

## Energy Charter Treaty Reform: Why withdrawal is an option

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### **Introduction<sup>1</sup>**

The Energy Charter Treaty (ECT) faces criticism for its outdated investment provisions and the threats it poses to the energy transition. ISDS claims brought pursuant to the ECT by fossil fuel investors demonstrate that these threats are imminent and real. Moreover, they are likely to increase as governments take more ambitious climate action. Most recently, in 2021, the German companies RWE and Uniper<sup>2</sup> each initiated arbitration proceedings against The Netherlands, challenging the Dutch government's decision to phase out fossil fuels by 2030. Taken together, the two investors are claiming damages of more than EUR 3.5 billion.<sup>3</sup>

Meanwhile, the ECT's compatibility with EU law is uncertain following recent rulings of the CJEU,<sup>4</sup> and Belgium has asked the Court to clarify whether the draft modernized ECT is compatible with the European Treaties. The request is still pending.<sup>5</sup>

In parallel, the EU and its member states have since 2019 been engaged in the wider multilateral process of "modernizing" the ECT. Recognizing the urgent need for reform, the EU initially intended to align the treaty with the EU approach to international investment law and the EU's climate objectives. However, it is increasingly clear that these objectives will be difficult to achieve, since any amendment of the treaty's text would require unanimity by all 56 contracting states present and voting at the meeting of the Charter Conference.<sup>6</sup> To date, many non-EU contracting states remain reluctant to make significant changes, and no compromise has been reached.

Given this current state of play, we examine what withdrawal could mean for the EU and its member states, along with its impact on the energy transition in general.

### **The EU Proposal and Attempts to Amend the ECT**

The EU's proposals—though more ambitious than those of other ECT members<sup>7</sup> – have been criticized as jeopardizing the climate agenda because they continue to allow fossil fuel companies to challenge climate action through ISDS.<sup>8</sup> Indeed, only the most recent proposal has differentiated between different types of economic activities, carving some fossil fuel projects out from the ECT's investment provisions.<sup>9</sup>

Specifically, the EU suggested distinguishing between existing and future fossil fuel investments. According to the EU, the ECT's investment protection provisions, including access to ISDS, should continue to apply to *existing* fossil fuel investments for a period of 10 years after entry into force of the amendment.<sup>10</sup> This would allow fossil fuel investors to bring ISDS claims for the entirety of this period. The EU suggests that *future* fossil fuel investments be excluded from the scope of application of the ECT's investment protection provisions as of the entry into force of the amendment with a major exception: gas-related investments made before the end of 2030 will be covered if they remain below a specific carbon threshold.<sup>11</sup> This cut-off date is extended to 2040 for investments that concern the conversion of powerplants

for the burning of natural gas. Civil society organizations have criticized this lack of ambition,<sup>12</sup> pointing out that the proposed carbon threshold for gas investments is significantly higher than what the EU internally defines as “sustainable” use of natural gas.<sup>13</sup>

Besides the proposal’s insufficient ambition, the lack of progress during the first four rounds of the modernization talks shows that success is far from certain; Luxembourgish energy minister Claude Turmes said that progressive states continue to face resistance from Japan, Norway, Switzerland, and the United Kingdom.<sup>14</sup> Some governments and parliamentarians have called on the EU to explore alternatives to a unanimous amendment<sup>15</sup> and the EU Commission itself no longer rules out a coordinated withdrawal of all member states.<sup>16</sup> It is therefore timely to examine the legal rules applicable to withdrawal from the ECT, the practical consequences of a withdrawal of a group of ECT contracting parties, and its effectiveness from a climate perspective.

## **The Option of Withdrawal and the Survival Clause**

### **Withdrawal**

Withdrawal, which is sometimes also called *denunciation*, can be understood as the “procedure initiated unilaterally by a State to terminate its legal engagements under a treaty.”<sup>17</sup> In other words, withdrawal puts an end to the participation of the withdrawing parties but without terminating the treaty itself, and the provisions of the treaty will remain in force among the non-withdrawing parties.

Article 54 of the VCLT stipulates that a state may withdraw from a treaty pursuant to the specific conditions for withdrawal that the treaty sets out. In the ECT, these rules are contained in Article 47, which provides that a contracting party may withdraw from the ECT at any time by serving written notice to the depositary. The withdrawal takes effect one year after the date of the receipt of such notice by the depositary. Pursuant to this rule, withdrawal could occur unilaterally or be coordinated, such as in case of a withdrawal of all EU member states.

### **The Survival Clause**

Withdrawal from the ECT faces an additional layer of complexity, as it would trigger the survival clause contained in Article 47(3). This article states:

*The provisions of this Treaty shall continue to apply to Investments made in the Area of a Contracting Party by Investors of other Contracting Parties or in the Area of other Contracting Parties by Investors of that Contracting Party as of the date when that Contracting Party’s withdrawal from the Treaty takes effect for a period of 20 years from such date.*

According to this clause, if one or more contracting states withdraw, the investment protection provisions of the treaty will continue to apply to all previously protected investments for 20 years after the withdrawal takes effect. Compared to state practice in different IIAs, this 20-year period is relatively long. 85% of IIAs containing a survival clause refer to a period of less than 20 years; most provide for 10 years or less.<sup>18</sup> Importantly, the survival clause in the ECT grants protection only to investments made *before* the withdrawal, allowing these investors to continue to use ISDS under the ECT to challenge climate policies and seek compensation. In

practice, investors have used the ECT's survival clause to that effect: since its unilateral withdrawal from the treaty in 2016, Italy has faced at least seven arbitration claims based on the survival clause, with cumulative amounts in compensation claimed exceeding USD 400 million.<sup>19</sup>

The 20-year survival clause could put the urgent action needed to achieve Paris commitments at risk. At the same time, if ECT parties spend years debating a modernized text, this may lead to a similar outcome. If such a text were to follow the EU's most recent proposal and given the current lack of progress at the negotiations, existing fossil fuel investments would be protected for a period of well over 10 years. Neither of these options is sufficient to reach the climate objectives that ECT parties have committed to.

To avoid these outcomes, contracting states would first have to agree to “neutralize,” i.e., extinguish, the legal effects of the survival clause in the ECT.<sup>20</sup> While a unanimous decision to neutralize might be unachievable, this could be done amongst a group of the ECT's contracting parties. In the following section we analyze the legal basis and practical consequences of such a neutralization.

### **Neutralization of the Survival Clause**

The neutralization of survival clauses in IIAs is not without precedent. However, so far, states have only neutralized survival clauses in bilateral, not multilateral, treaties. This was done through an agreement by the two parties to amend the treaty, followed by termination. Proceeding in this way, states have altered or extinguished survival clauses in at least eight instances. In some cases, they decided to shorten the period of additional protection.<sup>21</sup> In other instances, they extinguished the survival clause altogether.<sup>22</sup> To date, no claims have been based on a neutralized survival clause, and no arbitral tribunal has thus been confronted with the question of jurisdiction in such circumstances.<sup>23</sup> This fact is not conclusive as to whether arbitral tribunals will uphold or reject jurisdiction because of neutralization. However, evolving state practice is an indicator that neutralization is effective, as it manifests the will of the contracting parties and decreases the likelihood of success of claims for the investor when pursuing arbitration, thereby increasing the risk associated with initiating expensive arbitration proceedings.

Neutralization of a survival clause in a bilateral treaty by way of amendment is different from the neutralization of the survival clause in a *multilateral* treaty among only a group of the contracting states. For the case of a withdrawal from the ECT, the latter scenario is most relevant. From a public international law perspective, such a partial neutralization finds support in the international law rules for the *modification* of treaty provisions. According to these rules, to extinguish the effect of the survival clause, states may negotiate a modification or so-called *inter se* agreement. Contrary to an *amendment*, for which the ECT requires unanimity, a modification amounts to the “variation of certain treaty provisions only as between particular parties of a treaty, while in their relation to the other parties the original treaty provisions remain applicable.”<sup>24</sup>

### **Neutralization through Modification**

The ECT does not expressly mention modification, which is therefore governed by the default rule in Article 41 of the VCLT. This rule provides that “[t]wo or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone.” Modification is subject to two conditions aimed at safeguarding the basic integrity of the original treaty regime.

### **First Condition—Safeguarding third-party rights**

According to Article 41 (b)(i) of the VCLT the modification must “not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations.” There is academic consensus that the first condition depends on the legal nature of the rights and obligations that a treaty creates, and specifically, whether these rights and obligations are of a *reciprocal*, *interdependent*, or *integral* nature.<sup>25</sup> A multilateral treaty is reciprocal in nature if it is “providing for a mutual interchange of benefits between the parties, with rights and obligations for each involving specific treatment at the hands of and towards each of the others individually.”<sup>26</sup> This must be distinguished from interdependent or integral treaty undertakings that create obligations *erga omnes*.

As evidenced by the *Travaux Préparatoires* that led to its conclusion, the ECT was adopted as a “package deal” consisting of a bundle of reciprocal bilateral relations.<sup>27</sup> Rather than creating obligations that are binding *erga omnes partes*, obligations under the treaty operate bilaterally. In practice, if the actions of host state A violate the rights under the ECT of an investor from home state B having invested within the area of host state A, only this investor or home state B have standing to bring a claim.<sup>28</sup> It follows that the rights and obligations in the ECT are reciprocal in nature. An *inter se* modification to extinguish the survival clause would not therefore affect other parties’ rights contrary to the first condition in Article 41(b)(i) of the VCLT. An *inter se* neutralization hence meets the first condition.

### **Second Condition—Safeguarding the object and purpose of the treaty**

In addition, modification must “not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole” (Article 41 (b)(ii) of the VCLT). This condition is widely viewed to be substantially similar to, if not a reiteration of the first condition.<sup>29</sup> In ensuring that subsequent agreements do not affect the rights of third parties, both conditions follow the same rationale. The International Law Commission’s *Travaux Préparatoires* for the VCLT suggest that where an *inter se* agreement alters only bilateral relations it should be permissible. In this case, it would not be “incompatible with the effective execution of the object and purpose of the treaty.” Comparable rules of public international law indicate that only a derogation from interdependent rather than bilateral obligations would fail to meet the second condition. This might be the case where a subsequent *inter se* agreement “radically changes the position of every other party.”<sup>30</sup>

As has been established above, the ECT consists of a bundle of bilateral relations. The alteration of some of these relations among a group of the contracting parties would not adversely impact the rights of intra-ECT third parties, i.e., those of non-modifying states and their investors. For instance, if all EU member states decided to withdraw from the ECT and neutralize the survival clause amongst themselves, nothing would prevent an investor from a

non-EU party from bringing a claim against the withdrawing states. An *inter se* neutralization would therefore also meet the second requirement in Article 41(b)(ii) of the VCLT.

### **Conclusion**

There is a legal basis for a withdrawal from the ECT with an *inter se* neutralization of the survival clause. In contrast to the continued protection of existing and certain future fossil fuel investments under the EU's amendment proposal, such a withdrawal would put an immediate end to treaty-based fossil fuel protection and ISDS among all withdrawing states. In the short term, this would significantly reduce ISDS risks, given that 60% of the cases based on the ECT are intra-EU. It would also enable the EU and its member states to comply with the EU's climate objectives and EU law. If further contracting states were to join, the ISDS risk to strong climate action would be further reduced and could pave the way for a fresh, unencumbered negotiation of a truly modern energy treaty that would support the expedited phase-out from fossil fuels and the transition to renewable energy.<sup>31</sup>

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<sup>1</sup> This analysis draws in many respects from a study by Nicolas Angelet commissioned by ClientEarth.

<sup>2</sup> Uniper is a subsidiary of the Finnish state-owned company Fortum. While Finnish government officials have said that they were following the issue closely and are aware of any political implications, they frequently point to Fortum's fiduciary duty under Finnish corporate law to minimize losses from stranded assets: see Darby, M. (2020, May 22). *Not appropriate: Uniper seeks compensation for Dutch coal phase-out*. Euractiv. <https://www.euractiv.com/section/energy/news/not-appropriate-uniper-seeks-compensation-for-dutch-coal-phase-out/>.

<sup>3</sup> See Bohmer, L. (2021, February 3). The Netherlands is facing its first ICSID arbitration, as German energy giant RWE makes good on earlier threats. IAREporter. <https://www.iareporter.com/articles/the-netherlands-is-facing-its-first-icsid-arbitration-as-german-energy-giant-rwe-makes-good-on-earlier-threats/>; Bohmer, L. (2021, April 27). Uniper lodges treaty-based claim against The Netherlands. IAREporter. <https://www.iareporter.com/articles/uniper-lodges-treaty-based-claim-against-the-netherlands/>

<sup>4</sup> See European Union. (2020, May 29). Agreement for the termination of bilateral investment treaties between the member states of the European Union. [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22020A0529\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22020A0529(01))

<sup>5</sup> In another ongoing proceeding related to the ECT before the CJEU, Advocate General Szpunar furthermore indicated a possible answer to the Belgian request when taking the opinion that ISDS under the ECT is not applicable within the European Union: See Opinion by AG Szpunar in Case C-741/19, <http://curia.europa.eu/juris/document/document.jsf?text=&docid=238441&pageIndex=0&doclang=FR&mode=req&dir=&occ=first&part=1&cid=3329784>

<sup>6</sup> See Article 36 of the ECT.

<sup>7</sup> See The Energy Charter Secretariat. (2019, October 6). Decision of the Energy Charter Secretariat, pps. 2–57, <https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2019/CCDEC201908.pdf>

<sup>8</sup> See for example Climate Action Network Europe. (2021, February). Analysis of the EU proposal to change the definition of Economic Activity in the Energy Sector as part of the modernisation of the Energy Charter Treaty. [https://caneurope.org/content/uploads/2021/02/Analysis-of-the-COM-proposal-for-ECT-modernisation-on-the-Definition-of-Economic-Activity-in-the-Energy-Sector\\_February-2021.pdf](https://caneurope.org/content/uploads/2021/02/Analysis-of-the-COM-proposal-for-ECT-modernisation-on-the-Definition-of-Economic-Activity-in-the-Energy-Sector_February-2021.pdf)

<sup>9</sup> See EU Commission. (2021, January 25). EU text proposal for the modernisation of the Energy Charter Treaty. [https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc\\_159436.pdf](https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159436.pdf)

<sup>10</sup> See *ibid.*, page 2.

<sup>11</sup> See *ibid.*; the proposed carbon threshold is 380g “fossil” CO<sub>2</sub>/kWh.

<sup>12</sup> See *supra*, note 7.

<sup>13</sup> See *ibid.*

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<sup>14</sup> See Minister Claude Turmes' intervention at the event "Should EU Member States fix the Energy Charter Treaty or withdraw from it?" jointly organized by ClientEarth, EEB, FoE Europe, and CAN Europe on March 30, 2021, at minute 40:13. <https://www.youtube.com/watch?v=IqsPFBfXAoY>

<sup>15</sup> France's government has signalled its willingness to withdraw if swift and meaningful reform fails: see, Simon, F. (2021, February 3). France puts EU withdrawal from Energy Charter Treaty on the table. Euractiv. <https://www.euractiv.com/section/energy/news/france-puts-eu-withdrawal-from-energy-charter-treaty-on-the-table/>; MEP and Chair of the European Parliament's INTA Committee Bernd Lange recently called for a coordinated withdrawal of the EU from the ECT: See Lange, B. (2021, April 28). Die EU muss raus aus der Energiecharta. Frankfurter Rundschau. <https://bernd-lange.de/meldungen/gastbeitrag-fr-die-eu-muss-raus-aus-der-energiecharta>. 139 European and national parliamentarians urged the EU Commission to withdraw in a letter dated September 8, 2020. <https://www.ernesturtasun.eu/ecologia/statement-the-modernisation-of-the-energy-charter-treaty/>

<sup>16</sup> See Answer given by Executive Vice-President Dombrovskis on behalf of the EC: European Parliament. (2020, December 2). [https://www.europarl.europa.eu/doceo/document/P-9-2020-005555-ASW\\_EN.html](https://www.europarl.europa.eu/doceo/document/P-9-2020-005555-ASW_EN.html)

<sup>17</sup> See United Nations. (2003). Final clauses of multilateral treaties handbook, p. 109. <https://treaties.un.org/doc/source/publications/fc/english.pdf>

<sup>18</sup> Data retrieved from the UNCTAD International Investment Agreement Database, <https://investmentpolicy.unctad.org/international-investment-agreements>

<sup>19</sup> See *ibid.*

<sup>20</sup> If this were the desire of all ECT parties, such neutralization could be achieved through a unanimous amendment. Given the slow progress and lack of compromise at the modernization talks, such a unanimous solution may, however, be difficult to achieve.

<sup>21</sup> See for example the incorporation of the Argentina-Chile FTA into the Chile-Mercosur Agreement in 2017; termination of the Australia–Mexico BIT; termination of the Australia–Viet Nam BIT; termination of the Australia–Peru BIT.

<sup>22</sup> See For instance the termination of the Argentina–Indonesia BIT in 2016; termination of the Australia–Indonesia BIT in 2020; termination of the Australia–Hong Kong BIT in 2020; the 2019 Uruguay–Australia BIT that terminated the previous agreement and overrode its survival clause.

<sup>23</sup> See Tropper, J. (2020). The treaty to end all investment treaties. Völkerrechtsblog. <https://voelkerrechtsblog.org/de/the-treaty-to-end-all-investment-treaties/>

<sup>24</sup> See United Nations. (n.d.). Glossary of terms relating to treaty actions. [https://treaties.un.org/pages/overview.aspx?path=overview/glossary/page1\\_en.xml#amendment](https://treaties.un.org/pages/overview.aspx?path=overview/glossary/page1_en.xml#amendment)

<sup>25</sup> See Odendahl, K. (2012). Article 41. In O. Dörr & K. Schmalenbach (Eds.), *Vienna Convention on the Law of Treaties*. Berlin Springer. §18; see Fitzmaurice, G. G. (1958). *Third Report, Yearbook of the International Law Commission*, II. pp. 43–44, paras. 88–89; see Wood, M.M. et. al. (2009). *The International Law Commission 1999–2009*, vol. 5, page 742.

<sup>26</sup> Fitzmaurice, G.G. (1958). *Third Report on the Law of Treaties*. UN doc. A/CN.4/115, YILC, Vol. II, 20, 27, Art. 18, para. 2.

<sup>27</sup> Indeed, this seems to have been a decisive factor to allow signatories to find sufficient consensus, see Doré, J. (1996). *Negotiating the Energy Charter Treaty*. In T. Wälde (Ed.). *The Energy Charter Treaty: An east-west gateway for investment and trade*. Kluwer, p. 151.

<sup>28</sup> This also finds support in the International Court of Justice's ruling in the Barcelona Traction case, where the Court held that obligations relating to the diplomatic protection of foreign investments were not binding erga omnes partes: see ICJ. (1970). *Barcelona Traction, Light and Power Company, Judgment*, I.C.J. Reports, §33 ff.

<sup>29</sup> See Pauwelyn, J. (2003). Conflicts of norms in public international law: How WTO law relates to other rules of international law, at 436; Vidigal, G. (2013, November). From bilateral to multilateral law-making: Legislation, practice, evolution and the future of Inter Se agreements in the WTO. *European Journal of International Law*, 24(4), pps. 1027–1053, here: 1042; Sadat-Akhavii, S.-A. (2003). *Methods of resolving conflicts between treaties*. Graduate Institute of International Studies (Series), Vol. 3. Brill Academic Publishers.

<sup>30</sup> Article 60 (2)(c) of the VCLT; also see article 42(b)(ii) of the ILC Draft Articles on State Responsibility (2001).

<sup>31</sup> See The Creative Disrupters. (2018). Treaty on sustainable investment for climate change mitigation and adaptation, prepared as part of a submission to the Stockholm Treaty Lab Prize. <https://stockholmtreatylab.org/wp-content/uploads/2018/07/Treaty-on-Sustainable-Investment-for-Climate-Change-Mitigation-and-Adaptation-1.pdf>.