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The Withdrawal by the EU and some Member States from the Energy Charter Treaty: International Protection for Energy Investments and Climate Change Related Carve-outs

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The present post focuses on the latest European development on the modernization of the Energy Charter Treaty ("ECT"). It will do so by putting it in a broader geopolitical context and linking it to the fossil fuel-related investments carve-out, not originally envisaged in the EU proposal. It will then analyse carve-outs in investment treaties in light of the rule of law basis and general (legal) nature of post-establishment protection.

Chronicle of the Foretold Withdrawal of the EU and some (but not all) Member States from the ECT

In a 2015 article on Italy's 2014 withdrawal from the ECT and termination of its intra-EU bilateral investment treaties ("BITs") between 2008-2009, the present author predicted a possible dark fate for the ECT (at least as a treaty of European origin), including a possible domino effect (such as the withdrawal of other European Contracting Parties).

This would have been the case lacking a timely European initiative to tackle the compatibility of the ECT intra-EU application with EU law within the multilateral framework itself in the interest of energy investors' legal certainty; an initiative which, as well known, only developed after the 2018 *Achmea* judgement.

Regrettably, this possible dark fate for the ECT materialized on 30 May 2024 with the Belgian presidency's announcement that the Council reached a political compromise on the ECT, thus breaking the stalemate within the EU, which was also painfully preventing non-EU Parties from proceeding toward its modernization. On the one hand, the Council approved the withdrawal of the EU (and Euratom) from the ECT, already green-lighted by the Parliament in April 2024; on the other, Member States willing to remain ECT Parties will be able to do so – by approving or not opposing the adoption of a modernized agreement.

However, this unfortunate fate was already sealed by the withdrawal notifications by France, Germany and Poland in December 2022, and the preceding decision of some Member States in October to not back the Commission's proposal for a Council decision on the modernized ECT text for unspecified concerns over protection of fossil fuel investors. In 2023, Slovenia and

Luxembourg also notified their withdrawal, followed by Spain, Portugal and the UK in 2024.

The European epilogue on the ECT is a blow to the ambition of the EU as a global energy player and leader in renewable energies. The ECT will continue its path, regardless of the EU's disengagement, as a unique multilateral framework for energy cooperation with an Asian-Caucasian focus under Japan's leadership and with an expanding potential in Africa, the Middle East, and South America, whose membership includes key European energy partners (such as Azerbaijan).

It is also an unfortunate sign by the European block of policy instability in times of high geopolitical uncertainty and return of great powers' strategic competition, which would require on the contrary stability. This is key for an orderly exit from fossil fuel and speedy clean energy transition, avoiding putting financial stability and energy & economic security at risk.

This is especially so considering the so-called unavoidable "energy trilemma", affecting any Party to the Paris Agreement but particularly serious for the EU block (as the unprecedented energy crisis across the EU has shown). This is, in the words of Italy's diplomacy, "to have secure, stable and predictable supplies at competitive prices for households and businesses, without failing to meet the binding commitment to long-term sustainability…" under the Paris Agreement.

The Derailment Within the EU of the ECT Modernization Process: Is the Fossil Fuel Carve-out Responsible?

The EU's proposal in 2021 to carve out fossil fuel investments from ECT post-establishment international protection, when the modernization process was almost concluded, underscores how investment treaty policy has become a catalyst for internal political divisions and instability within the EU since the Lisbon Treaty.

The carve-out was not among the closed list of topics for negotiation approved by the Energy Charter Conference in 2019. Neither was it included in the EU Council's original negotiating mandate or in the initial EU proposal.

The standards of treatment in investment law are, in fact, expression of the rule of law, and their application to already established foreign investments is also provided for by international custom.

As it results from the above chronicle, the carve-out has proved to be a contentious matter within the Council, too.

Are Carve-outs in Conformity with the International Rule of Law and Necessary to Fight Climate Change?

Carving out sub-categories of foreign investments (fossil fuel investments included) from post-establishment protection appears clearly at odds with the international rule of law basis and general (legal) nature of the substantive protection of foreign investments.

The same holds true for treaty mechanisms based on "political flexibility", which makes such post-establishment protection applicable upon condition of reciprocity and/or a Parties' Conference decision, which is also critical to international adjudication's independence (of the Contracting Parties in the first place). For instance, prohibition of unlawful expropriation binds any State; thus, subjecting its application in another Party's territory upon reciprocity's condition clearly does not accord with its customary status. Furthermore, doing so by a political decision impacting investments made under the coverage of a treaty also providing for international adjudication, interfering therewith, threatens its independence.

Standards of treatment and investor-State dispute settlement ("ISDS") clauses in European treaties, such as the ECT, apply just to established investments of foreign investors, in line with customary law, but do not extend the protection to attempts to make an investment, or to foreign individuals who attempt to make or are making an investment, contrary to NAFTA-featured treaties (cf for example articles 1(6) ECT and 1139 NAFTA).

Accordingly, European BITs, and the ECT alike, leave host States entirely free to regulate the admission and establishment of foreign investments pursuant to their sustainable development needs and goals (self-determined national contributions under the Paris Agreement included). As opposed to NAFTA-featured treaties making market access commitments enforceable in ISDS by putative investors, they rather protect lawfully established foreign investors' investments from the abusive exercise by host parties of their public powers.

European treaties do not, as such, incentivize (or even less subsidize) foreign investments, including fossil fuel or carbon-intensive investments against State climate change regulatory space.

Furthermore, to state the obvious, investment treaties (whatever their scope of application, limited or broader, may be), being embedded in the law of State international liability, are surely not insurance schemes.

As such, they by no means protect foreign investors against either their bad business decisions, or their (overoptimistic) subjective expectations in the making of the investment vis-à-vis State regulatory actions, especially when taken in times of emergency, which enjoy a presumption of legality under international law, as an extensive international case-law, indeed, confirms (for instance, *Invesmart v Czech Republic* and references therein).

Accordingly, losses resulting from non-discriminatory measures of general application normally taken by governments for the purpose of regulating economic activity in their territories (as well as devaluation and depreciation of currency) are not even among the non-commercial risks covered by multilateral insurance schemes, as the Multilateral Investment Guarantee Agency Convention (article 11 (a)(11) and (b)) makes clear.

Even less, treaties can shield investors from risks inherent in the nature of the business or operation itself. This is the case with transition risk for fossil fuel investors or any other investor in carbon-intensive industries, for which no host State can per se be held internationally liable (or environment-related risks for investments in general), as authoritatively pointed out by the International Law Association 2024 Report on Climate Emergency and the Financial Sector.

Investors must internalize climate change-related and environmental risks, and factor and price them in their investment projects for economic viability and financing purposes. Such risks represent credit risks for lenders and financial institutions, in turn posing risks to financial stability. This is an investor's key primary responsibility that can never shift to host States' public authorities, especially in a free-market economy.

This is especially so in those jurisdictions (internationally committed to long-term sustainability and bound to due diligence obligations related to the protection of the environment) which have implemented domestically the polluter pays principle and the precautionary approach.

While unnecessary to fight climate change and decline in nature, carve-outs and political flexibility, eroding the rule of law, do not fit with the human rights dimension of property rights' protection in Europe pursuant to the European Convention on Human Rights.

Considering the above, the ECT carve-out for fossil fuel investments will tellingly remain inoperative for those European Parties having disengaged ahead of the modernized text's adoption (including the ones insisting on its inclusion in the first place), and its status is so uncertain that the present writer will not bet on its retaining or activation by remaining Parties.

What Is Next?

While discussion on the ECT carve-out is contentiously over, climate change-related carve-outs, exceptions and reservations in investment treaties are also suggested in other international fora. For instance, they are mentioned in connection with compensation within UNCITRAL outside the boundaries of the mandate on ISDS reform, on the basis of perceptions, such as regulatory chill (see UNCITRAL Secretariat's Note, para. 78). They are argued by OECD within a project on investment treaties (and no mandate to do so) based on, among others, the hardly promising sample of the ECT carve-out, all matters deserving another post.

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