Summary Analysis: Arguments Relating to the Desirability and Feasibility of a Coordinated EU Withdrawal from the ECT and Neutralisation of the Sunset Clause

From: Clémentine Baldon and Nikos Braoudakis, Avocats

To: Veblen Institute

INTRODUCTION AND SUMMARY

1. In the context of recent announcements from major EU Member States wishing to withdraw from the Energy Charter Treaty ("**ECT**") due to its incompatibility with the EU's climate objectives,[1] the option of a coordinated withdrawal of the EU, its Member States, and other willing ECT Contracting Parties has gained some weight.[2]

2. One of the major arguments raised against coordinated withdrawal – as opposed to the reformed ECT[3] – is the "sunset clause" contained in Article 47(3) of the ECT, pursuant to which investments made prior to withdrawal will continue to be protected under the ECT for 20 years after a State withdraws.[4] Despite being one of the main concerns, the sunset clause would remain untouched under the modernised ECT, as it has never been discussed or even considered as part of the negotiations on the modernisation of the ECT.

3. It is thus often argued that a coordinated withdrawal may be accompanied by an *inter se* modification agreement that would neutralise the sunset clause among the participating States ("**Neutralisation Agreement**"), within the meaning of Article 41 of the Vienna Convention on the Law of Treaties ("**VCLT**").

4. This note aims at reviewing and analysing the arguments that have been advanced in relation to the desirability of such a coordinated withdrawal in contrast to the modernisation of the ECT (**A**) and to the legality of a Neutralisation Agreement (**B**).

5. This note concludes that there are strong arguments that confirm the availability of a Neutralisation Agreement as a suitable and effective alternative to the ECT modernisation. Not only this appears as the most desirable outcome in view of the

[1] So far, Poland, Spain, Germany, France, the Netherlands, Luxembourg, and Slovenia have expressed their intention to withdraw from the ECT, while Belgium and Austria announced they were considering it (see here).
[2] 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.
[3] See the Agreement in principle (24 June 2022).
[4] Article 47(3) ECT: "*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*".

continuing protection of fossil fuels under the modernised ECT, but the Neutralisation Agreement would also be firmly grounded in public international law.

A. Arguments Relating to the Desirability of a Coordinated Withdrawal v. ECT Modernisation

1. Arguments on the duration of investment protection in fossil fuels

6. Some authors argue that the modernisation of the ECT[5] would be preferable because it would limit fossil fuel protection to 10 years compared to 20 years in case of a withdrawal from the old ECT (as a result of the sunset clause)[6] – most often, the alternative of neutralising the sunset clause is simply ignored or silenced.[7] As demonstrated by researchers,[8] it is **incorrect and misleading** to state this:

   a. First, the fossil fuel partial "carve out" under the modernised ECT would only apply to investments made in the EU and the UK. In contrast, investments made in all other Contracting Parties (more than 20, in addition to those expected to join the ECT shortly), including those made by EU and UK investors, will continue to be protected. These countries include major oil producers (e.g. Kazakhstan and Azerbaijan) and capital exporting States. Therefore, fossil fuel investments, for the most part, would continue to enjoy protection under the reformed ECT indefinitely.

   b. Second, even in the EU and the UK, it is highly likely that foreign investment in fossil fuels made prior to 15 August 2023 will continue to be protected for a much longer period than the agreed 10-year period. Indeed, this period would only start to run at the entry into force of the provision containing this rule – which could be "*years from now*" and "p*ossibly at different times in different ECT contracting parties*". The entry into force of the provision may be conditional on attaining the ratification threshold required for amendments of the treaty (Article 42(4) ECT), which would move the period "*closer to 15 or even 20 years*".[9]

[5] The agreed reform provides for an option for States to opt out of fossil fuel protection for investments made in their territories; the EU and the UK would exclude such protection under the modernised treaty for existing investments after 10 years from the entry into force of the relevant provisions and for new investments made after 15 August 2023 as of that date. However, the agreed carve-out contains important derogations that may further dilute its effectiveness, in particular for gas investments (see OpenExp, "Modernisation of the Energy Charter Treaty: understanding what is at stake and what's next" (2022), p. 3).
[6] See e.g. J. Tropper, "Withdrawing from the Energy Charter Treaty: The End is (not) Near" (*Kluwer Arbitration Blog*, 4 November 2022); N. Lavranos, "Energy Charter Treaty: Withdrawing is worse than signing up to reformed deal" (*Borderlex*, 20 October 2022)
[7] Squire Patton Boggs, "France withdraws from the Energy Charter Treaty" (26 October 2022); G. Filhol and W. Brillat-Capello, "Effets juridiques du retrait de la France du Traité sur la Charte de l'énergie" (*Le Club des juristes*, 7 December 2022).
[8] OpenExp, above note 6; L. Schaugg and A.S. Nair, "The Reform That Isn't" (*Verfassungsblog*, 18 November 2022).
[9] L. Schaugg and A.S. Nair, above note 9. Otherwise, it may enter into force upon provisional application of the modernised treaty – if provisional application is voted, which seems unlikely considered the mixed agreement status of the ECT under EU law, even though here States might have an incentive to vote rapidly.

2. Arguments on the role of the ECT in the energy transition

7. Arguments against a coordinated withdrawal generally tend to solely focus on fossil fuels and portray the protection of renewable energy investments under the ECT as a driver of the energy transition.[10]

8. This ignores several core considerations:

   a. The fact that the modernised ECT would substantially extend treaty coverage to include new or emerging energy activities,[11] some of which may in fact result in higher greenhouse gas emissions than fossil fuels (e.g. biomass,[12] biofuels);

   b. The fact that urgently undertaking an energy transition must encompass a high degree of flexibility for States to regulate, encourage and limit energy activities, including in the renewable energy sector, and be able to adjust these choices at a later stage.[13] As stated by an author, extended protection under the modernised ECT "*cements future energy policy and is at odds with what we need in the energy transition: flexibility for a search for the best energy solutions*";[14]

   c. Last, assuming that the ECT is a driver of the energy transition simply because it protects investments in renewable energy and because a majority of disputes concerned such investments is based on the unverified premise that it increases investment in clean energy.[15] It also neglects the above two points.

3. Arguments on the risk of corporate and investment restructuration circumventing the Neutralisation Agreement

9. An argument sometimes raised against the practical effectiveness of a coordinated withdrawal and elimination of the sunset clause is the unintended effect that it might prompt corporations (e.g. those most likely affected by governmental measures targeting fossil fuel investments[16]) to restructure in States where they could still enjoy continued protection under the ECT.[17]

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[10] See e.g. Global Arbitration Review, "European exodus from the ECT: politics and unintended consequences" (15 November 2022); G. Filhol and W. Brillat-Capello, above note 8.
[11] IISD, "Uncertain Climate Impact and Several Open Questions" (July 2022), pp. 9 *et seq*.
[12] See e.g. https://www.chathamhouse.org/2017/02/woody-biomass-power-and-heat
[13] See e.g. Veblen Institute, "Protecting renewables with the Energy Charter Treaty: a false good idea" (July 2022).
[14] C. Eckes, "Stepping out of the modernized Energy Charter Treaty – the best way forward?" (*European Law Blog*, 23 September 2022). See also, L. Schaugg and A.S. Nair, above note 9.
[15] OpenExp, above note 6, p. 7; CCSI, "The Role of Investment Treaties and Investor-State Dispute Settlement in Renewable Energy Investments" (December 2022), and its accompanying infographic "Are IIAs and ISDS helping or hindering progress towards renewable energy goals?".
[16] For instance, Shell moved its headquarters from the Netherlands to the UK in January 2022 (see here).
[17] J. Tropper, above note 7, notably arguing that there is more leeway for corporate restructuring under the old ECT than under the modernised version; Ashurst, "European states seek to exit the Energy Charter Treaty what does this mean for energy investors" (4 November 2022) (while acknowledging the possibility that the sunset clause is abandoned between a group of withdrawing States).

10. While this is indeed a risk to consider, States have the ability to curtail it in the Neutralisation Agreement. They could explicitly exclude the possibility of companies circumventing the effects of the *inter se* modification treaty by changing their corporate structure and/or restructuring their investment. It has thus been concluded that "*a combination of withdrawal and an inter-se modification of the ECT would be able to terminate all rights of investors that at the time of their investment were seated within the EU or a withdrawing third state that agrees to the inter-se modification of the ECT*".[18]

B. ARGUMENTS RELATING TO THE LEGALITY OF A NEUTRALISATION AGREEMENT

11. It should first be recalled that **as a general rule in public international law, States are free to define the content of their agreements and to conclude them with the counterparts they choose**.[19] In other words, they are the masters of their treaties, which they can organise and control as they see fit. Consequently, States may always terminate, suspend, modify or amend the provisions of a prior treaty, as long as there is mutual consent. Accordingly, since the adoption of the VCLT, **leading scholars have continuously held that a multilateral treaty may be terminated in relation to a group of parties only** (in their reciprocal relations) while remaining in effect with respect to parties outside that group.[20]

12. Against this background, the arguments raised relating to the legality of a Neutralisation Agreement are analysed below.

1. Legality of a Neutralisation Agreement in light of Article 41 VCLT

13. Some authors have expressed doubts on whether a Neutralisation Agreement would meet the conditions of Article 41(1)(b) VCLT, against which the legality of the agreement must be assessed. However, the analysis of this provision and its interpretation shows that an *inter se* agreement neutralising the ECT sunset clause between signatories would likely comply with both of its subparagraphs.

14. First, in accordance with **Article 41(1)(b)(i) VCLT**, the *inter se* modification of a treaty should "*not affect the enjoyment by the other parties of their rights under the treaty or*

[18] C. Eckes and L. Ankersmit, "The compatibility of the Energy Charter Treaty with EU law" (21 April 2022), p. 53.
[19] See e.g. F. Capotorti, "L'extinction et la suspension des traités" (1971) 73 *Collected Courses of the Hague Academy of International Law*, p. 512; UN Secretariat, "Possible reform of investor-State dispute settlement (ISDS), Multilateral instrument on ISDS reform", UN Doc. A/CN.9/WG.III/WP.221, 22 July 2022, paras 34-35.
[20] ibid., pp. 466, 490 and 502-513. See also I. Sinclair, *The Vienna Convention on the Law of Treaties* (Manchester University Press 2nd edn, 1984), p. 185; T. Giegerich, "Article 54" and "Article 58", in O. Dörr and K. Schmalenbach (eds), *Vienna Convention of the Law of Treaties: A Commentary* (Springer 2nd ed., 2018), pp. 1022 and 1073-1074. This is based on the fact that all treaties have the same objective degree of effectiveness and that, consequently, within a certain group of parties, the expression of consent can determine the fate of treaties previously agreed upon by the same parties – the only limit being *jus cogens*. Regarding the ECT specifically, see J. Klabbers, "A Moral Holiday – Withdrawal from the Energy Charter Treaty" (*ESIL Reflections*, 15 December 2022).

the performance of their obligations". According to the International Law Commission,[21] this condition is met if the modification does not prejudice the rights of the other States Parties and does not add to their obligations.[22]

15. In the case of a treaty such as the ECT, establishing bilateral and reciprocal obligations, an *inter se* agreement to neutralise the sunset clause would not affect the rights of countries unwilling to participate in the Neutralisation Agreement, since the clause would continue to produce its effects in relations with these countries. Thus, **the first condition set by Article 41(1)(b) VCLT should be met.**

16. In addition, suggestions that Article 41(1)(b)(i) VCLT would also cover investors' rights as third parties are not credible. Indeed, the wording of the provision is explicit in addressing the rights of other parties to the treaty – *i.e.* States only, excluding any natural persons.[23]

17. Second, **Article 41(1)(b)(ii) VCLT** adds the condition that the modification should "*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*".

18. In the case of the Neutralisation Agreement, there are strong arguments suggesting this condition will be met (i.e. that it would not imply a derogation incompatible with the execution of the object and purpose of the ECT), as developed in several articles.[24]

19. In particular, it is widely agreed that this condition aims to ensure that States do not escape from non-reciprocal (*erga omnes*) and absolute obligations (e.g. human rights treaties); conversely, where an *inter se* agreement alters only bilateral relations, it should be permissible.[25] As stated above, the ECT instead establishes a bundle of bilateral relations and reciprocal obligations that bear no absolute character. In the present case, all rights of non-modifying States would thus be left intact.

2. Legality of the Neutralisation Agreement in light of Article 16 ECT

20. Some authors have argued that Article 16 of the ECT,[26] either by itself or read in combination with Article 41 VCLT, would prohibit any meaningful neutralisation of the sunset clause. It has been suggested that "*it is highly likely that many arbitral tribunals will still uphold jurisdiction given Article 16 ECT and previous case law on inter se*

[21] The United Nations expert body working on the progressive development and codification of international law.
[22] K. von der Decken, "Article 41", in O. Dörr and K. Schmalenbach (eds), above note 21, p. 783.
[23] ibid.
[24] ClientEarth and IISD, "Energy Charter Treaty Reform: Why withdrawal is an option" (24 June 2021); L. Schaugg and A.S. Nair, above note 9; M. Dietrich Brauch "Should the European Union fix, leave or kill the Energy Charter Treaty?" (*blogdroiteuropéen*, 9 February 2021).
[25] See K. von der Decken, above note 23, p. 783; F. Capotorti, above note 20, pp. 508-509.
[26] Article 16 ECT provides that when ECT Contracting Parties are at the same time parties to another treaty (prior or subsequent) that contains provisions relating to investment protection or investor-State dispute settlement, the regime most favourable to the investor prevails.

modifications".[27] However, this argument (held by a minority of views) **does not sustain for a number of reasons**:

a. Article 16 ECT only deals with treaties that share the same subject matter and provides a conflict rule to resolve overlapping regimes (e.g. the EU Treaties contain investment protection rules that may conflict with the ECT provisions);[28]

b. Article 16 ECT concerns the relationship between coexisting investment treaties within the meaning of Article 30 VCLT, according to which the rules on priority between coexisting treaties apply without prejudice to the right of modification;[29]

c. Arbitral tribunals have simply assessed that the EU Treaties do not constitute an implicit *inter se* modification of the ECT between EU Member States – as it would not meet Article 41 VCLT conditions.[30] This finding is therefore irrelevant in the presence of an agreement specifically designed to satisfy these conditions and explicitly addressing the sunset clause. Even arbitral case law cited in support of the claims that Article 16 would prevent neutralisation acknowledge this;[31]

d. Article 16 ECT does not – and cannot –[32] prevent States to expressly revoke their consent by mutual agreement.[33] It cannot be inferred that, from the mere fact that "*eliminating the sunset clause would be a case of a worse position of investors*",[34] Article 16 would set in stone the sunset clause. This would purely negate both (i) the principle that States remain masters of their treaties and (ii) that the object of sunset clauses is to address unilateral withdrawal only;

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[27] J. Tropper, above note 7. Such a contention is notably based on the fact that, under that provision, arbitral tribunals have rejected the contention that EU Treaties resulted in an implicit *inter se* modification of the ECT eliminating consent to intra-EU arbitration. See also C. Tietje, "Der Energiecharta-Vertrag im Kreuzfeuer der Kritik" ("*The Energy Charter Treaty in the crossfire of criticism*") (*Verfassungsblog*, 15 November 2022); H. Huremagić and J. Tropper, "Mission Impossible?" (*Völkerrechtsblog*, 17 November 2021); J. Tropper and K. Wagner, "Don't Pull the Plug on the Energy Charter Treaty" (*Völkerrechtsblog*, 16 May 2022).

[28] See e.g. ClientEarth, "Arguments in favour of Energy Charter Treaty withdrawal" (30 September 2022).

[29] L. Schaugg and A.S. Nair, above note 9, referring to Article 30(5) of the VCLT.

[30] See e.g. T. Voon and A.D. Mitchell, "Denunciation, Termination and Survival. Interplay of Treaty Law and International Investment Law" (2016) 31(2) *ICSID Review*, pp. 413-433.

[31] Vattenfall v. Germany, ICSID Case No. ARB/12/12, Decision on the Achmea Issue, para. 229: "*If the Contracting Parties to the ECT intended a different result, and in particular if they intended for EU law to prevail over the terms of the ECT for EU Member States, it would have been necessary to include explicit wording to that effect in the Treaty. The need for such a provision is reinforced by the existence of Article 16 ECT, since it points to the opposite result*"; BayWa v. Spain, ICSID Case No. ARB/15/16, Decision on Jurisdiction, Liability and Directions on Quantum, paras 280 and 282: "*International law … allows those States to establish the priority of the regime treaty over other sources of international law, at least so long as peremptory norms are not implicated.* […] *If this dictum* [Achmea] *were to be applied to the ECT, it would authoritatively establish, as between Germany and Spain, that the TFEU modifies Article 16 of the ECT on an inter se basis*."

[32] Article 41(1)(b) VCLT provides that *inter se* modification is not possible if it is "prohibited by the treaty". Article 16 ECT (or any other provision) does not prohibit it.

[33] See e.g. ClientEarth, above note 29.

[34] C. Tietje, above note 28.

e. Finally, the Neutralisation Agreement could in any event expressly override the non-derogation clause in Article 16 ECT.[35] Even assuming the conflict rule in Article 16 ECT would operate, it exists without prejudice to any subsequent rule explicitly intended to reverse it.[36]

3. Legality of the Neutralisation Agreement in light of the argument that "an *inter se* modification would thwart the purpose of sunset clauses in general"

21. It has recently been argued that an *inter se* modification of the ECT "*would result in sunset clauses becoming void in international treaty law practice as a whole; these would ultimately no longer have any meaning, since they could be repealed or amended at any time*".[37] Such a statement is both **inaccurate and misleading**:

a. Sunset clauses are designed to ensure investors continue to enjoy protection of investments made in the territory of a State after it withdrew from the treaty. The wording of these clauses, including the one contained in Article 47(3) ECT, leaves no doubt on the fact that only unilateral withdrawal is addressed. Conversely, sunset clauses "*may not disqualify states from being the masters of their treaties*" and prevent them from mutually engaging in subsequent treaty modification,[38] even where such modification results in the extinction of the treaty's legal effects between the signatory parties.[39]

b. In addition, such a general contention has no legal ground and would negate the conditions laid down by Article 41 VCLT – again, an *inter se* modification of the ECT would leave the sunset clause intact for other Contracting Parties' investors.

4. Legality of the Neutralisation Agreement in light of the argument according to which "*the European Commission services have concluded that there is no alternative to modernisation*"

22. As of today, the Commission has merely referred to the sunset clause to discard alternatives to modernisation; it has never provided any genuine legal evaluation of a coordinated withdrawal with an *inter se* agreement to neutralise the sunset clause between

[35] L. Schaugg and A.S. Nair, above note 9.
[36] See above note 32 and K. von der Decken, above note 23, p. 548, on the "*limited legal effect of conflict clauses claiming priority over later treaties*": "*as a general rule, a State that has concluded a treaty on a certain subject matter does not lose its capacity to conclude later inconsistent treaties even if the treaty in question prohibits later incompatible agreements. Therefore, later treaties conflicting with the earlier treaty remain valid and give States Parties the opportunity to incorporate a colliding conflict rule, which, as a consequence, may even cancel out the first conflict clause*". See also F. Capotorti, above note 20, p. 503.
[37] C. Tietje, above note 28.
[38] L. Schaugg and A.S. Nair, above note 9.
[39] See e.g. F. Capotorti, above note 20, pp. 510-512; I. Sinclair, above note 21, p. 185; T. Giegerich, above note 21, p. 1022.

participating States.[40] Thus, no conclusion may be drawn from the Commission's strategy as it stands.

23. In addition, it is worth noting that on 5 October 2022, the Commission has published a draft agreement between the EU and all its Member States intended to clarify that "*the ECT does not apply and never applied to intra-EU relations*".[41] This document – entitled "Subsequent Agreement on the interpretation of the Energy Charter Treaty" – is framed as an agreement within the meaning of Article 31(3)(a) VCLT, while explicitly citing Article 41 CVLT (and justifying compliance with the conditions laid down by this provision). Such a subsequent agreement may thus qualify as an *inter se* modification agreement under Article 41 CVLT,[42] as some authors suggested. Thus, this would be an acknowledgement by the European Commission itself of the feasibility of a mechanism such as the Neutralisation Agreement.[43]

24. It follows from the foregoing that there are strong arguments in support of the availability of a Neutralisation Agreement as a suitable and effective alternative to the ECT modernisation. Not only this appears as the most desirable outcome in view of the continuing protection of fossil fuels under the modernised ECT, but the Neutralisation Agreement would also be firmly grounded in public international law.

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[40] European Parliament, Parliamentary question – Answer given by Executive Vice-President Dombrovskis on behalf of the European Commission (2 December 2022). See also the Commission's proposal for a common position at the 33rd meeting of the Energy Charter Conference.

[41] European Commission, Draft Subsequent Agreement on the Interpretation of the ECT, COM(2022) 523 final, 5 October 2022. See also the Commission's proposal for a common position at the 33rd meeting of the Energy Charter Conference.

[42] This could be supported by the fact that subsequent interpretation agreements within the meaning of Article 31(3)(a) VCLT are normally "*limited to a common act or undertaking between all the parties*", according to the International Law Commission and may be requalified as *inter se* modification agreements; otherwise an agreement between a limited number of parties may instead qualify as a supplementary means of interpretation under Article 32 VCLT, which are conferred lower interpretive weight (ILC, Draft conclusions on subsequent agreements and subsequent practice in relation to the interpretation of treaties, with commentaries, UN Doc A/73/10, Commentary to Conclusion 4, para. 12, and Commentary to Conclusion 7, paras 21 *et seq.*). Arbitrators may also be tempted to deny such an agreement's precedence over the initial text of the ECT (see Sevilla Beheer v. Spain, ICSID Case No. ARB/16/27 [2022], paras 652 and 670). This further highlights the appropriateness of Article 41 VCLT (see O. Dörr, "Article 31", in O. Dörr and K. Schmalenbach (eds), above note 21, p. 594).

[43] L. Schaugg and A.S. Nair, above note 9. In fact, the Commission has stated that "*that agreement will codify the interpretation of the EU and its Member States in a separate treaty (something that is possible because of the bilateral nature of the obligations)*" (see Commission's proposal, above note 41). Therefore, the fact that it explicitly acknowledged that such an agreement was possible regarding the *interpretation* of a multilateral treaty – while this possibility appears to be more debated than in the case of an *inter se* modification (see above note 42) – reinforces the idea that a Neutralization Agreement is feasible at the EU level.