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Citation: Collins, D. (2024). The UK's Withdrawal from the Energy Charter Treaty Poses Risks for Energy Affordability and Security. International Trade Law and Regulation, 30(3), pp. 127-128.

This is the accepted version of the paper.

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The UK's Withdrawal from the Energy Charter Treaty Poses Risks for Energy Affordability and Security

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Scarcely covered by the mainstream media, last the UK withdrew from the controversial Energy Charter Treaty (ECT), following nine EU Member States, including G7 countries France, Germany and Italy.

Entering into force in 1998 and signed by the UK in 1994, the ECT is an international investment agreement (IIA) designed to encourage foreign direct investment in the energy sector by providing protection to foreign investors against excessive governmental interference, such as expropriation or the denial of justice in administrative or legal proceedings. The ECT has been perhaps the most significant of all the IIAs, spawning more investor-state dispute settlement (ISDS) claims than any other single treaty and with it, a host of awards issued by ad hoc tribunals. By falling under the protection of the ECT, foreign investors were granted assurances that they could rely on international law rather than the unfamiliar and unstable legal systems in host countries. Investment in the energy sector is especially needful of stable and reliable legal protections because of the extended period between making an investment and achieving a return. Under the ECT, investors may seek compensation for the loss of their future profits, not merely sustained losses. Many of the investment projects facilitated by the ECT related to infrastructure privatization projects in former Soviet countries.

Very much a product of its time, the ECT faced growing criticism for its continued encouragement of investment into energy derived from fossil fuels, paying insufficient attention to the modern fixation on climate change mitigation via renewable sources. Announcing the UK's withdrawal, the Minister of State for Energy Security and Net Zero stated that continued ECT membership was incompatible with the country's transition towards Net Zero. With this justification in mind, the UK's withdrawal from the ECT could not have come at a worse time; it was acknowledged recently that the true costs of the UK's Net Zero transition were wildly understated – costing trillions of pounds more than had been reported to parliament. Government ministers were accused by former Chancellor of the Exchequer of being 'systematically dishonest' about the costs of the plans.

Some academic commentators consider the ECT to be out-dated in an era where the shift to renewable energy sources has dominated government policy, at least in rich countries. Efforts had been made in the last few years to reform the ECT to make it more 'green' (see an earlier City Law Forum blog post by this author) but these were never fully implemented. Changing a multilateral treaty is much more difficult now than it was in the 1990s, particularly when unanimity is required among the 50+ signatories.

Citing its incompatibility with the green transition, the European Parliament called for a coordinated exit from the ECT in 2022. Four EU member-states have already withdrawn from the ECT with several others having either notified or declared their intention to withdraw. To some, the UK's following suit may appear as yet another example of the UK

reflexively following EU policy despite having left the bloc four years ago. The UK had been a strong proponent of modernizing the ECT whereas the EU appears to have given up, stating that its single market rules make it legally impossible for some states to remain while others, including the EU itself, withdraw.

Criticisms of the ECT, while environmentally-focused, reflect broader resentment towards international investment law itself as system which enables multinational enterprises to wrest compensation from governments for enacting regulations which they believe are in societies' interest, creating a 'chilling effect' that undermines sovereignty. Contrary what had been expected when the ECT was drafted, most of the claims under the treaty were not brought against oil rich post-Soviet countries but against Western European ones. The UK had done reasonably well under the ECT, having never faced a claim as a host state. Some UK companies have successfully used the ECT to defend their interests abroad. For example, the British oil company Rockhopper was awarded £210 million from the Italian government after it was banned from conducting offshore drilling, in violation of the ECT.

The UK's withdrawal from the ECT will take effect in one year after last week's announcement. Importantly, though, the ECT contains a sunset clause which means that investments made under it as at date of withdrawal remain protected under the treaty for another 20 years. So the ECT will continue to cover investments made in the UK until as late as 2045. Still, withdrawing from the ECT could make investing in fossil fuels in countries with an unstable legal system, or one which is antithetical to traditional fuels, too risky for UK firms. At the same time, fossil fuel investment in the UK could be undermined as foreign fossil fuel investors may not trust the UK legal system, including its courts, to treat them fairly. This could raise prices for consumers – an unwelcome addition to the cost-of-living crisis.

Despite what proponents of Net Zero and detractors of the ECT have argued, the UK (and the world) still relies on oil and gas for its energy needs. Wind and solar power are not yet feasible alternatives and may never become so. The expansion of nuclear energy, which is the only viable means of achieving Net Zero targets and (theoretically) arresting climate change, remains politically unpopular across Europe. Hopefully, the slow demise of the ECT will not cause a chilling effect of a different (and more literal) kind, one that makes countries across Europe more dependant than ever on fossil fuel-derived energy from Russia, the Middle East and other places with which they do not enjoy warm relations.