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Energy Charter Treaty – Recent Developments

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I. Introduction

Over the last few months, several European Union ("**EU**") Member States have announced that they intend to withdraw from the Energy Charter Treaty (the "**ECT**"). At the time of writing, Germany, Slovenia, Poland, the Netherlands, France, Spain and Luxembourg have made such announcements.

The timing of these announcements preceded the expected vote by the Contracting Parties to the ECT regarding amendments to the text of the 1994 ECT (the "**Modernised ECT**"). The vote was scheduled to take place on 22 November 2022. However, reportedly due to a failure by the European Commission to gain the consensus of EU Member States—a majority of which are Contracting Parties to the ECT—the vote was called off at the eleventh hour. It has now been postponed until April 2023. If adopted in April 2023, the Modernised ECT will enter into force 90 days after its ratification by three-fourths of the treaty's Contracting Parties. The Modernised ECT, if adopted, contains notable changes to the scope of investment protection afforded by the treaty.

We provide a summary of these developments and their potential impact on international arbitration claims brought by investors in ECT Contracting Parties.

II. The ECT

The ECT is a multilateral investment treaty, that entered into force in 1998, which establishes a legal framework in order to promote long-term international cooperation in the energy sector.

The ECT obliges the states who are Contracting Parties to the treaty to encourage and create stable, equitable, favourable, and transparent conditions for investors of other Contracting Parties.[1] In order to qualify for the protection afforded by the ECT, investments must be associated with "*Economic Activity in the Energy Sector*". In practice, this includes activities such as *inter alia* (i) oil and gas exploration, (ii) construction and operation of power generation facilities, including those powered by renewable energy sources such as wind, solar, and hydro, and (iii) decommissioning of energy related facilities, including oil rigs, oil refineries and power generating plants.[2]

Each Contracting Party gives its unconditional consent to the submission of disputes between a Contracting Party and an investor of another Contracting Party relating to an investment to international arbitration.[3]

III. Amendments to the ECT

Since 2017, discussions have been underway regarding efforts to negotiate and agree a modernised text of the ECT. On 24 June 2022, it was announced that the Contracting Parties reached an agreement in principle on the modernised text. The Modernised ECT contains certain notable changes.

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As explained by the Energy Charter Secretariat, the proposed changes include:

1. Alignment between the ECT and the Paris Agreement, which is a legally binding international treaty on climate change.[4] For example, the EU and the UK have opted to carve-out fossil fuel related investments from investment protection under the ECT, including for existing investments after 10 years (instead of 20 years under the current ECT).[5]
2. A provision stating that an investor from a Contracting Party that is part of a regional economic integration organisation ("**REIO**"), such as the EU, cannot bring an investor-state arbitral claim against another Contracting Party member of the same REIO—*i.e.*, prohibiting what is referred to as "*intra-EU arbitration*".[6]
3. A narrowed definition of a qualifying "*investment*" and "*investor*" under the treaty. An "*investment*" must fulfil a list of characteristics, such as the commitment of capital, the expectation of gain or profit, be made for a certain duration or involve the assumption of risk. An "*investor*" cannot hold the nationality—or permanent residency—in the Contracting Party hosting the investment, and must demonstrate that it carries on substantial business activity in the host state.[7]
4. Provision for a list of measures that constitute a violation of the ECT's fair and equitable treatment ("**FET**") standard, including a description of the circumstances that give rise to an investors' legitimate expectations.[8]
5. Clarification that the treaty's expropriation provision covers indirect expropriations, identifying in this context the types of measures that *cannot* be considered an indirect expropriation.[9]
6. Provision that the treaty's observance of undertakings clause—*i.e.*, umbrella clause—only applies to breaches of specific written commitments made through the exercise of governmental authority.[10]

As noted, it is anticipated that the ECT Contracting Parties will vote in April 2023 on whether to formally adopt the Modernised ECT. If adopted, the Modernised ECT will enter into force 90 days after its ratification by three-fourths of the treaty's Contracting Parties.

IV. Announced Intention by Contracting Parties to Withdraw from the ECT

In parallel to these developments, several ECT Contracting Parties—that are also EU Member States—have announced that they intend to withdraw from the ECT. At the time of writing, Germany, Slovenia, Poland, the Netherlands, France, Spain and Luxembourg have made such announcements. It is reported that Austria is also considering withdrawal.

These Contracting Parties have cited various reasons for their intention to withdraw. The reasons appear generally to centre around complaints that the ECT impedes their ability to tackle climate change. Relatedly, there are around a billion Euros' worth of outstanding ECT arbitral awards rendered against EU Member States—a figure which continues to grow, and which EU Member States may be keen to limit insofar as possible.

Withdrawal, however, does not take immediate effect. Rather, Article 47 of the ECT (Withdrawal) contains what is referred to as a "*sunset clause*", which provides that, following formal notification of a Contracting Party's withdrawal from the ECT, the withdrawal shall take effect one year after the notification is given.[11] Further, the protections afforded by the ECT shall continue to apply to pre-existing investments made in the territory of a Contracting Party for a period of 20 years after the withdrawal has taken effect—*i.e.*, "*the sunset period*".

Additionally, in the face of the announcements regarding withdrawal, the Energy Charter Secretariat, which provides the Energy Charter Conference "*with all necessary assistance for performance of its duties*,"[12] issued a Guidance Note explaining that withdrawal from the ECT may need to conform with Article 62 on the Vienna Convention on the Law of

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Treaties[13] (the "**VCLT**").

Article 62 of the VCLT only allows a state—as a matter of general international law—to withdraw from a treaty due to "*fundamental changes of circumstances*" that were "*essential*" for the decision to enter into the treaty, and which "*radically*" transform the obligations created by the treaty so that its further implementation becomes unduly burdensome.[14] In addition, the change of circumstance relied on as the reason for withdrawal must have been unforeseen by the contracting parties to that treaty.

The Energy Charter Secretariat also observed that the International Court of Justice, in *Gab?íkovo-Nagymaros Project (Hungary/Slovakia)*, did "*not consider that new developments in the state of environmental knowledge and of environmental law can be said to have been completely unforeseen*."[15]

As a result, the analysis as to whether an ECT Contracting Party can validly withdraw from the ECT is not straightforward. And the issue of withdrawal may be subject to challenge, for example by investors bringing claims in international arbitration against Contracting Parties that have purported to withdraw from the ECT.

Against this backdrop, the European Parliament passed a resolution on 24 November 2022, "*urg*[ing] *the Commission to initiate immediately the process towards a coordinated exit of the EU from the ECT and calls on the Council to support such a proposal*".[16] Although this resolution is not binding on the European Commission, it is an indication of the EU's intention as regards the ECT. For the EU to withdraw from the ECT, the Council of the EU—which is one of the EU's legislative bodies and is comprised of representatives from the EU Member States—would need to formally approve a withdrawal from the ECT by the EU. This is a very recent development, so precise details as to the path ahead are not yet clear.

V. Implications for Potential Claims by Investors Against ECT Contracting Parties

The developments outlined above carry several implications, some of which overlap:

1. Investors in ECT Contracting Parties may seek to submit claims to international arbitration before a vote is passed and the Modernised ECT becomes effective, because they will presumably want their claims to come under the current ECT's standards of investment protection.
2. A Contracting Party's attempt to withdraw from the ECT altogether may not impact an investor's ability to commence international arbitration in the short-to-medium term, given the ECT's 20-year sunset clause.
3. Withdrawal is likely to become a contested issue in individual cases. The Energy Charter Secretariat suggested that Article 62 of the VCLT would apply to any attempt to withdraw from the ECT. In this context, the reasons given by a Contracting Party for its withdrawal may need to be assessed against Article 62's criteria on an individualised basis. As a result, international arbitration tribunals confronted with claims by investors against a state that has purported to withdraw from the ECT may have to rule on the validity of that withdrawal as a jurisdictional issue.
4. If the Modernised ECT is adopted next year, an ECT Contracting Party can choose both to ratify the Modernised ECT and pursue withdrawal in parallel, since these are independent issues. Indeed, a Contracting Party wishing to minimise international arbitration claims against itself may well choose to vote for and ratify the Modernised ECT—with its narrower investor protections—and pursue withdrawal on a longer timeline.
5. Finally, it is worth noting that if the Modernised ECT is not adopted at the vote scheduled for April 2023, the scope of investment protection offered under the current ECT will continue to remain in force for Contracting Parties.

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[1] ECT, Article 10.

[2] ECT, Article 1(5).

[3] ECT, Article 26(3)(a).

[4] It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015, and entered into force on 4 November 2016. *See* UNFCC, The Paris Agreement, available here.

[5] *See* Energy Charter Secretariat, *Public Communication explaining the main changes contained in the agreement in principle*, 24 June 2022, 1. Definitions – Pillar 2: Flexibility, available here.

[6] *Id.*, 6. Regional Economic Integration Organisation (REIO).

[7] *Id.*, 2. Investment Protection – Definitions of Investment and Investor.

[8] *Id.*, 2. Investment Protection – Definition of Fair and Equitable Treatment.

[9] *Id.*, 2. Investment Protection – Definition of Indirect Expropriation.

[10] *Id.*, 2. Investment Protection – Umbrella clause.

[11] ECT, Article 47(2).

[12] ECT, Article 35.

[13] VCLT, Article 62.

[14] Energy Charter Secretariat, *Sunset Clause (Article 47 of the ECT) in relation to Article 62 of the Vienna Convention on the Law of Treaties (VCLT)*, 3 November 2022, available here.

[15] *Ibid*.

[16] European Parliament resolution of 24 November 2022 on the outcome of the modernisation of the Energy Charter Treaty (2022/2934(RSP)), at 20, available here.

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's International Arbitration, Judgment and Arbitral Award Enforcement or Transnational Litigation practice groups, or any of the following:

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