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## Protections for Hydrogen Projects under the Modernized Energy Charter Treaty

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For over two decades, investors in the energy sector have benefited from protections found in The Energy Charter Treaty (“ECT”). Investors in hydrogen projects will soon be able to benefit from these same protections.

### THE ENERGY CHARTER TREATY AND ITS UPCOMING MODERNIZATION

The ECT is a multilateral treaty among more than 50 different countries and was designed to stimulate foreign direct investments and global cross-border trade in the energy market. The ECT has been in force since 1998 and unlike other multilateral treaties which cover multiple industries (e.g., NAFTA and its successor the US-Mexico-Canada Agreement), its scope is limited to the energy sector. Over the past 20 years, the energy landscape has evolved significantly. With the rise of clean energy sources like hydrogen, countries that signed and ratified the ECT (called “Contracting Parties”) recognized the need to update the treaty to further promote emerging green energy solutions.

In May 2020, the EU submitted a proposal for the modernization of the ECT. On June 24, 2022, the Contracting Parties of the ECT reached an agreement in principle regarding the modernization of the ECT. The draft text of the modernized ECT was communicated to the Contracting Parties on August 22, 2022. The modernized ECT was initially scheduled to be voted on by the Energy Charter Conference on November 22, 2022, but was postponed until April 2023. If adopted in April 2023, the modernized ECT will enter into force 90-days after the ratification by three-fourths of the Contracting Parties.

Per the ECT’s press release regarding its modernization efforts, the modernized ECT is the product of intense negotiations built around three stated goals: (1) updating the list of Energy Materials and Products; (2) flexibility; and (3) the introduction of a review mechanism. This client alert



is concerned primarily with the updated Energy Materials and Products list.

## THE HYDROGEN SECTOR

An immediate beneficiary to these changes is the hydrogen industry. The ECT only covered a specific list of “energy materials and products” that, until now, included nuclear energy, oil and gas, and the production of electrical energy (which had been interpreted to cover green energy projects from solar or wind power).

Updating the list to include **hydrogen** and hydrogen-related compounds like **anhydrous ammonia** will bring those investments under the treaty’s umbrella of coverage. The ECT’s investment protections will then apply not only to the *production* of hydrogen and anhydrous ammonia, but also to a wide range of economic activity including the storage, land transport, transmission, distribution, trade, marketing, and sale of hydrogen. More specifically, those protections will include the “host” State promising not to harm a foreign investor’s energy investments:

- The State will not expropriate (i.e., “take”) assets unlawfully;
- The State promises to afford “fair and equitable treatment” that does not frustrate an investor’s “legitimate expectations”;
- The State will not discriminate against a foreign investor investing in a hydrogen project;
- The State will provide protection and security; and
- The State will honor its contractual and extra-contractual commitments (also called an “umbrella clause”).

The above is, of course, a simplified rendering of the ECT’s protections, and an investor planning to take advantage these protections would do well to seek legal advice on the full contours of the treaty.

These treaty protections are valuable to energy investors because of how the energy sector operates. Energy projects historically require significant up-front capital expenditures and result in a homogenous product. Consequently, energy projects are susceptible to “bait-and-switch” strategies that use incentives to induce a foreign investor to inject the up-front capital at the company’s risk. Then, after the project is built and producing energy, a state actor can step in and change the rules of the game.

## HOW TO QUALIFY FOR ECT PROTECTION

To invoke the ECT successfully, a party must be a qualifying **investor** (a natural person or a business) from a Contracting Party. Currently, there are over 50 Contracting Parties to the Energy Charter Treaty, and about half are members of the European Union (EU). But several EU Member States have announced their intentions to leave the Energy Charter Treaty, so the ECT membership is subject to change and should be reviewed regularly by a prudent investor.

Next, the **investment** must be in a jurisdiction of another Contracting Party to the treaty. Dual citizens cannot make a claim regarding a jurisdiction where they have citizenship. Also, the modernized ECT will no longer allow claims from an investor against a country that is part of “the same Regional Economic Integration Organization.” In other words, an investor from one EU Member State cannot bring an ECT claim against another EU Member State. So, for example, if a Portuguese investor (inside the EU) and a Swiss investor (outside the EU) both invested in an Austrian hydrogen project, and the Austrian government violated the ECT to the detriment of the foreign investors, then the Swiss investor could invoke the ECT, but the Portuguese investor could not.

Therefore, if an investor was planning to invest in a hydrogen project anywhere in the EU, then it would be advantageous to structure the investment through a non-EU State that is also a Contracting Party to the Energy Charter



Treaty. In this case, the UK, Japan, or Switzerland are all viable options and cross-border tax considerations will also likely play a significant role in choosing among non-EU jurisdictions.

But note that the modernized ECT may not be invoked by “mailbox companies” that were created solely for the purpose of benefiting from treaty protection. From now on, the investor will need to show substantial business activities beyond just incorporation in that jurisdiction (e.g., physical presence, employees, payment of taxes, etc.). These limitations are in addition to other carve-outs outlined in the ECT’s Denial of Benefits clause, which should be reviewed carefully to ensure the investor and the planned investment can claim the treaty’s protections. This coincides with increasing limitations on such “paper” companies for income tax treaty purposes as well. It may be that establishing substance for one purpose may be sufficient for the other.

### CONCLUSION

It is an exciting time to be investing in the energy sector and hydrogen in particular. The modernized ECT will soon be a viable means to safeguard some cross-border hydrogen investments. And even if your planned investment would not qualify for protection under the ECT, there is still the chance for similar protections under other bilateral investment treaties. Given past experience with governments’ treatment of energy projects, it is well worth reviewing the full range of possible options to give your investment all the legal protections available under international law.

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