


DEVELOPMENTS IN THE FIELD

The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?

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I. Introduction

On 24 June 2022, the Contracting Parties of the Energy Charter Treaty (ECT) finalized discussions on the modernization of the treaty. After fifteen rounds of negotiations, an agreement in principle was reached to be adopted by the Energy Charter Conference on 22 November 2022 in Ulaanbaatar, Mongolia.¹ The ECT, adopted in 1994, establishes a legal framework that aims to promote international cooperation in the energy sector.² It has a membership of 53 countries primarily from Europe and Central Asia, as well as the European Union (EU) and the European Atomic Energy Community. In recent years, the ECT attracted widespread public attention due to its impact on states' environmental and climate policies. Particularly, the treaty's provisions on investment protection, with investor-to-state dispute settlement (ISDS) at the centre, allow foreign investors in the energy sector to challenge adverse state action before international arbitration and claim compensation for measures affecting their business activities. Fossil fuel investors have increasingly used the ECT to challenge environmental and climate measures, such as phasing out coal-fired power generation, banning offshore oil drilling in coastal areas, and prohibiting gas fracking projects. Such cases have fuelled concerns regarding the abilities of governments to roll-out large-scale climate action. The Intergovernmental Panel on Climate Change (IPCC) has warned that international investment agreements (IIAs) like the ECT could 'be used by fossil-fuel companies to block national legislation aimed at phasing out the use of their assets'.³

¹ Energy Charter Secretariat, 'Public Communication Explaining the Main Changes Contained in the Agreement in Principle', CCDEC 2022 10 GEN (24 June 2022), <https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2022/CCDEC202210.pdf> (accessed 5 December 2022).

² The Energy Charter Treaty, Consolidated Version (adopted on 17 December 1994, entered into force on 16 April 1998), Article 2, <https://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf> (accessed 5 December 2022).

³ IPCC, 'Climate Change 2022: Impacts, Adaptation and Vulnerability: Summary for Policymakers' (28 February 2022), https://www.ipcc.ch/report/ar6/wg2/downloads/report/IPCC_AR6_WGII_SummaryForPolicymakers.pdf (accessed 2 December 2022), 14–81.

With some of these damage claims running into billions of euros, the ECT enables fossil fuel investors to offload the costs and risks associated with their affected assets onto society at large in the face of necessary climate action. This would go, in the words of the editorial board of the *Financial Times*, against the ‘heart of the capitalist social contract’ and the ‘ability of markets to deal adequately with the challenge of climate change’.⁴

The Contracting Parties of the ECT have been discussing the modernization of the ECT since 2017 with the purpose to update and better clarify some of its investment protection standards and to bring them more in line with other approaches included in recent IIAs.⁵ Although the text of the agreement in principle remains formally confidential, it was leaked through the media in early September.⁶ The Energy Charter Secretariat boasts that the agreement in principle marks ‘the first coordinated multinational effort to successfully implement a comprehensive review aligned with the Paris Agreement’.⁷ However, the governments of Poland, Spain, the Netherlands, France, Germany, Slovenia and Luxembourg have announced their intentions to withdraw from the ECT, citing that the modernization results are insufficiently in line with national and European targets resulting from the Paris Climate Agreement.⁸ Subsequently, the EU has been unable to adopt a common position in favour of the modernized ECT, leading to the postponement of the final vote by the Energy Charter Conference to April 2023.⁹ With the European Parliament adopting a resolution calling on the European Commission to start preparing a coordinated EU withdrawal, continued membership of the EU will be unlikely, casting a shadow over the future of the ECT.¹⁰

This article offers a reflection on the modernization of the ECT and the key policy debates and events involved. Section II discusses the main interactions of the ECT with states’ climate commitments. Section III assesses the main outcomes of the modernization process, whereas Section IV considers some of the remaining questions regarding the withdrawal from the ECT and the broader implications for the global investment treaty regime.

⁴ ‘Governments Should not Foot the Bill for Stranded Assets’, *Financial Times* (21 February 2021), <https://www.ft.com/content/6e480f92-894a-494e-90ee-c60d20ce22f9> (accessed 5 December 2022).

⁵ Energy Charter Secretariat, ‘Decision of the Energy Charter Conference: Modernisation of the Energy Charter Treaty’, CCDEC 2017 23 STR (28 November 2017), <http://dev.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/2017/CCDEC201723.pdf> (accessed 5 December 2022).

⁶ Agreement in Principle on the Modernisation of the Energy Charter Treaty (24 June 2022), https://www.bilaterals.org/IMG/pdf/reformed_ect_text.pdf (accessed 5 December 2022).

⁷ Energy Charter Secretariat, ‘Agreement in Principle on the Modernized ECT is of Systemic Relevance for Climate Action’, 9 September 2022, https://www.energycharter.org/media/news/article/agreement-in-principle-on-the-modernised-ect-is-of-systemic-relevance-for-climate-action/?tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Baction%5D=detail&cHash=7affd64c1208e3559da7a1e8a411333a (accessed 5 December 2022).

⁸ Frédéric Simon, ‘Another Blow for Energy Charter Treaty as Luxembourg Announces Exit’, *EurActiv* (20 November 2022), <https://www.euractiv.com/section/energy/news/another-blow-for-energy-charter-treaty-as-luxembourg-announces-exit/> (accessed 5 December 2022).

⁹ Frédéric Simon, ‘Brussels Calls for Pause in ECT Reform Talks after Losing Key EU Vote’, *EurActiv* (21 November 2022), <https://www.euractiv.com/section/energy/news/brussels-calls-for-pause-in-ect-reform-talks-after-losing-key-eu-vote/> (accessed 5 December 2022); Energy Charter Secretariat, ‘The 33rd Meeting of the Energy Charter Conference Held under the Chairmanship of Mongolia’ (22 November 2022), https://www.energycharter.org/media/news/article/the-33rd-meeting-of-the-energy-charter-conference-held-under-the-chairmanship-of-mongolia/?tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Baction%5D=detail&cHash=800c9a7d86cf6b8d3ab99b5e47e213f (accessed 5 December 2022).

¹⁰ European Parliament, ‘Resolution on the Outcome of the Modernisation of the Energy Charter Treaty’ (24 November 2022), https://www.europarl.europa.eu/doceo/document/TA-9-2022-0421_EN.html (accessed 5 December 2022).

II. The ECT's Interactions with Climate Commitments

To limit global warming to 1.5°C above pre-industrial levels, governments must bring global energy-related CO₂ emissions to net zero by 2050.¹¹ This would include phasing out or retrofitting high-emitting infrastructure and no investments in new fossil fuel supply. This will inevitably impact foreign investments in the energy sector, and almost certainly create trillions of unprofitable or 'stranded' assets.¹² The owners of these assets could resort to the ECT, which offers protection to a broad range of foreign investments related to economic activities in the energy sector. These activities cover all energy sources (oil, gas, coal, nuclear, renewables) along the entire supply chain – from extraction and refining to production, storage, transportation, distribution, trade, sale and disposal of related waste.¹³ The value of existing fossil fuel infrastructure in Europe currently protected by the ECT has been estimated at €344.6 billion.¹⁴ Under the ISDS mechanism, foreign investors could sue governments for adopting measures in the energy sector which would allegedly be in breach of the ECT's substantive standards on 'fair and equitable treatment' or 'indirect expropriation' for which compensation is deemed required.

The fossil fuel industry is already the most litigious sector in ISDS, accounting for 20 per cent of the total known ISDS cases across all sectors.¹⁵ Some of the largest fossil fuel companies have been successful in ISDS, with eight out of the eleven largest known awards (all over US\$1 billion) involving fossil fuel companies or shareholders.¹⁶ Fossil fuel investors have also increasingly used the ECT to challenge environmental and climate measures. In August 2022, UK-based oil firm Rockhopper won an award of €190 million plus interest in compensation for the Italian government's decision to ban oil drilling in coastal areas out of environmental concerns.¹⁷ In 2021, German energy companies RWE and Uniper both lodged claims of €1.4 billion and €1 billion, respectively, against the Netherlands for prohibiting coal-fired power generation by 2030 to comply with the Paris Climate Agreement.¹⁸ In August 2022, UK-based energy company Ascent Resources lodged a €500 million damages claim against Slovenia for requiring an environmental impact assessment for the company's gas project with help of low-volume hydraulic fracturing and the subsequent adoption of a hydraulic fracking ban.¹⁹

Such claims could weigh significantly on public budgets and influence how public resources are allocated in the energy transition. The mere threat of ISDS can discourage governments from taking regulatory measures in the energy sector, potentially leading to situations of 'regulatory chill'.²⁰ Climate ministers of Denmark, France and New Zealand

¹¹ IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (October 2021), https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroBy2050-ARoadmapfortheGlobalEnergySector_CORR.pdf (accessed 2 December 2022).

¹² JF Mercure, P Salas, P Vercoulen et al, 'Reframing Incentives for Climate Policy Action' (2021) 6 *Nature Energy* 1133–1143.

¹³ Consolidated ECT, Article 1(5).

¹⁴ Investigate Europe, 'ECT Data Analysis: Results and Methods' (23 February 2021), <https://www.investigate-europe.eu/en/2021/ect-data/> (accessed 2 December 2022).

¹⁵ Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuel Industry', IISD Report (December 2021), <https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf> (accessed 2 December 2022).

¹⁶ UNCTAD, 'Investment Dispute Settlement Navigator', <https://investmentpolicy.unctad.org/investment-dispute-settlement> (accessed 2 December 2022).

¹⁷ *Rockhopper v Italy*, ICSID Case No. ARB/17/14, Award (23 August 2022).

¹⁸ *RWE v the Netherlands*, ICSID Case No. ARB/21/4; *Uniper v the Netherlands*, ICSID Case No. ARB/21/22.

¹⁹ *Ascent v Slovenia*, ICSID Case No. ARB/22/1.

²⁰ Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7:2 *Transnational Environmental Law* 229–250.

have openly admitted to delaying their phase-outs of oil and gas production in fear of arbitration cases.²¹ With access to ISDS, the fossil fuel industry also finds itself in a stronger position *vis-à-vis* governments in compensation negotiations, possibly resulting in overcompensation and unlawful state aid.²² Hence, the ECT could make it more costly and thus more difficult for states to take climate measures.

III. The Main Outcomes of the Modernization Process

The reformed ECT continues to indefinitely protect both existing and new investments in fossil fuels. The updated text includes, however, a ‘flexibility mechanism’ that would allow Contracting Parties to exclude investment protection for fossil fuels in their territories. Only the EU and the UK have opted for this through exclusions in Annex NI. For the EU, new investments in fossil fuels made after 15 August 2023 would no longer be protected. However, there are exceptions for certain gas-related investments in power plants, infrastructure and pipelines, which would remain protected until the end of 2030, or at latest until the end of 2040.²³ Existing investments in fossil fuels made before 15 August 2023 would remain protected until ten years after the new treaty enters into force, or at latest until the end of 2040.²⁴ Only Japan, Switzerland and Turkey have opted to apply the flexibility mechanism *vis-à-vis* investors from the EU (and the UK) reciprocally.²⁵

The modernized ECT also extends investment protection to new energy activities and fuels, such as carbon capture, utilization and storage, hydrogen, anhydrous ammonia, biomass, biogas and synthetic fuels (with certain carve-outs for the EU, UK and Switzerland).²⁶ Such expansion of the scope of the ECT would not only risk further locking-in protection for fossil fuels as many of these energy products still heavily rely on fossil fuel inputs, but also constrain governments’ flexibilities for the necessary regulatory experimentation leading to climate adaptation.²⁷

The updated text also seeks to clarify some of the substantive standards on investment protection. The revised standard on ‘fair and equitable treatment’ now provides for a list that designates certain measures that would constitute a violation of this standard, including the frustration of an investor’s legitimate expectations.²⁸ The reformed standard on ‘indirect expropriation’ stipulates that non-discriminatory measures adopted to protect legitimate policy objectives, such as public health, safety and the environment, would not constitute indirect expropriation.²⁹ A new article reaffirms the Contracting Parties’ right to regulate to achieve such legitimate policy objectives.³⁰ However, recent

²¹ Elizabeth Meager, ‘Cop26 Targets Pushed Back under Threat of Being Sued’, *Capital Monitor* (14 January 2022), <https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/> (accessed 2 December 2022).

²² Stuart Braun, ‘Multi-Billion Euro Lawsuits Derail Climate Action’, *DW* (19 April 2021), <https://www.dw.com/en/energy-charter-treaty-ect-coal-fossil-fuels-climate-environment-uniper-rwe/a-57221166> (accessed 2 December 2022).

²³ Agreement in Principle, Annex NI, Section B, Article 1.

²⁴ *Ibid.*, Annex NI, Section C, Article 1.

²⁵ *Ibid.*, Annex NPT and Annex IA-NI.

²⁶ *Ibid.*, Article 1(5); Annex EM I; Annex NI, Section B.

²⁷ CIEL, ‘A Backdoor for Fossil Fuel Protection: How Extending ECT Coverage to CCUS, Hydrogen, and Ammonia will Lock-In Oil and Gas’, Briefing (October 2022), https://www.ciel.org/wp-content/uploads/2022/10/October-2022_CIEL_Briefing_A-Backdoor-for-Fossil-CIEL_brief_Fuel-Protection-How-Extending-ECT-Coverage-to-CCUS-Hydrogen-and-Ammonia-will-Lock-In-Oil-Gas-Oct-2022.pdf (accessed 5 December 2022).

²⁸ Agreement in Principle, Article 10.

²⁹ *Ibid.*, Article 13.

³⁰ *Ibid.*, New Article: Right to Regulate.

scholarship suggests that including more detailed provisions or exceptions in investment treaties still has limited effectiveness and does not necessarily increase or safeguard the policy space of governments to regulate in the public interest.³¹

Crucially, the controversial ISDS mechanism remains largely unchanged, leaving widely recognized problems such as the lack of impartiality and independence among arbitrators, inconsistency in arbitral awards or the failure to require the exhaustion of domestic remedies unaddressed. A new provision attempts to rule out intra-EU arbitration.³² This follows up on the landmark *Komstroy* ruling by the Court of Justice of the EU where the application of the ECT in investment disputes between an EU member state and an investor of another EU member state was found incompatible with EU law.³³ However, uncertainty remains regarding the ECT's broader compatibility with EU law.³⁴

New provisions on sustainable development, corporate social responsibility and clean energy transition are largely aspirational and merely reaffirm the Contracting Parties' existing rights and obligations under multilateral agreements, such as the UNFCCC and the ILO fundamental conventions.³⁵ Similarly, the Contracting Parties shall only 'encourage' investors to 'adopt and implement voluntarily' principles of responsible business conduct such as the United Nations Guiding Principles on Business and Human Rights.³⁶ New dispute settlement arrangements allow the Contracting Parties to refer these matters to a conciliator in the event of a dispute, which could lead at best to a non-legally binding report with recommendations with no sanction mechanism.³⁷

IV. Conclusion and Outlook

Despite the modernization efforts, the updated ECT still brings considerable risks for governments in their environmental, climate and energy policies. Several EU member states have indicated their intentions to withdraw from the ECT as it is not sufficiently aligned with the Paris Climate Agreement. At the same time, the ECT Secretariat aims to expand membership to countries in Africa, Asia and Latin America, which could also bring greater risks for the energy transition in those regions. However, the modernization process is far from concluded. The adoption of the amendments requires unanimity among the Contracting Parties present and voting at the Energy Charter Conference in April 2023. If adopted, the modernized ECT will enter into force only if three-quarters ratify it, which may take years. Without the necessary support within Europe, it remains uncertain whether the modernization will be up for voting in April 2023 at all.

Alternatively, there are increased calls for a coordinated EU withdrawal from the ECT. Withdrawal is possible under Article 47, but this would trigger the 'sunset clause' under which existing investments would remain protected for another twenty years after withdrawal.³⁸ A coordinated EU withdrawal should therefore be accompanied by an *inter se* agreement that neutralizes the sunset clause on the basis of Article 41 of the Vienna

³¹ Wolfgang Alschner, *Investment Arbitration and State-Driven Reform: New Treaties, Old Outcomes* (Oxford: Oxford University Press, 2022).

³² Agreement in Principle, Article 24(3).

³³ *Republic of Moldova v Komstroy LLC* [2021] ECLI:EU:C:2021:655.

³⁴ Christina Eckes and Laurens Ankersmit, 'The Compatibility of the Energy Charter Treaty with EU Law', Amsterdam Centre for European Law and Governance, University of Amsterdam (21 April 2022), <https://www.clientearth.org/media/2n2po04j/report-on-ect-compatibility-with-eu-law.pdf> (accessed 12 December 2022).

³⁵ Agreement in Principle, Article 19.

³⁶ *Ibid.*, Article 19(6).

³⁷ *Ibid.*, Article 28bis.

³⁸ *Ibid.*, Article 47(3).

Convention on the Law of the Treaties.³⁹ The European Commission has itself already prepared a draft *inter se* agreement to clarify that the ECT and its sunset clause do not apply, and never applied to intra-EU relations.⁴⁰ This draft could be modified to allow other withdrawing Contracting Parties outside the EU to join and limit the sunset clause.

Finally, the turn of events in relation to the ECT also has implications for the other 2,221 IIAs currently in force. Many of these treaties still contain old-style provisions on investment protection and ISDS incompatible with climate objectives. At the very least, the ECT debate has opened up a space for governments to discuss and reconsider what types of investments should be encouraged and protected both at home and abroad and to bring greater coherence in their investment and climate policies. However, the question remains whether to continue with a legal framework that prioritizes investment protection and arbitration at a time of unprecedented transition and uncertainty, or whether other instruments are more appropriate to boost the clean energy transition.

Conflicts of interest. The author declares none.

³⁹ Lukas Schaugg and Aishwarya S Nair, 'The Reform that Isn't: Why the Reformed Energy Charter Treaty Threatens Climate Commitments', *Verfassungsblog* (18 November 2022), <https://verfassungsblog.de/the-reform-that-isnt/> (accessed 12 December 2022).

⁴⁰ European Commission, 'Annex to the Communication from the Commission to the European Parliament and the Council, as well as to the Member States on an Agreement between the Member States, the European Union, and the European Atomic Energy Community on the Interpretation of the Energy Charter Treaty', COM(2022) 523 final (5 October 2022), https://eur-lex.europa.eu/resource.html?uri=cellar:3d54cece-4494-11ed-92ed-01aa75ed71a1.0001.02/DOC_2&format=PDF (accessed 12 December 2022).