



# Modernisation of the Energy Charter Treaty

## *Understanding what is at stake and what's next*

The so-called “*agreement in principle*” is a compromise proposal to amend the Energy Charter Treaty following 15 negotiation rounds that took place from July 2020 until June 2022.

All ECT contracting parties participated to these negotiations except Norway and Italy. The former was excluded from the modernisation process because it signed the ECT in 1995 but never ratified it. Italy did not participate to the modernisation

process because it withdrew from the ECT in 2016. However, Italy is indirectly party to the ECT through its EU/EURATOM membership.

The 52 ECT contracting parties, including Italy through the EU/EURATOM membership and Norway, are invited to adopt the so-called “*agreement in principle*” at the Energy Charter Conference, scheduled for November 22<sup>nd</sup>.

The ECT rules for the voting and the entry into force of the so-called “*agreement in principle*” for all ECT contracting parties require:

- **Unanimity vote of the so-called “*agreement in principle*” of all the contracting parties present and voting** at the meeting of the Energy Charter Conference. The vote will take place through the ECT silent procedure which means the **so-called “*agreement in principle*” will be considered adopted if no contracting party objects to its adoption by November 22<sup>nd</sup>** (ECT-Article 36 and ECT rules and procedures).
- **The entry into force of the so-called “*agreement in principle*”, if adopted by November 22<sup>nd</sup>, requires the ratification, acceptance, or approval by at least three-fourths of the ECT Contracting Parties (ECT-Article 42).** This is equivalent to the ratification by 39 ECT contracting parties or 37 countries party to the ECT and the EU/EURATOM ratifications.
- **It is possible to apply provisionally the so-called “*agreement in principle*”, if adopted by November 22<sup>nd</sup>, if such provisional application is not inconsistent with the constitution, laws, or regulations of each contracting party (ECT- Article 45). In countries where ratification of the ECT by parliament is required, provisional application is unlikely to occur.**

The voting rules for the EU and Member States regarding the ECT

- The ECT is a mixed agreement, co-signed by the EU and the Member States, which includes Investor-State-Dispute-Settlement (ISDS) mechanism. Therefore, **the approval of the so-called “*agreement in principle*” by the European Commission on behalf of the EU/EURATOM requires Member States’ consent** (Opinion 2/15).
- **The European Commission** has an obligation of close cooperation with the Member States to meet its **duty of loyal cooperation (Article 4 of the Lisbon Treaty)**.
- The **European Commission proposed** to the European Council **to support the adoption** on behalf of the EU/EURATOM of the so-called “*agreement in principle*” at the Energy Charter Conference.
- **A qualified majority vote at the European Council** is required to allow the European Commission to approve on behalf of the EU/EURATOM the so-called “*agreement in principle*”.
- The **qualified majority** for a vote at the European Council is reached if i) **55% of the Member States, equivalent to 15 out of 27**, vote in favour of the European Commission proposal to approve the so-called “*agreement in principle*” **and** ii) the Commission proposal is supported by **Member States representing at least 65% of the total EU population**.
- Under the **qualified majority** vote, **a coalition of at least 4 Member States could block the support to the approval of the so-called “*agreement in principle*”** as proposed by the European Commission.
- Under the **qualified majority** voting rules, **abstention of a Member State counts as a vote against** the Commission proposal.

Based on the above voting and entry into force rules, three scenarios may occur:

I - **The chaos scenario** in which the so-called **"agreement in principle"** will be adopted by November 22<sup>nd</sup>.

The chaos scenario may occur if:

- a - **No ECT contracting party objects** by November 22<sup>nd</sup> **the approval** of the so-called "agreement in principle"
- b - The **European Commission** i) **does not respect its duty of loyal cooperation** with the Member States as stated in the Lisbon Treaty, ii) **ignores the withdrawal announcements** made by several Member States which add to the effective withdrawal of Italy since 2016, and iii) **does not replace its current proposal** to the Council to support the adoption of the so-called "agreement in principle" **by a proposal to withdraw the EU/ EURATOM from the ECT.**
- c - **EU countries withdrawing from the ECT do not form a coalition, of at least 4 Member States, to block the support of the adoption** of the so-called "agreement in principle" as proposed by the European Commission if this proposal is not cancelled.
- d - **None of the 27 EU Member States abstains** at the European Council meeting from the vote on the Commission proposal to approve the so-called "agreement in principle" at the Energy Charter Conference.

ECT withdrawal rules and their implications for the EU

- **Contracting parties to the ECT can withdraw at any time after five years from the date on which this Treaty has entered into force.** Any such **withdrawal shall take effect** upon the expiry of **one year after** the date of the receipt of the withdrawal notification by Portugal, the Depositary country (ECT -Article 47)
- There is **no need for the EU to wait for a common accord of all Member States to withdraw** EU/ EURATOM because the ECT is a mixed agreement, and the EU will be acting exclusively within its sphere of competence (Opinion 1/19).
- **The withdrawal of the EU/EURATOM and the EU Member States does not prevent other contracting parties from approving the so-called "agreement in principle". To the contrary, the withdrawal of the EU/EURATOM, before November 22<sup>nd</sup>, will facilitate the entry into force of the so-called agreement in principle between the remaining parties.** The unanimity vote required by the ECT rules apply only to parties present and voting at the Energy Charter Conference and the ECT entry into force rule, which requires ratification by three-fourths contracting parties, applies only to those parties remaining in the ECT.
- The **EU participation to the ECT is legally problematic** given that Member States representing more than 65% of the total EU population have decided to withdraw from the ECT.

The **chaos scenario will lock all ECT contracting parties in the existing ECT as both the provisional application and the entry into force of the modified ECT are unlikely to occur** (Table 1) given i) the inconsistency of the provisional application

with the national rules in countries where national parliaments must ratify the modified ECT, and ii) the endless time needed for the ratification of the amended text by 39 contracting parties.

**Table 1. Implications of the ECT "agreement in principle", if approved by November 22<sup>nd</sup>, for different economic activities and different contracting parties**

Economic activity	End date for protection of new foreign investment per energy source				End date for protection of existing foreign investment					
	EU*	United Kingdom	Switzerland	Other ECT contracting parties	EU	United Kingdom	Switzerland	Other ECT contracting parties		
Coal	Applicable only after the ratification** of the changes by 3/4 of the ECT contracting parties				Applicable by 31/12/2040 only if by that time changes are ratified by 3/4 of the ECT contracting parties	Applicable 10 years after the ratification of the changes by 3/4 of the ECT contracting parties				
Oil										
Gas									No end date	
Fossil fuels hydrogen and synthetic fuels									Applicable only after the ratification of the changes by 3/4 of the ECT contracting parties	
Gas power plants with emissions <380 gCO <sub>2</sub> /kWh	Applicable by 31/12/2030 if by that time amendments are ratified by 3/4 of the ECT Contracting parties	No end date	No end date	No end date	No end date	No end date	No end date	No end date***		
Gas power plants with emissions <380 gCO <sub>2</sub> /kWh replacing coal and oil power plants	Applicable 10 years after the ratification of the changes by 3/4 of the ECT contracting parties			No end date						
Gas pipelines that can be used for hydrogen	No end date			No end date						
Nuclear	No end date				No end date					
Low-carbon hydrogen										
renewable hydrogen										
Low-carbon synthetic fuels										
Carbon capture and storage installations	Not protected	No end date	Not protected		Not protected					

\*Extending protection of existing foreign investment in fossil fuels and in new and existing foreign investment in nuclear is the European Commission's decision. This decision did not result from the negotiations with other ECT contracting parties.

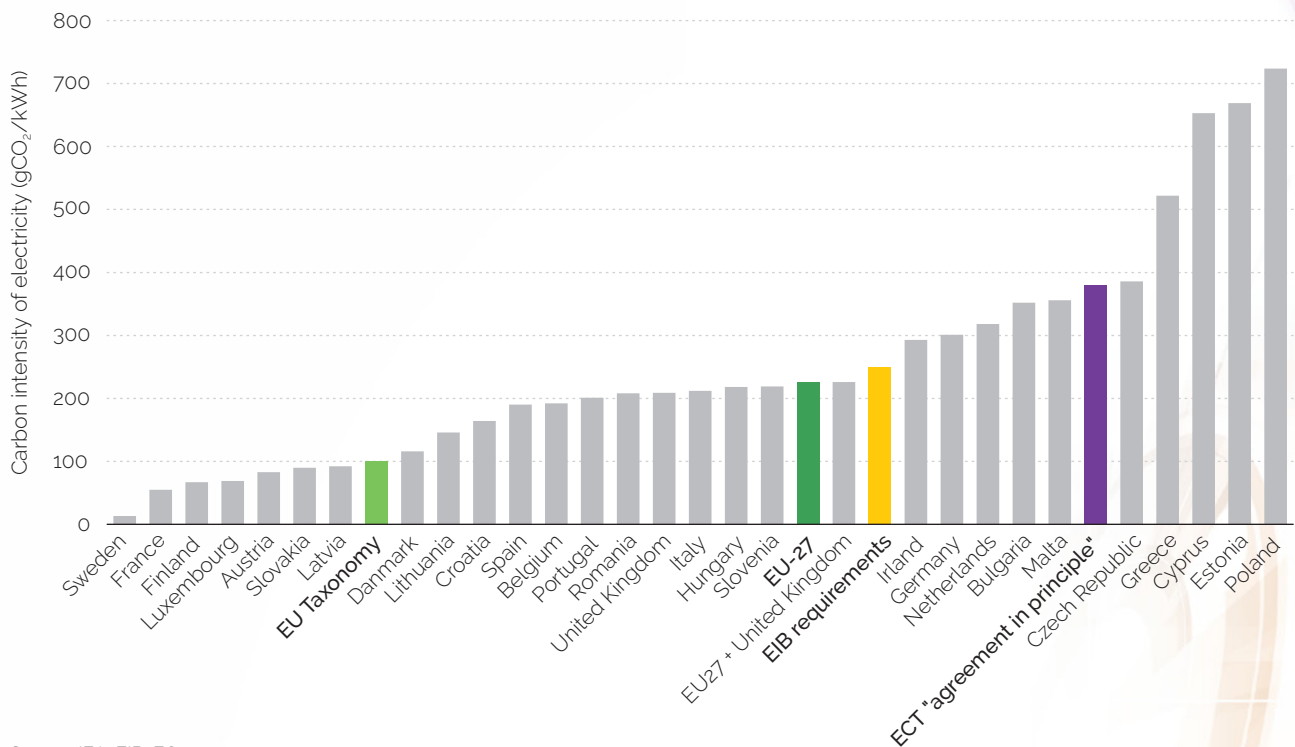
\*\* The entry into force of the amendments as foreseen by 15 August 2023 is unlikely to happen given that provisional application of the amendments cannot occur in countries where the parliament's ratification is required.

\*\*\* Japan, Switzerland and Turkey do not give their unconditional consent for disputes that may raise from investors based in one the Contracting Party that have excluded some energy sources from ECT investment protection.

**The Chaos scenario will also increase the malfunctioning of the EU electricity market and the perceived decarbonisation risk by investors** given i) the historical differences in the carbon intensity of electricity across the EU, and ii) the inconsistency between the carbon intensity

of electricity allowed in the ECT so-called "agreement in principle" compared to the one in the EU Taxonomy and the one considered in the energy lending policy of the European Investment Bank (EIB) (Figure 1).

**Figure 1. Carbon intensity of electricity in EU27+UK, EU taxonomy and EIB energy lending policy**



Source: IEA, EIB, EC.

**Overall, the Chaos scenario will lock the planet in more carbon protected by the ECT ISDS mechanism, increase the cost of the decarbonisation of the energy system while keeping the EU highly dependent of fossil fuels** given i) the expected chill effect to avoid new ISDS claims if governments decide to stop fossil fuels installations before the end of their lifetime as required by the climate neutrality objective, ii) the expected increased share of stranded fossil fuel assets, and iii) the expected slow decarbonisation of the energy system driven by the increase of the perceived decarbonisation risk by investors.

Previous estimates showed that the continuation of the ECT would by 2050 i) increase the cumulative carbon emissions protected by the ECT regime to at least 216 Gt - This is equivalent to more than one-third of the remaining global carbon budget to limit planet's warming to 1.5°C by the end of the century-, ii) end up with stranded fossil fuels protected by the ECT amounting to at least €2.15 trillion, and iii) increase the cost of potential ISDS claims to at least €1.3 trillion out of which 42% to be paid by EU taxpayers.



**II - The EU and climate friendly scenario** in which **the EU/EURATOM and the Member States will withdraw from the ECT before November 22<sup>nd</sup>.**

The EU and climate friendly scenario may occur if:

- a - The **Czech presidency** of the EU council **requests the European Commission to respect its duty of loyal cooperation** with the Member States as stated in the Lisbon Treaty.
- b - The **European Commission** i)  **Cancels its current proposal** to the European Council to support the approval of the so-called "**agreement in principle**", ii) **prepares a proposal** to the European Council **to withdraw the EU/EURATOM from the ECT before November 22<sup>nd</sup>**, iii) **facilitates/coordinates the withdrawal** of the remaining EU countries and iv) **prepares a subsequent agreement to cancel the sunset clause between the EU Member States.**

**The EU and climate friendly scenario is the only scenario that may lead to the ratification** of the so-called "**agreement in principle**" **by the ECT contracting parties satisfied by the proposed amendments.** In fact, the unanimity vote required by the ECT rules apply only to parties present and voting at the Energy Charter Conference and the ECT entry into force rule, which requires ratification by three-fourths contracting parties, applies only to those parties remaining in the ECT.

Importantly, **the EU and climate friendly scenario is the only scenario allowing the cancellation of the sunset clause** between EU countries, and other ECT contracting parties that could withdraw afterward. Thus, reducing the risk of costly ISDS claims and their chill effect on climate legislation.

Moreover, **the EU and climate friendly scenario will end the strategy of expanding the ECT to developing countries with rich fossil fuels reserves.** Under the leadership of EU countries, an expansion strategy has been developed to replace Russia, following its withdrawal in 2009, by other countries with rich fossil fuels reserves. The expansion strategy is paid for by

Understanding the ECT sunset clause and the options to cancel it:

- **Withdrawing from the ECT triggers the sunset clause** which **extends ECT ISDS** protection for existing investments for **20 years more after the withdrawal from the Treaty takes effect** -one year after the notification of the withdrawal to Portugal, the ECT depository country (ECT-Article 47).
- The sunset clause was not included in the list of items to amend. Therefore, the so-called "**agreement in principle**" **neither cancels the sunset clause nor reduces the period during which it would apply in the case of withdrawal after the approval of the proposed amendments.**
- The **sunset clause cannot be cancelled between some parties** because the existing **ECT does not admit any derogation to the application of the ISDS** mechanism between signatories where any such provisions are more favourable to the investor (ECT-Article 16). Given that the entry into force of the so-called "**agreement in principle**", if adopted by November 22<sup>nd</sup>, is unlikely to occur any soon, the existing ECT will continue to apply. Thus, the cancellation of the sunset clause between EU countries is unlikely to happen.

**After withdrawing from the ECT, EU countries could and should cancel the sunset clause** between themselves through i) **a subsequent agreement between withdrawing countries** and ii) by introducing **a non-ECT use conditionality for the use of public subsidies that prevent companies that would activate the ECT sunset clause from the access to any public subsidies**, whether direct (through infrastructure of state aid) or indirect (through tax exemptions) and by **excluding these companies from any public procurement.** It is unlikely that EU investors will activate the sunset clause given that i) the energy sector is highly subsidies and ii) the important role public procurement plays in energy investments.

the financial contributions of ECT contracting parties to the functioning of the ECT secretariat as well as voluntary contributions provided either by the European Commission or by some EU Member States as part of their support to developing countries under various development programmes.

By 2020, EU countries' contributions to ECT secretariat amounted to 57% of its total budget. The withdrawal of the EU and its Member States from the ECT will reduce drastically the overall budget of the ECT secretariat and consequently its outreach activities to developing countries. It is highly unlikely that major countries covering the remaining 43% - Japan, the UK, Turkey, and Switzerland - would increase their contributions to

cover the lost budget. On the contrary, especially given the rule that contributions per country cannot exceed 20% of the total budget, Japan (the single largest contributor to the ECT Secretariat budget), the UK, and perhaps Turkey would have to significantly reduce their contributions to keep their contributions within the 20% limit, resulting in a much smaller ECT budget than 43%.

### III - *The Tzar scenario* in which **countries parties at the same time to the ECT and to the Eurasian Economic Union will object the approval of the so-called "agreement in principle"** by November 22<sup>nd</sup>.

The Tzar scenario may occur if:

- a - The **Russian Federation has renewed its interest in the ECT given the current geopolitical context** and pushes countries that are party to the Eurasian Economic Area **to reject the so-called "agreement in principle" as the EU did a few years ago regarding the Russian proposal to modernise the ECT.**
- b - **Kazakhstan takes the lead** of such initiative given the STATI ISDS claim considered abusive by the Kazakh minister of justice who disagrees with the one-way application of the ISDS mechanism. Therefore, **it is unlikely that Kazakhstan is satisfied with the so-called "agreement in principle"** which has been designed to protect mainly EU interests.
- c - **Some or all countries that are party to the Eurasian Economic Union decide to support publicly Belarus following the decision to suspend the provisional application of the ECT in Belarus and its observer status.** This decision, initiated by the EU, was taken last June in the absence of most of the countries party to the Eurasian Economic Union.

**The Tzar scenario will be a slap to the EU leadership** in the modernisation of the ECT. The possibility of this scenario should not be ignored, given that all countries of the Eurasian Economic Union were absent from the Modernization meeting in June. Given the growing number of EU Member States announcing their decision to withdraw from the ECT, a collective withdrawal of the EU/EURATOM and all EU Member States will be the only option left.

### Takeway

**Energy security of EU countries is the ECT "raison d'être". It became obsolete when Russia withdrew from the treaty in 2009.** The **Russian-Ukraine war provides evidence on the uselessness of the ECT** to ensure the supply of the EU with fossil fuels from the former Soviet Union. The intra EU-ISDS claims provide evidence about the ECT lock-in-effect in outdated subsidies and regulatory regimes.

The attractiveness of developing countries and emerging countries to FDIs from countries that are not party to the ECT provides evidence of the uselessness of the ECT for the energy transition in the global South. As of today, **arguments of the promoters of the continuation of the ECT are more of prophecy than data-driven arguments.**

The so-called "*agreement in principle*" confirms the ECT cannot be aligned with today's decarbonisation goals of the energy system. The **EU withdrawal wave is a healthy sign for energy and climate policies as well as the rule of law** based on equal treatment of foreign and domestic investors.

Overall, after two years of negotiations **the failure of the ECT modernisation became a fact. The withdrawal of the EU and its Member States is the only way forward. Consequently, other OECD countries that are party to the ECT will also withdraw.** In other words, **it will end the ECT era.**

**The ECT cannot erase its origin**, that it was created by the EU and Russia to protect their investments in fossil fuels, and moreover, **still today it does not involve the current major players** such as the US, China, Indonesia, India, or Brazil. **Patchwork fixes cannot make the ECT a platform for an "Energy Transition."**

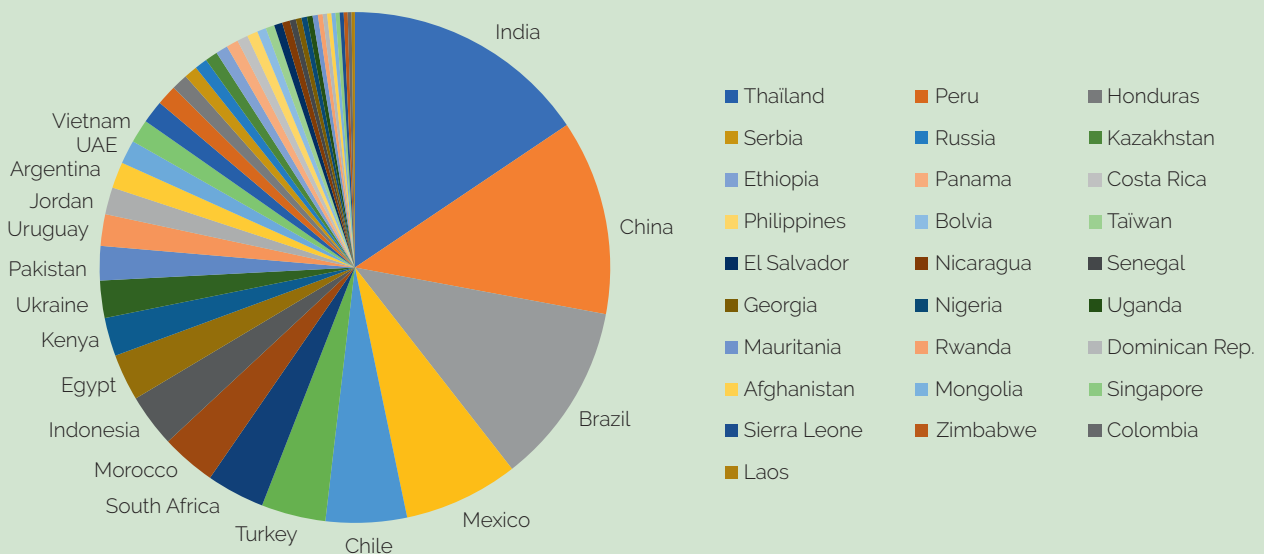
**The need of the ECT to attract foreign direct investment (FDI) in renewables is a myth**

Promoters of the ECT and its continuation wrongly consider the high number of ISDS claims related to regulatory changes in the production of electricity from renewable energy sources as an indicator of the importance and the need of the ECT for the energy transition. However, these claims are mainly intra-EU disputes and according to the European Court of Justice, *intra-EU ISDS claims should not have existed at the first place as disputes in the EU are governed by EU law*. FDI decisions in the energy sector are, more likely, driven by national policies and country-level factors such as market size and per capita income, infrastructure and investment/energy policies as shown by the OECD study on the drivers of divestment

decisions of multinational enterprises. The *collective withdrawal of the EU and its Member States and the cancellation of the sunset clause between EU countries are likely to reduce to zero the number of ISDS claims related to FDIs in renewable energy projects.*

*The renewable argument is also not supported by the data available on FDI in renewable energy projects, especially when it comes to developing countries. In fact, over the period 2010-2018, FDI in renewable energy projects amounted to US\$160 billion in these countries, out of which India, China and Brazil were the three main recipients (Figure 2) while none of these three countries is party to the ECT nor started its accession process or planning to do.*

**Figure 2. Share of Foreign Direct Investment in Renewable Energy projects among recipient countries over the period 2010-2018 (BNEF)**



Similarly, *the first country of origin of FDI in renewable energy projects* in these countries was by far *the United States, a country that never joined the ECT nor is planning to do so in the foreseeable future*. Over the period 2010-2018, the contribution of the US to FDI

in renewable energy projects in developing countries and emerging economies was equivalent to the sum of the contribution of the three major ECT contracting parties investing in FDI in renewables (France, Spain and the United Kingdom) (Table 2).



**Table 2. Top 10 countries of origin of FDI in renewable energy projects in non-OECD countries over the period 2010-2018 (US\$ bn)**

Ranking	Country	bn US\$
1	United States	30
2	France	11
3	Spain	10
4	United Kingdom	9
5	Italy	8
6	Japan	7.9
7	Germany	8
8	Singapore	7.8
9	China	5.6
10	Netherlands	5.6

Source: BNEF.

Importantly, over the same period, China was by far the largest investor in renewable energy projects in ECT constituency. **The Chinese FDIs in renewable energy projects in Indonesia**, who is only an observer country to the ECT since 2009, **were equivalent to the sum of EU countries FDIs**

**in Turkey, Ukraine and Jordan** between 2010 and 2018. Japan is the main provider of FDI in renewable energy projects in Pakistan; a country member of the ECT constituency who did not join the ECT despite the invitation of the Energy Charter Conference since 2006.

**Table 3. FDI in renewable energy projects in ECT constituency over the period 2010-2018 (US\$ bn)**

Ranking	Country	ECT status	Million US\$	Main country of origin of investors
1	Indonesia	Observer to the Energy Charter Conference since 2009, but did not start the accession process	3.2	China
2	Pakistan	Invited to accede to the ECT since 2006	2.1	Japan
3	Morocco	Working on the internal approval of the accession reports since 2015	2.4	France and Germany
4	Turkey	ECT contracting party since 2001	1.4	Germany
5	Ukraine	ECT contracting party since 1999	1.3	Austria
6	Jordan	ECT contracting party since 2018	1.1	Germany, France, Netherlands and Japan

Moreover, according to [FDI Intelligence](#), the renewable sector was the biggest recipient of FDI since 2020. In 2021, the sector attracted \$ 80 bn, which is 8% decrease compared to 2020. But still consistent with the super-cycle that

started in 2019. However, **in 2021 more than 100 projects worth around US \$30 billion were allocated to investment in activities related to green hydrogen**. But, as of today there are **no commercial green hydrogen plants running**.



Comments and questions are welcome and should be addressed to:  
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