

Kluwer Arbitration Blog

ECT Modernisation Perspectives: No Winners: The Long End of the ECT Modernisation Process

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By the end of April 2023, observers of the ECT modernisation process may have felt as if they were waiting for Godot. The vote on the outcome of the ECT modernisation process, scheduled to take place at an *ad hoc* meeting of Energy Charter Conference at the end of April 2023, was [postponed](#) for the second time. At the time of writing, no new date for the vote has been fixed.

The ECT is perhaps the most controversial international investment agreement (IIA). Concluded in the wake of market liberalisations in the former Eastern Bloc after the end of the Cold War, the multilateral treaty was drafted to serve as a framework for energy cooperation, energy security, and the protection of foreign investments in the energy sector. The protections have been enthusiastically operationalised by investors. Over the past 20 years, the ECT has become the most frequently invoked IIA, giving rise to [over 150 proceedings](#).

As a result of its broad membership and crucial sectoral scope, the ECT has been at the heart of some of the most controversial issues of investor protection and investment arbitration in recent years. It has shaped the debate on intra-EU investor-state dispute settlement (ISDS) and – due to its focus on the energy sector, including fossil fuels – has come to represent everything that is wrong with ISDS to its [critics](#).

Over the past two years, the Energy Charter Conference – the institution of state parties to the ECT – conducted negotiations to modernise the treaty. This Blog has [provided extensive coverage](#) of the modernisation process. With the vote on the modernisation of the treaty postponed for the second time, it appears that the process may conclude without any winners.

Negotiation Process

The roots of the modernisation efforts of the ECT can be [traced back to 2009](#) when Russia withdrew from the provisional application of the Treaty. As discontentment with the ECT grew in the 2010s, the parties to the ECT launched the modernisation process in 2017. A Subgroup on Modernisation prepared the negotiations between 2018 and 2020, and the formal negotiations [began in June 2020](#).

After fifteen rounds of negotiations, the Energy Charter Conference published an [Agreement in](#)

Principle on the modernisation of the Treaty in June 2022. Subsequently, the modernised text was put on the agenda for a vote for the 33rd Meeting of the Energy Charter Conference on 22 November 2022. Shortly before the meeting, however, the European Commission **requested** the ECT Secretariat to remove the adoption of the modernised text from the agenda because EU Member States were divided on how to proceed. The renewed postponement of the vote is the result of the EU continued efforts to find a common position amongst its institutions and member states on the ECT (see [here](#)).

Objectives

The modernisation process pursued several objectives. For the purposes of ISDS, the key goals were to update the investment protection provisions and to address concerns about the impact of the ECT on climate mitigation efforts. The investment protection provisions from the early 1990s have been considered outdated in light of the growing complexity of the international investment regime.

The idea was also to have the ECT dovetail with the global energy transition. Critics of the effects of the ECT in protecting investment in fossil fuels include members of the **academic community**, the **IPCC** and the **Special Rapporteur on Climate Change and Human Rights**. The modernisation was supposed to assuage these concerns by shifting the focus of the Treaty to the protection of green investments. Instead of being perceived as an impediment to the energy transition, the modernised ECT was meant to be a “**complement to the Paris Agreement**”. This goal was at least not unreasonable. According to a **recent study**, roughly half of the cases brought under the treaty relate to investment in renewables.

Outcomes

The **modernised ECT text** has received mixed reactions. On the one hand, the modernised text contains many innovations that seem to position the ECT well to support investment in renewable energy and bring the Treaty in line with modern approaches to ISDS. It explicitly applies to “green fuels” (inter alia hydrogen and biomass), and references climate change mitigation as a legitimate policy objective under a new article on the “right to regulate”. Additionally, it clarifies some of the substantive standards of investment protection (FET, expropriation), excludes intra-EU ISDS from the scope dispute settlement, and the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration are made applicable to all ISDS proceedings (Article 26(6)) (for further changes, see [here](#)).

On the other hand, the modernised ECT does not entirely turn its back on the protection of investments in fossil fuels. Rather, the modernised treaty contains a “flexibility mechanism”. This mechanism allows Contracting Parties to exclude the protection of fossil fuels within their territories. But it is only optional, and existing investments will continue to benefit from the protection of the treaty for 10 years from entry into force of the new provisions.

This compromise has been **criticised** by commentators (see also [here](#)), and activists have slammed the results of the modernisation process **as insufficient** to align the ECT with climate mitigation

efforts.

Dissatisfaction and Withdrawals

Many EU Member States have been dissatisfied with the outcome of the modernisation negotiations, in particular with regards to the continued protection of fossil fuels under the Treaty. Following a growing rift between the European Commission, supporting reform, and several Member States, seeking withdrawal, the states decided to take action. Over a few weeks preceding the Conference in November 2022, where the modernised Treaty was scheduled to be adopted, Belgium, France, Germany, Luxembourg, the Netherlands, Slovenia, Spain, and Poland announced their intention to withdraw from the Treaty. At least France, Germany and Poland also formally notified the ECT Secretariat of their withdrawal from the treaty.

This could not be ignored by the EU institutions, and the Commission requested the ECT Secretariat to reschedule the planned vote on the modernised text. In addition, the European Parliament passed a resolution calling the Commission and EU Member States to start “preparing a coordinated exit from the ECT and an agreement excluding the application of the sunset clause between willing contracting parties”. According to recent reports, the European Commission is preparing the withdrawal of the EU as well as its Member States coordinated withdrawal, as previously suggested by the European Parliament. Interestingly, the Energy Charter Secretariat responded to the resolution with several “clarifications”, perhaps trying to win support for the modernisation. At the same time, some EU Member States indicated their preference to stay in a modernised version of the treaty, opening up the option of a partial EU exit.

Withdrawing from the ECT will prevent the protection of investments in fossil fuels (and renewables) in the future but existing investments will continue to enjoy protection under the Treaty due to its sunset clause. Article 47(3) of the ECT extends the protection of investors for twenty more years after the withdrawal of a Contracting Party takes effect.

Accordingly, commentators have regularly pointed out that reform may be preferable to withdrawal. Withdrawing not only thwarts the opportunity to incentivize investments in modern renewables but may also lock in the protection of exactly those fossil fuel investments that should be phased out as quickly as possible. While the EU is exploring options to limit the application of the sunset clause inter-se, it is unclear whether such efforts will be accepted by arbitral tribunals. The sunset clause is supposed to provide legal certainty to investors. Modifying the scope of the provision is fraught with uncertainty and could be rejected by arbitral tribunals, which have viewed inter-se modifications of the ECT critically in the past.

No Winners

The likely withdrawal of the EU and its Member States will weaken the normative framework for energy governance that the Treaty sought to establish. Investors in the energy sector – renewable and fossil alike – will benefit from less substantive and procedural protections.

From a climate protection perspective, future fossil fuel projects will no longer be able to rely on the ISDS mechanism at the very least. These projects are also least likely to have benefitted from

ISDS anyway, as investors have to comply with existing regulations in host states, which are increasingly stringent with regards to new energy projects.

In respect of the sunset clause, it is likely that legal uncertainty will prevail for some time. In the recent [internal paper](#), the Commission fleshed out an inter-se agreement of EU Member States on the non-applicability as a likely option going forward. This is supposed to be supplemented with bilateral agreements with a “coalition of the willing” among states that remain parties to the ECT. But even if some states agree on terminating the sunset clause, it is unclear as to whether this proposition will be accepted by investment tribunals when push comes to shove.

Whichever perspective one takes, it seems as though the end of the ECT regime as we know it is near – but then again it has seemed like this for some time now.

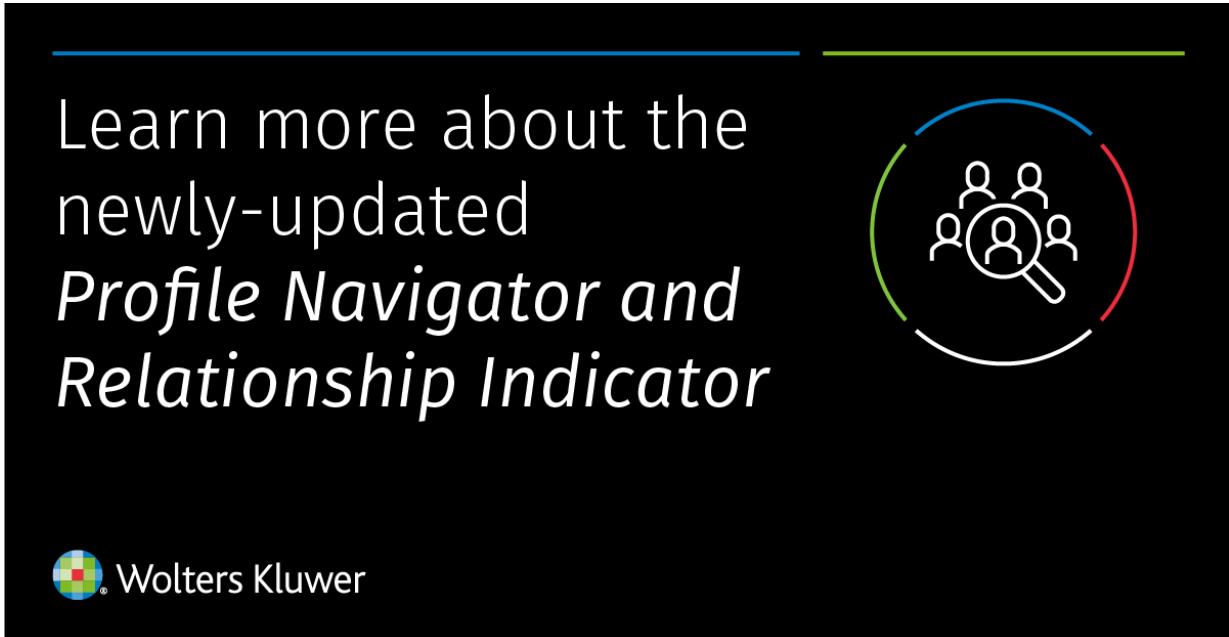
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This entry was posted on Monday, May 8th, 2023 at 8:44 am and is filed under [Climate change](#), [ECT Modernisation](#), [ECT Withdrawal](#), [European Union](#), [ISDS Reform](#)

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