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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Investors Left Hanging As Europe Balks At Modernizing ECT

By **Caroline Simson**

Law360, New York (November 23, 2022, 8:29 PM EST) -- The fate of the Energy Charter Treaty remained in limbo last week after European Union member states were unable to agree on whether to modernize the controversial trade pact, leaving the bloc in an awkward position as it looks to woo the investors expected to finance its climate ambitions.

Five months ago, it appeared there was a united European front in favor of modernizing the aging treaty, which came into force in the post-Soviet era of the 1990s. The trade deal has become a lightning rod in recent years because it allows investors to bring arbitration claims against states if they believe their investments have been harmed.

The European Commission announced in June that EU member states had agreed to implement a modernization plan that would phase out protections for fossil fuels, saying the updated pact would "facilitate sustainable investments in the energy sector by creating a coherent and up-to-date framework."

But the modernization effort is facing what may be a fatal blow. On Nov. 18, four EU member states — which a European Council spokesperson would not identify — blocked an effort to keep the modernization plan on track. Subsequently, the European Commission asked to postpone a vote on modernization that had been slated to take place Nov. 22 with other ECT signatories, which include numerous countries outside the EU.

It's not exactly the best look for an economic bloc that's trying to attract investment in the green energy sector, DLA Piper partner James E. Berger told Law360.

"As a non-European who watches the issue carefully, it just doesn't look to me like there's any consensus among the member states about the right way to move forward with this," he said.

"They need foreign investment — they're going to build the infrastructure to move to greener forms of energy," he added. "When foreign investors look at what's going on with the ECT ... their confidence in Europe has got to be rattled at this point. There's too much churn, and too much change."

As of right now, the fate of the modernization plan is unclear. The Energy Charter Secretariat, a Brussels-based international organization responsible for the ECT, said on Nov. 22 that the modernization plan would be put back on the agenda next spring.

At the same time, however, there have been calls within the European Parliament for the European Commission's international trade department to prepare a coordinated exit from the ECT. A vote on the issue is scheduled to take place during a plenary session on Nov. 24.

Even though some of Europe's loudest and most influential voices — including Spain, France, Germany and the Netherlands — have said they will withdraw from the ECT, with some even calling for the European Commission to coordinate a bloc-wide exodus, that may never happen. There are still EU member states that don't agree with that position, or at least have not yet publicly announced any objections to the treaty or the modernization plan.

"I would say it could not happen unless a majority of EU member states put pressure on the EU to do

that, and possibly not even a simple majority would suffice," said Graham Coop, a partner at Volterra Fietta who was general counsel to the Energy Charter Secretariat for seven years.

"Although we see that many of the most developed and wealthiest EU member states have indicated they don't like the treaty and want to withdraw from it, they're not a majority of the EU member states," he continued. "You've still got lots of other Central and Eastern European EU member states that don't particularly want to see the treaty die."

Complicating the treaty's future are several legal nuances that make it difficult for a smaller group of countries to effect any changes to the pact — an important consideration when the treaty has 53 signatories, including many countries outside of Europe. Some, like Japan, have already said they want the treaty to stay the way it is.

The proposed modernization of the ECT takes the form of an amendment to the treaty, which must be adopted unanimously by a conference of parties to the ECT. These parties may abstain from voting for such an amendment, but the modernization cannot proceed if even one of them votes against it.

The treaty also requires that amendments have the support of a majority of ECT parties, meaning if too many countries abstain or fail to attend a meeting where a vote is scheduled, an amendment can be defeated.

Even if an amendment passes, countries must then decide individually whether to ratify it. The amendment only enters into force if a three-fourths majority of ECT parties have ratified it, and then only between countries that have ratified it.

Countries that withdraw from the pact — as Italy did several years ago — also face the complicating factor of a 20-year sunset clause, under which investment protection in the treaty continues to apply during that period. There has been some discussion in Europe in recent weeks of how withdrawing countries may be able to get around this provision, but many questions remain.

Earlier this month, the ECT Secretariat issued a statement noting that under international law, the sunset clause in the ECT will only become inapplicable if there are unforeseen "fundamental changes of circumstances." The International Court of Justice has already determined in an unrelated case that climate change does not qualify under that standard, the secretariat said.

That means a country relying on that defense before an international tribunal would likely face an uphill battle.

"If it comes to arbitration, an arbitral tribunal will completely disregard this," said Crina Baltag, an associate professor (docent) in international arbitration at Stockholm University. "This is not possible, at least under the current rules of treaty law."

There has also been a suggestion that countries that withdraw from the pact could agree to terminate the sunset clause among themselves. But whether such an agreement would hold up before an international tribunal isn't known, since it would contradict the withdrawal mechanism within the ECT.

"If I were representing an investor from an EU member state wishing to make a claim against the government of another EU member state, I would argue as their counsel that such a purported inter se agreement was not valid under international law because it was made in violation of the clear provisions for amendment and withdrawal set out in the ECT itself," Volterra Fietta's Coop said.

There's also questions about how suddenly pulling the investment protection rug out from underneath investors — even those with investments in less desirable forms of energy like coal — could look to investors in the renewables sector.

Alejandro A. Escobar, who chairs the public international law practice group at Baker Botts LLP, told Law360 he's skeptical that withdrawing member states would make such an agreement without having something in its place.

"I have my doubts that that will actually be transformed into an actual policy decision," he said. "The most logical thing would be that once they have a modernized treaty that they replace the entire previous treaty, including the sunset clause. I expect that they won't do away with the sunset clause if they have no replacement treaty."

That point emphasizes the conundrum facing Europe as it looks to fulfill an ambitious agenda aimed at addressing climate change. Experts in the field insist the energy transition can only take place with the help of private investment — something the European Commission appeared to recognize when it pushed for the modernization to continue as planned last month, after the Netherlands announced it would be withdrawing from the ECT.

In a statement last month, the European Commission noted the "current geopolitical challenges and the resulting need to diversify sources of energy for Europe makes membership to the Energy Charter Treaty more pertinent than ever."

--Editing by Alanna Weissman and Lakshna Mehta.

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