, Germany and Poland have already exited the treaty and Luxembourg's withdrawal will be effective in mid-2024.

Why are states withdrawing from the ECT?

A clash between energy investors' protections and states' need for energy reform

The withdrawals reflect a growing concern by numerous signatory states and European institutions that the ECT standards of investment protection create unacceptable levels of dispute risks for states. Some of the treaty standards, such as the obligation to guarantee fair and equitable treatment ("FET") to investors, or the requirement to protect investors' legitimate expectations, are viewed by many states as overbroad. Specifically, the ECT's investor-state dispute settlement ("ISDS") system facilitates claims by energy investors where states have made legislative changes required to reach emission reduction goals set by the 2015 Paris Agreement and the 2019 European Green Deal. A review of the ECT's cases in the past 20 years shows an overall increase in investor-state claims filed against measures related to renewable energy reforms.

A failure to reform and modernize the ECT

A 2018 ban of intra-EU investor-state arbitration would bring the ECT's weaknesses into ever sharper focus just a few months after the Energy Charter Conference launched negotiations for a much-needed modernization of the ECT in November 2017. The ECT Modernization Group released reform proposals on June 24, 2022 that specifically reduced investor protections under the ECT in the name of environmental protection. The group suggested, among other proposals, that signatories should be allowed to limit or exclude protection provisions for fossil fuel investments. However, in November 2022, the abstention of four EU member states halted the EU's adoption of the proposed reforms. Since then, the EU Parliament has called for a "*coordinated exit*" from the ECT, which the European Commission echoed on July 7, 2023.

How do the withdrawals impact existing investments?

Under the ECT, a contracting party may withdraw from the treaty at any time by written notice (Article 47(2)). The withdrawal becomes effective one year later, but under the ECT's sunset clause (Article 47(3)), investments made before the withdrawal's effective date – including fossil fuel investments – remain protected by the ECT's provisions for 20 years following withdrawal. This extended protection has been criticized by states and politicians as obstructing the adoption of meaningful environmental policies and legislations.

For example, at least seven arbitration claims were filed against Italy since its withdrawal in 2016, under the protection of the sunset clause effective until 2036. In 2017, the UK oil and gas company Rockhopper, which had invested in a putative offshore oil and gas field in Italy in 2014, initiated arbitration against the Italian state following Italy's ban on offshore oil production activities in late 2015. Rockhopper claimed that Italy's ban and, thereafter, refusal to award Rockhopper an oil production concession both constituted an unlawful expropriation and breached Italy's FET obligation. The Tribunal found that Italy had unlawfully expropriated Rockhopper's investment and awarded over EUR 184 million to Rockhopper in 2022.

So, what should investors expect?

For now, it is unlikely that states will directly amend the ECT and its sunset clause. So – while the sun sets, investors can rely on the ECT to police their energy investments. However, investors should be mindful of creative proposals to dilute investor protections.

One example is the proposal of the European Commission in October 2022 (and again in its July 7, 2023 explanatory memorandum, supported by the EU Parliament) for EU member states, the EU and Euratom to conclude *inter se* agreements interpreting the ECT's sunset provisions as inapplicable. Under such an *inter se* agreement, investors from states signatory to the agreement would therefore no longer benefit from the extended 20-year protection when investing in the territory of the *inter se* agreement contracting party. While theoretically attractive, implementing *inter se* agreements might prove difficult, as both the Vienna Convention on the Law of Treaties and the ECT include mechanisms to prevent the conclusion of subsequent treaty modifications.

We will closely monitor any developments which could impinge on investor protection. To stay informed as to how this trend could concretely impact your business, contact our Disputes Resolution team and subscribe to this blog for further updates.

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