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Denial of Benefits under the Energy Charter Treaty to Investors Owned or Controlled from Russia and Belarus: A Proposal by the European Commission

Graham Coop, Amaia Rivas Kortazar (Pinsent Masons) · Friday, June 28th, 2024

The European Commission's "Proposal for a Council Decision on the partial suspension of the application of the Energy Charter Treaty between the Union and any legal entity that is owned or controlled by citizens or nationals of the Russian Federation or of the Republic of Belarus, and any Investment within the meaning of the Energy Charter Treaty which is an Investment of an Investor of the Russian Federation or of the Republic of Belarus" (the "Proposal") raises more questions than it answers. Some of these relate to the respective powers of the European Union (the "EU") and its institutions while others are related to the application of the Energy Charter Treaty (the "ECT") in the public international law context. This post is intended to address the most significant among these questions, with a specific focus on the international legal aspect.

Structure and Content of the Proposal

In structural terms, the Proposal consists of two parts: an explanatory memorandum, in which the background and motivation of the Proposal are set out, and the "Proposal for a Council Decision" itself.

Pursuant to the three operative provisions, the Proposal by the European Commission (the "Commission") to the European Council (the "Council") is that the Council in turn direct the Commission to issue a Declaration (the "Declaration") in the form set out in the Annex. This is a separate document issued by the Commission contemporaneously with the Proposal.

The Declaration purports to be an international legal instrument issued pursuant to paras (1) and (2) of Article 17 of the ECT. As such, it purports to deny the advantages of Part III of the ECT – apparently to the maximum extent legally permissible – with respect to Russia and Belarus. Notably, it purports to do this on behalf of the EU, of Euratom and of all EU member States which are also Contracting Parties to the ECT. The purported constitutional basis for the Declaration is set out in the Proposal (including its explanatory memorandum and preambular clauses).

As a preliminary threshold issue, the Proposal and Declaration are based on an assumption (set out in the Explanatory Memorandum, pp 1 and 2) that neither Russia nor Belarus is a Contracting Party to the ECT (*i.e.*, that both are third States within the meaning of Article 17). This assumption

is no doubt correct for all practical purposes so far as Russia is concerned. The position with regard to Belarus is more complex, but not the focus of this post.

Does the Proposal Have a Sound Basis in EU Law?

The Proposal and Declaration purport to be based on Articles 207 and 218(9) of the Treaty on the Functioning of the European Union (the "TFEU"). Article 207 provides that the EU's competence with respect to "common commercial policy" shall include "foreign direct investment". This provision has been invoked as a basis for numerous EU initiatives with respect to ISDS in the past. As for Article 218(9), this provides that the Council can, on a proposal from the Commission, decide to suspend application of an agreement.

The Proposal and Declaration, therefore, purport to be a "suspension" – or more precisely a "partial suspension" – of the ECT with respect to Russia and Belarus. This constitutional basis to suspend an agreement to which the EU is a party has been exercised before, notably in relation to the Agreement between the European Community and the Russian Federation on the facilitation of the issuance of visas to the citizens of the European Union and the Russian Federation (*see* Council Decision (EU) 2022/1500 of 9 September 2022).

Is a denial of benefits a suspension?

It may be questioned, however, whether, in exercising its undoubted right at international law to deny benefits pursuant to ECT Article 17, the EU is in fact partially suspending the ECT or rather merely exercising a right conferred on all ECT Contracting Parties. Even after its Article 17 notice takes effect, the EU will still be applying the ECT, as it was before. It is true that Part V of the 1969 Vienna Convention on the Law of Treaties (the "VCLT") refers to the possibility of suspending the operation of a treaty in accordance with its own terms (as well as on other grounds), but many of these references contemplate the suspension of a treaty *in toto*, or with respect only to certain clauses or to certain contracting parties.

Furthermore, the notion of "suspension" intuitively implies an action of a temporary nature. By contrast, ECT Article 17 does not explicitly offer the possibility of a temporary denial of advantages. Nor does anything in the Proposal and Declaration suggest that the effects of the EU's proposed Article 17 notice are intended to be anything other than permanent.

Moreover, it does not appear that the Commission intends that the EU follow the procedure set out in Section 4 of Part V of the VCLT with respect to suspension (notably notifying the other ECT Contracting Parties of its intention and offering them a period of at least three months to object, with possible dispute resolution proceedings in case of disagreement).

For all these reasons, the Commission's intention that the EU deny benefits to certain investors under the ECT sits uncomfortably with the notion of "partially suspending" the operation of the ECT, as the Proposal's cited legal basis sets out.

Can the EU deny benefits on behalf of EU member States?

The Declaration purports to deny benefits pursuant to ECT Article 17 on behalf of the EU, of Euratom and of all EU member States which are also Contracting Parties to the ECT. It may be

questioned whether the EU is in fact competent to exercise Article 17 on behalf of its member States, or rather only on its own behalf, with its relevant member States retaining competence to exercise Article 17 for themselves. Certainly Germany, having issued its own similar Article 17 notice on 15 March 2023, might take the view that it retains full competence in this regard.

International Legal Aspects

In international legal terms, the Proposal is based on paras (1) and (2) of Article 17. These paragraphs have significantly different objects and purposes. Para (1) is intended to enable ECT Contracting Parties to prevent free-riding by denying benefits to claimants owned or controlled from a third State, where the claimant has no substantial business activities in the Contracting Party of its incorporation. Para (2) is intended to enable ECT Contracting Parties to deny benefits to investments owned or controlled from a third State with which the denying Contracting Party does not maintain diplomatic relations, or as to which it has implemented sanctions which would be violated or circumvented if such benefits were granted.

Para (1): preventing free-riding by mailbox companies

The invocation of para (1) has not in itself raised any particular legal issues of principle in the past, although it is debatable whether, in the case of the Proposal and Declaration, the object and purpose referred to in the Explanatory Note is consistent with the broad and unqualified use of para (1) in relation to all investors (and not just sanctioned investors) which are ultimately owned or controlled from Russia or Belarus. Over the life of the ECT, several respondents have sought to invoke para (1) retrospectively, after an investor has initiated investment arbitration proceedings. This gives rise to a timing question (whether retrospective or only prospective invocation is permissible) which we address below. Para (1) can also give rise to an issue whether the claimant has substantial business activities in the Contracting Party of its incorporation. Tribunals have generally treated this as a relatively straightforward question of fact.

Para (2): giving effect to sanctions

The invocation of para (2) is a little more complex, assuming that the denying Contracting Party sanctions only some, but not all, investors from the relevant third State (as is the case with the Proposal). Specifically, it may be questioned whether a denial under para (2) of benefits to all investors from the third State, where only some such investors are sanctioned, goes beyond the object and purpose of para (2).

Three other ECT Contracting Parties – Ukraine, Germany and the UK – have issued Article 17 declarations with regard to Russian investors. Ukraine's declaration is based on para (2) only and denies benefits to all Russian investors; the declaration also implies that Ukraine in fact sanctions all Russian investors. Germany's declaration invokes paras (1) and (2) and it is unclear whether Germany's invocation of para (2) is intended to apply to all or only to sanctioned Russian investors. The UK's declaration again invokes paras (1) and (2) and clearly provides that the denial of benefits under para (2) applies only to Russian investors named in the UK's Sanctions List (as that list may evolve from time to time).

The EU Proposal

The Proposal and Declaration are based on paras (1) and (2). As with Germany's declaration, it is unclear whether the EU's proposed denial of benefits pursuant to para (2) is intended to apply to all Russian and Belarusian investors or only to those subject to EU sanctions. Assuming that the EU issues an Article 17 declaration on the basis of the Proposal, this issue will no doubt be addressed by a competent arbitral tribunal, should it ever arise. The invocation of para (1) as well as (2) could give the respondent an alternative basis, assuming appropriate facts, on which to argue that the benefits of Part III of the ECT have been validly and effectively denied.

When does an Article 17 denial of benefits take effect?

As stated above, ECT Article 17, like other denial of benefits clauses, gives rise to a timing issue. At least three views may be distinguished from ECT and other arbitral jurisprudence. At the most restrictive, investors have argued, and some tribunals have held, that a denial of benefits clause may be invoked only before the investor makes its investment, as otherwise the investor's detrimental reliance on the non-invocation of the clause at the date of investment would be frustrated. An intermediate position, which other tribunals have supported, is that a denial of benefits clause may be invoked at any time before a dispute crystallises, but not thereafter. These positions generally lead investors to argue that an Article 17 notice can be effective only in relation to future investments or disputes and that such a notice cannot apply in relation to existing or clearly foreseeable disputes. On the other hand, respondents generally argue the most expansive view, *i.e.*, that a denial of benefits clause may be invoked even after a dispute has arisen, so long as it is done within a reasonable time.

Conclusion

For all these reasons, the Proposal gives rise to many complex issues of international and European law which – assuming it is implemented as proposed – we can expect to see extensively discussed, litigated and arbitrated before relevant tribunals and institutions for years to come.

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