Memorandum on the Legal Consequences of a Withdrawal of the EU from the Energy Charter Treaty on Member States

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INTRODUCTION AND SUMMARY

1. In the context of recent announcements from major EU Member States wishing to withdraw from the Energy Charter Treaty ("**ECT**"), the European Commission ("**Commission**") faces increasing pressure to acknowledge the failure of ECT "modernisation", abandon the current reform process and consequently prepare for the "*coordinated withdrawal from the Treaty on behalf of the EU and its Member States*".[1]

2. In this context, we were asked to assess the legal consequences for the EU Member States in the case of uncoordinated[2] EU withdrawal from the ECT ("**EU withdrawal**"), and more precisely whether such an event would consequently force Member States to follow suit.

3. In principle, the EU Member States cannot conclude and operate themselves investment treaties with third countries, due to the EU exclusive competence with regard to foreign direct investment ("**FDI**"). In addition, the ECT does not appear to be covered by the Regulation No 1219/2012 of the EU (the "**Grandfathering Regulation**" or "**Regulation**") that specifically empowers Member States to maintain in force pre-existing investment treaties. However, the ECT has a specific position under EU law.

4. The following legal analysis considers the above to highlight the far-reaching consequences that a change in circumstances such as EU withdrawal would bear. It concludes that, under EU law, there are strong arguments supporting that, as scholars have argued,[3] EU withdrawal from the ECT would force Member States to leave the treaty too. It however suggests caution as this touches upon a still-debated and forward-looking legal issue, whose answer may vary according to the evolution of the legal framework.

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[1] See e.g. the European Parliament resolution of 24 November 2022 on the outcome of the modernisation of the Energy Charter Treaty, at https://www.europarl.europa.eu/doceo/document/TA-9-2022-0421_EN.pdf.
[2] The term uncoordinated withdrawal refers to the hypothesis where the EU withdraws from the treaty in its own name and (some or all) Member States do not follow suit.
[3] C. Eckes and L. Ankersmit, "The compatibility of the Energy Charter Treaty with EU law" (21 April 2022), p. 54, at https://www.clientearth.org/media/2n2po04j/report-on-ect-compatibility-with-eu-law.pdf.

A. THE EXCLUSIVE COMPETENCE OF THE EU REGARDING FOREIGN DIRECT INVESTMENTS NORMALLY PRECLUDES MEMBER STATES FROM CONCLUDING AND OPERATING THEMSELVES INVESTMENT TREATIES WITH THIRD COUNTRIES

5. Since the entry into force of the Lisbon Treaty in 2009, FDI fall within the exclusive competence of the EU, as part of the common commercial policy.[4]

6. The Court of Justice of the European Union (the "**CJEU**" or the "**Court**") has stressed that "*an international agreement cannot affect the allocation of powers fixed by the Treaties or, consequently, the autonomy of the Community legal system*".[5] It is therefore considered that elements of the autonomy of the EU legal order, such as the allocation of powers established by the EU Treaties, "*belong to the non-derogable core of EU primary law as they contain within them the very foundations of the Community legal order*".[6]

7. The Court has clarified that the EU's exclusive competence with regard to FDI concerned the substantive parts of international investment agreements (*i.e.* those containing investment protection standards)[7] – while provisions relating to investor-State dispute settlement ("**ISDS**") (if any) still require the consent of Member States.[8]

8. In addition, it is settled case law that "*by virtue of Article 2(1) TFEU, the Member States, unless so empowered by the European Union, are prohibited from adopting acts producing legal effects in areas which fall within an exclusive competence of the European Union*".[9]

9. Accordingly, only the EU may legislate and adopt legally binding acts within that area. Member States therefore lack the competence to conclude and operate themselves investment treaties with third countries, unless empowered by the EU.

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[4] Articles 2(1), 3(1)(e) and 207 TFEU; Regulation No 1219/2012, Recital 1.

[5] CJEU, Cases C-402/05 P and C-415/05 P, 3 September 2008, *Kadi II*, § 282, at https://curia.europa.eu/juris/document/document.jsf?text=&docid=67612&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=10872.

[6] M. De Boeck, *EU Law and International Investment Arbitration* (Brill Nijhoff, 2022), pp. 203, 249, 318 and 325; N. Lavranos, "Protecting EU law from international law" (2010) 15 *European Foreign Affairs Review*, p. 269.

[7] CJEU, Opinion 2/15, 16 May 2017, §§ 82 ff, at https://curia.europa.eu/juris/document/document.jsf?text=&docid=190727&doclang=EN.

[8] Investment agreements containing ISDS clauses, such as the ECT, are known as 'mixed agreements' under EU law.

[9] CJEU, Opinion 2/15, § 250.

B. THE ECT IS NOT SUBJECT TO THE GRANDFATHERING REGULATION EMPOWERING MEMBER STATES TO MAINTAIN PRE-EXISTING AGREEMENTS IN FORCE

10. The Grandfathering Regulation notably allows Member States to maintain in force pre-existing "bilateral investment agreements" despite the new allocation of competence in favour of the EU, in accordance with Article 2(1) TFEU.[10]

11. The Grandfathering Regulation is based on the acknowledgement that investment protection provisions in investment treaties[11] are incompatible with the EU's exclusive competence and overlap with EU rules on the movement of capital between Member States and third countries.[12] This is precisely what the Regulation was intended to resolve, by enabling Member States to exercise powers in an area where the EU retains exclusive competence.[13] It has therefore been argued that without the Regulation the EU Member States would have been forced to eliminate investment treaties.[14]

12. Thus, a key question in order to assess the impact of the EU withdrawal on Member States is whether the ECT is covered by the Grandfathering Regulation.

13. Articles 1 and 2 of the Regulation lay down the following features that define the scope and conditions under which existing treaties may be maintained in force, in accordance with Article 3:

    (i) The term "bilateral investment agreement" is defined broadly so as to mean "any agreement with a third country that contains provisions on investment protection" (Article 1(2));

    (ii) Bilateral investment agreements signed before 1 December 2009 must have been notified by 8 February 2013 (or within 30 days of the date of the Member State's accession to the UE) (Article 2). In addition, Article 4 provides that the Commission must publish an updated list of notified treaties each year.

14. It appears that the ECT does not meet these conditions:

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[10] Article 2(1) TFEU: "*When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts*". The Regulation also lays down the conditions under which Member States can be authorized to amend or conclude bilateral investment agreements with third countries after 9 January 2013.

[11] The Regulation covers only provisions "*dealing with investment protection*" (Article 1(2)), in line with the allocation of competence between the EU and Member States (see Recital 3 of the Regulation and above part 1)

[12] Preamble of the Regulation. See specifically, Recital 2: "*Those rules can be affected by international agreements relating to foreign investment concluded by Member States*" (see also Recital 4).

[13] See Recital 5 of the Regulation: "*[...] the conditions <u>for their [bilateral investment agreements'] continuing existence</u> and their relationship with the Union's investment policy require appropriate management*" (emphasis added); C. Eckes and L. Ankersmit, above note 3, p. 55. Others provide that the Regulation was merely meant to avoid uncertainty on the legal fate of these treaties "*due to the shift in the allocation of powers to the EU*", while stressing that opinions remained divided on whether the 2009 transfer of competence affected the existing agreements concluded by the Member States (see M. De Boeck, above note 6, pp. 203-213 and 318).

[14] C. Eckes and L. Ankersmit, above note 3, pp. 54-55.

(i) First, the term "bilateral investment agreement" used throughout the Regulation is explicit when referring to *bilateral* treaties. Even though some may argue that under a strict reading of the text of Article 1(2) such definition also addresses multilateral treaties, this should logically exclude multilateral treaties like the ECT.[15]

(ii) Second, and in any event, the ECT was not notified by any of the Member States and is therefore absent from the official list of agreements covered by the Regulation published by the Commission.[16]

15. It therefore seems reasonable to conclude that the ECT is not covered by the Grandfathering Regulation. It follows that this Regulation does not empower EU Member States to exercise powers normally vested in the EU in this area, with respect to the ECT.[17]

C. THE SPECIFIC POSITION OF THE ECT UNDER EU LAW

16. The fact that the ECT is not subject to the Grandfathering Regulation does not mean that the ECT is a 'stray' agreement that would plainly and immediately need to be eliminated because of its incompatibilities with EU law.

17. Indeed, there is a fundamental difference between the ECT and other investment agreements to which Member States are parties to, since the EU itself is a signatory. In fact, the ECT is – as things stand – "an act of EU law" that forms an "integral part" of the EU legal order. The CJEU has explicitly stated this in its *Komstroy* ruling:

> "*It is apparent from the Court's settled case-law that an agreement concluded by the Council, pursuant to Articles 217 and 218 TFEU constitutes, as regards the European Union, an act of one of its institutions, that the provisions of such an agreement form an integral part of the legal order of the European Union from the time it enters into force and that, in the context of that legal order the Court has jurisdiction to give a preliminary ruling on the interpretation of that agreement.*
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> […]

[15] G. Coop, "20 Years of the Energy Charter Treaty" (2014) 29(3) *ICSID Review*, p. 524: "*This Regulation clearly does not address multilateral investment treaties, including the ECT*"; C. Eckes and L. Ankersmit, above note 3, p. 55; J. Kleinheisterkamp, "Investment protection and EU law: The intra- and extra-EU dimension of the energy charter treaty" (2012) 15(1) *Journal of International Economic Law*, p. 106.

[16] List of the bilateral investment agreements referred to in Article 4(1) of Regulation (EU) No 1219/2012 of the European Parliament and of the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries, OJ C 313 (17 August 2022), at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022XC0817%2803%29&qid=1669394010836.

[17] In case it becomes necessary, the EU may however legislate to adopt a similar text specifically dealing with the ECT, which would empower Member States to maintain their membership under certain conditions.

> *As stated in paragraph 23 of this judgment, the ECT itself is an act of EU law.*"[18]

18. In this context, there is no conflict *per se* between the substantive parts of the ECT and EU law,[19] since the ECT *is* EU law. The overlap between the two set of substantive rules and the lack of competence of the Member States are not an issue (yet). In other words, as long as the EU is still a party to the ECT, the Member States' ECT membership does not raise any competence issues, given that, as stated by Christina Eckes and Laurens Ankersmit, "*it is the EU that is exercising its powers over those parts of ECT for which it is competent*".[20] It does not seem that the fact that Member States and the EU are parties to the ECT in their own names changes anything: it would be difficult to blame Member States for participating in an investment treaty that has 'EU law' status.

19. The EU leaving the ECT would therefore represent a decisive change in circumstances with potentially far-reaching consequences, in light of the above.

D. THE ENSUING OBLIGATIONS FOR MEMBER STATES IN CASE OF EU WITHDRAWAL

20. In view of the foregoing, if the EU withdraws from the ECT, the ECT would lose its 'EU law' status and become an 'ordinary' investment treaty signed by Member States with third countries. Thus, the ECT would (i) potentially clash with existing EU internal market rules and (ii) be maintained in conflict with the allocation of competence within the EU in the area of FDI, since it could not benefit from the Grandfathering Regulation (See Section B).

21. As recalled above, the Member States' pre-existing international obligations cannot derogate from the allocation of powers and competence within the EU. In principle, this speaks against the existence of a legal act in violation of the division of competence.[21]

22. In this regard, certain EU law scholars have unambiguously held that *"[i]f the EU were to withdraw from the ECT, EU Member States as parties to the ECT are under an obligation under EU law to [withdraw] as well"*, since remaining party to the treaty without the EU *"would result in them exercising a competence that they no longer have*".[22]

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[18] CJEU, Case C-741/19, 2 September 2021, *Komstroy*, §§ 23 and 49 (emphasis added), at https://curia.europa.eu/juris/document/document.jsf?text=&docid=245528&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=172021.

[19] In terms of legal order – this does not preclude any other incompatibilities between ECT provisions and EU law (see M. De Boeck, above note 6, p. 320).

[20] C. Eckes and L. Ankersmit, above note 3, p. 55

[21] M. De Boeck, above note 6, p. 204.

[22] C. Eckes and L. Ankersmit, above note 3, pp. 54-55. See also, J. Kleinheisterkamp, above note 15, p. 88.

23. However, some authors have expressed different views[23] and no definite answer was brought to this question since it first emerged.[24] It has been argued that Article 351(1) TFEU – which protects third countries' rights under agreements pre-existing Member States' accession to the EU –[25] may (i) create an obstacle to an obligation to denounce the ECT for Member States that joined the EU after the ECT, but also (ii) be applied by analogy to agreements entered into by Member States at a time where they had the competence to do so.[26]

24. In our view, such arguments are not as compelling as those speaking in favour of an obligation to withdraw.

25. First, Article 351(2) TFEU provides for a conflict clause in case of incompatibilities with EU primary law:

> "*To the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude*." (emphasis added)

26. In particular, the CJEU case law shows that in the event that such "appropriate steps" have failed, Member States are under the obligation to withdraw from the treaty:

> "*In this case, the Portuguese Government has not succeeded in adjusting the contested agreement by recourse to diplomatic means within the time-limit laid down by Regulation No 4055/86.*
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> *It must be borne in mind that the Court has already held that, in such circumstances, in so far as denunciation of such an agreement is possible under international law, it is incumbent on the Member State concerned to denounce it (see, to that effect, Case C-170/98 Commission v Belgium [1999] ECR I-5493, paragraph 42).*"[27]

27. Although the wording used by the Court seems straightforward enough, some commentators have instead construed this case law as setting an obligation to denounce

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[23] M. De Boeck, above note 6, p. 325: "*It is not fully clear how the intervening transfer of competences from the Member States to the EU during the existence of those agreements affects the continued compatibility of those extra-EU BITs*" (see also pp. 203 ff).
[24] While this question was largely discussed at the time of entry into force of the Lisbon Treaty, it has lost its relevance since the adoption of the Grandfathering Regulation.
[25] Article 351(1) TFEU: "*The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties*."
[26] M. De Boeck, above note 6, pp. 205-213 and 318. Some scholars thus argued that pre-existing investment treaties remained valid under EU law (p. 319).
[27] CJEU, Case C-62/98, 4 July 2000, Commission v. Portugal, §§ 33-34, at https://curia.europa.eu/juris/document/document.jsf?text=&docid=45421&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=251885.

a treaty only if this would resolve the incompatibility *in concreto*.[28] It was notably submitted that in the context of the extra-EU BITs, "*an obligation of unilateral denunciation on the basis of article 351(2) TFEU is not an appropriate outcome from the perspective of EU law*" because of survival clauses that may prevent any effective termination.[29] But even assuming that such reading is appropriate, it may be argued that "appropriate steps" could consist in adopting a "common attitude",[30] such as coordinated withdrawal through an *inter se* agreement that would neutralise these clauses, as suggested elsewhere[31] and already done by Member States in the context of intra-UE BITs.[32]

28. Second, the application of Article 351(1) TFEU by analogy would likewise likely lead to the same conclusion. Indeed, Article 351 is "*merely a specification of the more general duty of loyal cooperation*" enshrined in Article 4(3) TEU, which also provides that "*Member States shall take any appropriate measure [...] to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union*".[33] The duty of loyal cooperation may then ultimately compel Member States to denounce the ECT in case of EU withdrawal.[34]

29. **Therefore, despite remaining uncertainty, especially in the absence of case law, there are strong arguments suggesting that all Member States would be under the obligation to exit – collectively, preferably – the ECT in case of EU withdrawal. This matter would probably need to be addressed by the CJEU, unless ECT-specific regulation is preemptively adopted by the EU to allow the continuing application of the ECT the same way it did for bilateral treaties.**

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[28] M. De Boeck, above note 6, p. 232.
[29] ibid., p. 234.
[30] In line with Article 351(2) TFEU, second sentence.
[31] L. Schaugg and A.S. Nair, « The Reform That Isn't » (*Verfassungsblog*, 18 November 2022), at https://verfassungsblog.de/the-reform-that-isnt/; M. Dietrich Brauch « Should the European Union fix, leave or kill the Energy Charter Treaty? » (*blogdroiteuropéen*, 9 February 2021), at https://blogdroiteuropeen.com/2021/02/09/should-the-european-union-fix-leave-or-kill-the-energy-charter-treaty-by-martin-dietrich-brauch/; -C. Eckes, « Stepping out of the modernized Energy Charter Treaty – the best way forward? » (*European Law Blog*, 23 September 2022), at https://europeanlawblog.eu/2022/09/23/stepping-out-of-the-modernized-energy-charter-treaty-the-best-way-forward/.
[32] Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union, OJ L 169 (29 May 2022), at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A22020A0529%2801%29.
[33] J. Kleinheisterkamp, above note 15, p. 88; M. De Boeck, above note 6, p. 210.
[34] Conversely, other authors hold that the EU's duty of loyalty towards Member States imply a duty to honour pre-existing international agreements (see M. De Boeck, above note 6, pp. 205 and 318, notably referring to J. A. Bisschoff, "Just a little bit of "mixity"? The EU's role in the field of international investment protection law", 48 Common Market Law Review, p. 1548).