PAUL HASTINGS

STAY CURRENT

A CLIENT ALERT FROM PAUL HASTINGS

April 2015

Follow @Paul_Hastings

Italy's Withdrawal from the Energy Charter Treaty: Which Consequences for Foreign Investors?

BY LORENZO PAROLA, FRANCESCA PETRONIO & FABIO COZZI

I. Premise

Italy is reported from many sources to have withdrawn from the Energy Charter Treaty ("ECT"), through a formal notice sent to the Energy Charter Secretariat, according to the available information, in January 2015.[1]

The news appears to be confirmed by the Ministry of the Economic Development (*Ministero dello Sviluppo Economico*, "MISE") that declared to journalists that Italy's decision is justified in light of the need to reduce the costs related to the participation to international organizations. As a matter of fact, article 8 of Law no. 190/2014 provides for the renegotiation of several international agreements, including the ECT, with the purpose of reducing the costs implied in the participation to treaties and international organizations. MISE added that Italy withdrew only from the ECT and not from the European Energy Charter, which provides the political foundation for the Charter process (basically, the first step in the accession to the Treaty, not implying obligations for the member States), and therefore Italy will continue to participate as an observer to the works of the Energy Secretariat (like, for instance, the United States and Canada). Moreover, according to MISE, the decision to withdraw from the ECT would not prejudice Italian investors, since the European Union is a signatory of the ECT.

II. Background

The ECT, signed in 1994, is a multilateral treaty aimed at establishing a legal framework for the promotion of a long-term co-operation in the energy field and enhancing the economic growth through measures to liberalize investment and trade in energy. Among the other things, the scope of the ECT is to facilitate transactions and investments reducing political and regulatory risk. One of its most significant features is the protection granted to investments in the energy sector.

Contracting parties are actually bound to afford to foreign investments made under the Treaty a "fair and equitable treatment" and most constant protection and security, and they shall not impair in any way by unreasonable measures the management, maintenance, use or disposal of the investment. They shall also accord to protected investments a treatment not less favorable than that accorded to investments made by own investors or of the investor of any other contracting state or third state, whichever is the most favorable (the "most favorable treatment" clause). Protection is also provided against unlawful nationalization or (direct or indirect) expropriation.

The ECT sets out also—like most of the investment treaties—a dispute resolution clause that gives to the investor the chance to submit to international arbitration any dispute concerning a breach of

Part III of the ECT. International arbitration, as an instrument additional or alternative to domestic litigation, has proved to be an effective tool for investors looking for an impartial tribunal, a predictable and clear procedure, as well as reasonably fast results, avoiding the risks related to a litigation before the court of the host state (not necessarily because the investor may have little trust in the impartiality of state courts or is not familiar with the national rules of procedure, but, for instance, because national legal systems may sometimes lack in efficiency).

However, the member States are entitled to declare to avail themselves of the exception under Article 26(3)(b)(i), that allows to refuse the consent to international arbitration where the investor has previously submitted the dispute to local courts or administrative tribunals of the host state or to any applicable, previously agreed dispute settlement procedure: such a commencement would imply a forfeiture of the right to resort to international arbitration under the ECT (the so called "fork-in-the-road"). Italy, together with twenty-three other signatories, opted for this exception that implies a careful evaluation of the strategy before commencing a litigation related to a possible Treaty violation, in order to avoid any conflict between domestic proceedings and the right to bring the case before an international tribunal.

As to the actual relevance of the ECT, according to the last data provided by the United Nations Conference on Trade and Development ("UNCTAD")[2] and by the Energy Charter Secretariat,[3] the recourse to investor-state disputes in Europe is increasing. The overall number of investor-state arbitrations under the ECT is 60 as of the end of 2014, and half of the intra-EU investor-state disputes commenced in 2014 have been brought under the ECT.

Italy registered its first known case in 2014, and the risk of future disputes—in particular in the renewable energy sector—may have played a role in the decision to withdraw from the ECT, other than the mere need to reduce the expenditure implied in the participation to international organizations and treaties.

III. Preliminary Remarks on the Effects of Italy's Withdrawal from the ECT

Italy's decision to withdraw from the ECT would not determine any immediate consequence, in terms of investment protection, for the following reasons:

- Withdrawal of a contracting party takes effect upon the expiry of one year after the date of notification (Article 47 of the ECT). This means that Italy's withdrawal will be effective starting from January 2016[4] (unless a different date has been specified in the notification of withdrawal). All the investments made before that date will receive full protection.
- Provisions of the ECT will continue to apply to investments made before January 2016 for a period of further 20 years (so called "sunset clause").
- Italy is a signatory of 91 bilateral investment treaties and other 64 investment agreements, which may provide protection to the investment made after January 2016.

IV. The Role of the European Union

Moreover, it has to be highlighted that the European Union ("EU") has exclusive competence on foreign direct investments and is a signatory of the ECT. In particular, in the Declaration of Transparency made in accordance with Article 26(b)(ii) of the ECT, the European Commission stated that both the EU and the Member States are internationally responsible for the fulfillment of the obligations contained in the ECT, in accordance with their respective competence.

Extra-EU investors may, therefore, bring a claim against the European Commission where the alleged breach of the investment treaty is related to provisions deriving from the EU and included in the EU competence, whilst the breach attributable exclusively to an act of the Member State

would trigger only the liability of such an EU Member State. The *Electrabel v. Hungary* case actually highlighted the impact of EU law on investment disputes, and raised the attention on the possible opportunity for non-UE investors—to be evaluated in light of the circumstances of the case—to bring the ECT claim directly against the EU Commission (of course not before an ICSID tribunal, since the EU is not part of the ICSID Convention) and not, or not only, against the Member State. In fact, in *Electrabel v. Hungary*[5] the arbitral tribunal, basically, concluded that Hungary could not be held responsible for actions it was required to take under EU law, since EU Member States have ceded certain sovereign powers to the EU.

As to intra-UE investments, the EU Commission is actually intervening in many arbitration proceedings brought under the ECT, arguing that the obligations set forth in the Treaty do not apply between EU Member States, in force of a "disconnection clause." The arbitral tribunal in charge of the above-mentioned dispute between the Belgian company Electrabel and Hungary found that the EU became party to the ECT without any distinction or reservation to Article 26(1) of the ECT, and therefore the EU—according to the arbitral tribunal—accepted that investors from one Member State could initiate investor-state arbitration against another Member State under the ECT. It has to be seen whether the tribunals in charge of the pending cases brought by EU investors against EU Member States—mainly related to the recent changes in the renewable energy legal framework—will reach the same conclusion, rejecting the EU Commission's arguments.

V. Conclusions

Even if, from a purely political standpoint, Italy's withdrawal from the ECT may be interpreted as a negative signal for foreign investors, from a legal perspective we may preliminary conclude that such a decision will not have immediate adverse consequences: the investments already in place and the investments completed before January 2016 will receive full protection under the ECT, for a subsequent 20-year period.

Moreover, foreign investors may evaluate the opportunity to complete the planned investments before January 2016 in order to receive full protection from the ECT, or, in the future, seek legal advice in order to structure their investment to fit the preconditions set forth in the bilateral investment treaty that may possibly apply.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Milan

Lorenzo Parola
39.02.30414.206
lorenzoparola@paulhastings.com

Francesca Petronio
39.02.30414.226
francescapetronio@paulhastings.com

Washington D.C.

Fabio Cozzi
1.202.551.1987
fabiocozzi@paulhastings.com

---

[1] *See Il Sole 24 Ore*, April 25, 2015, and *Global Arbitration Review*, April 23, 2015, http://globalarbitrationreview.com.

[2] *See* UNCTAD *IIA Issues Note – Recent Trends in IIAS and ISDS*, available on www.unctad.org.

[3] *See Energy Charter 2014 Annual Report*, available on www.encharter.org.

[4] Lacking an official communication from the Ministry of Foreign Affairs, we rely on the declarations rendered by the Ministry of Economic Development to the newspaper *Il Sole 24 Ore* on Saturday April 25, 2015.

Paul Hastings LLP

Stay*Current* is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2015 Paul Hastings LLP.

[5] *See Electrabel v. Hungary*, Decision on Jurisdiction, Applicable Law and Liability, November 30, 2012, available on www.italaw.com.