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Insight

UK withdrawal from the ECT – what next for investors?

As the UK announces its exit from the ECT, we discuss possible options open to investors.

On 22 February 2024, the United Kingdom (“**UK**”) became the latest country – and the first non-EU contracting party – to announce its intention to withdraw from the Energy Charter Treaty (“**ECT**”), attributing its decision to the failure by the ECT contracting parties to adopt a modernised form of the treaty.

With the UK’s withdrawal and the EU’s indecision, the adoption of the modernised ECT is now highly unlikely. While existing energy investments of investors in the UK, and UK investors abroad, will continue to be protected during the 20-year sunset period, investors will need to assess whether any other treaty in place will apply thereafter or whether there will be a treaty vacuum with respect to a specific country. Assessing alternative treaty options and dispute-forum planning will remain critical for investors.

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1. The UK joins rush for the exit

On 22 February 2024, the UK announced its exit from the ECT. The official press release explains that the decision to withdraw is motivated by the failure to modernise the ECT in alignment with the transition to net zero, of which the UK has been a strong advocate.[1] The decision follows last year’s “ultimatum” by the Minister of State for Energy Security and Net Zero, Graham Stuart, who announced that the UK would reconsider its membership unless the modernised ECT was adopted.[2]

In June 2022, the ECT contracting parties reached an Agreement in Principle on a modernised ECT – one of the most progressive treaty reform efforts to date – led largely by the EU and the UK.[3] The modernised text included a novel optional fossil fuel carve-out under which fossil fuel investments made after August 2023 would no longer be covered by the treaty, while existing investments would only be protected for ten years. Only the UK and the EU announced their intention to carve-out fossil fuel investments.[4]

However, shortly before the Agreement in Principle was due to be formally adopted in November 2022, several EU member states announced their intention to withdraw from the ECT altogether.[5] This was followed by a non-paper from the European Commission proposing the EU’s coordinated withdrawal.[6] While several EU countries announced their intention to exit, only four countries (France, Germany, Poland and Luxembourg) formally notified their withdrawal.[7] In the absence of a common EU position, plans for a vote on the modernised ECT have been shelved. The UK’s decision to withdraw reduces even further the prospects of a modernised ECT.

2. Consequences for both UK and foreign investors

2.1 The 20-year sunset clause

In order to withdraw from the ECT, a contracting party shall deposit its notification of withdrawal with the treaty's depositary. The withdrawal takes effect one year after the date of receipt of such notification, after which the sunset clause in Article 47(3) is triggered, extending the protection of existing investments for 20 years after withdrawal.

While some EU Member States have argued that the sunset clause could be "neutralised" by relying on the "fundamental change of circumstances" rule in Article 62 of the Vienna Convention, the Energy Charter Secretariat has rejected this proposition.[8] The EU has also proposed adopting a subsequent agreement on the interpretation of the ECT among EU Member States.[9] It is unclear whether arbitral tribunals will be persuaded by either of these arguments; tribunals have already confirmed the application of the ECT's sunset clause in cases against Italy, despite its withdrawal in 2016.[10]

At present, therefore, it appears on the face of it that the UK will remain bound by the ECT throughout the sunset period. As such, investments by foreign investors in the UK, and by UK investors in other Contracting parties to the ECT, will remain protected for 20 years from the effective date of the UK's withdrawal.

2.2 Protection under other investment treaties

While the UK has never been a respondent party to an arbitration under the ECT, UK investors have brought 18 cases against both EU and non-EU contracting parties, in relation to renewable energy and oil and gas investments, among others.[11]

The UK ECT withdrawal puts the UK's investment treaty network under the spotlight. While the UK is party to 85 BITs which are in force,[12] its withdrawal from the ECT will leave a vacuum in relation to some countries. The UK has BITs with 20 of the 50 ECT contracting parties, which include some EU countries, such as Lithuania, Czech Republic or Croatia, and non-EU countries, such as Turkey, Jordan or Yemen.[13] Investors will be able to rely on these BITs that previously co-existed with the ECT.

The UK's recent accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("**CPTPP**") last year[14] will ensure that investment protection and access to ISDS in relation to Japan remains in place, although in a more restricted manner than under the ECT.[15]

With respect to the EU – the UK's largest trade partner – the EU-UK Trade and Cooperation Agreement ("**TCA**") provides only limited protection to foreign investors and does not foresee investor-state dispute settlement.[16] The UK Free Trade Agreement with Iceland, Liechtenstein and Norway similarly does not provide for investor-state arbitration.

Investors in the energy sector should be mindful of the challenges that the UK's withdrawal from the ECT will necessarily bring in relation to investment protection:

- For UK investors looking to make new energy-related investments in any current or former ECT contracting party (such as the EU, Switzerland or several Eastern European, Middle Eastern and Asian countries), investors should assess their options beforehand and consider structuring their investments to ensure protection and access to investor-state dispute settlement. The same will apply to foreign investors (from ECT contracting parties) looking to invest in the UK energy sector.

- Existing UK investors abroad and foreign investors in the UK should bear in mind that the protection offered by the ECT will lapse in 20 years. Investors should reassess their options and potentially consider restructuring their investments to secure protection under other investment treaties. In cases where an alternative treaty is available, investors should assess how that treaty differs from the ECT and whether there are any additional requirements they may need to comply with to be protected under an alternative treaty.
- In the absence of investment treaty protection being available, investors will need to consider the possibility of obtaining protections and guarantees under an investment contract with the host State. Furthermore, it will be prudent for investors to include within their risk assessment an understanding of the availability of protections for foreign investments under the domestic laws of the host State as well as under any other international treaties (including human rights treaties) which the host State may have entered into.

References

[1] Press release, *UK departs Energy Charter Treaty*, 22 February 2024, available at: https://www.gov.uk/government/news/uk-departs-energy-charter-treaty.

[2] Press release, *UK reviewing membership of energy treaty*, 1 September 2023, available at: https://www.gov.uk/government/news/uk-reviewing-membership-of-energy-treaty.

[3] See N. Lawn and I. San Martín, " The End is Near: the European Commission's Proposed Coordinated Withdrawal from the ECT", 24 July 2023, available at: https://arbitrationblog.kluwerarbitration.com/2023/07/24/the-end-is-near-the-european-commissions-proposed-coordinated-withdrawal-from-the-ect/ ; See also I. San Martín and L. Giacometti, "Modernising the Energy Charter Treaty – What is the Swiss Position", 12 May 2023, available at: https://www.lalive.law/wp-content/uploads/2023/05/MODERNISING-THE-ENERGY-CHARTER-TREATY-%E2%80%93-WHAT-IS-THE-SWISS-POSITION_-Final-version-for-blog.pdf, p. 1-2.

[4]Decision of the Energy Charter Conference, 24 June 2022, available at: https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2022/CCDEC202210.pdf , p. 3.

[5] Spain, Germany, France, Poland, Slovenia, Belgium, Portugal and Luxembourg all announced their intention to withdraw in 2022, the Netherlands and Denmark in 2023.

[6] Non-paper from the European Commission, available at: https://www.euractiv.com/wp-content/uploads/sites/2/2023/02/Non-paper_ECT_nextsteps.pdf, p. 3 *et seq.*

[7] Based on information as of December 2023. Italy withdrew from the Treaty back in 2016.

[8]Energy Charter Secretariat note, 3 November 2022, available at: https://www.energycharter.org/media/news/article/sunset-clause-article-47-of-the-ect-in-relation-to-article-62-of-the-vienna-convention-on-the-law/.

[9] European Commission, "Proposal for a Council Decision on the position to be taken on behalf of the European Union in the 33rd meeting of the Energy Charter Conference", 5 October 2022, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52022PC0521.

[10] See e.g., *VC Holding II and others v. Italy*, ICSID Case No. ARB/16/39, 4 June 2018.

[11] See e.g., *Rockhopper v. Italy,* ICSID Case No. ARB/17/14, 23 August 2022, *InfraRed v. Spain*, ICSID Case No. ARB/14/12, 2 August 2019, *JKX Oil & Gas and Poltava v. Ukraine,* PCA Case No. 2015-11, 6 February 2017.

[12] According to UNCTAD: https://investmentpolicy.unctad.org/international-investment-agreements/countries/221/united-kingdom.

[13] The 20 countries are: Bosnia and Herzegovina, Croatia, Slovenia, Moldova, Azerbaijan, Bulgaria, Kazakhstan, Georgia, Turkmenistan, Kyrgyzstan, Albania, Uzbekistan, Armenia, Lithuania, Ukraine, Mongolia, Turkey, Czech Republic, Yemen, and Jordan.

[14] Protocol on the Accession of the United Kingdom of Great Britain and Northern Ireland to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, 16 July 2023, available at: https://www.dfat.gov.au/sites/default/files/cptpp-accession-protocol-united-kingdom-cptpp.pdf.

[15] Comprehensive and Progressive Agreement for Trans-Pacific Partnership, chapter 9, available at: https://www.mfat.govt.nz/assets/Trade-agreements/TPP/Text-ENGLISH/9.-Investment-Chapter.pdf.

[16] Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part, 24 December 2020, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22021A0430(01).