The EU's Bittersweet Proposal to Redefine 'economic activity' under the Energy Charter Treaty: Expected Implications for International Arbitration

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Following a highly-publicized diplomatic battle among the EU Member States (MS), the EU revealed in mid-February its proposal to amend the ECT's definition of the "Economic Activity in the Energy Sector" (EAES). The announcement allayed fears of the intra-EU discussions on the matter falling apart. Insofar as it sets forth a vision for amendments that might be acceptable to fossil-fuel exporting ECT members, the EU proposal is expected to weigh heavily on the fate of the ECT modernisation negotiations. It is expected that the negotiations will either result in the modernisation process being concluded this year – preferably by the COP26 Summit scheduled in November – or will otherwise fall apart. This post offers an early look at the consequences that adopting the EU's proposal on EAES could entail for the future of investment arbitration under the ECT.

Charter Wars: A New Hope

With both the EU and virtually all of its MS being parties to the ECT, the European Commission (EC) was mandated to represent the MS in the ECT modernization negotiations. Under the final EU proposal submitted by the EC, the definition of EAES – which basically sets the limits for what constitutes protected investments under the ECT – would still include "exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products". Technically, the proposed changes concern not the definition of EAES, but the notion of "Energy Materials and Products" referred to therein. For ECT arbitration users, the suggested amendments to the definition of Energy Materials and Products present two important developments.

First, and less controversially, the proposal extends treaty protection to investments made in selected renewable energy sources, namely: (i) undenatured ethyl alcohol of 80 per cent or more alcohol by volume; (ii) low-carbon hydrogen; (iii) renewable hydrogen; (iv) methanol; (v) formic acid; and (vi) biomass. While investors in renewables are no strangers to ECT arbitration, an explicit extension of the scope of treaty protection so as to cover these highly promising and sustainable energy sources would perhaps turn the page in the ECT's history. It is uncertain, though, if such an extension would encourage investments in countries that have thus far relied on fossil fuels for export revenues or for their own energy needs, although it certainly would boost investors' confidence.

The second set of proposed changes indicate the EU's intent to abolish treaty protection for investments in fossil fuels, although not all at once. Crucially and most polemically, the EU proposes to maintain treaty protection until the end of 2030 for future investments in electricity generation from oil and other gaseous hydrocarbons through power plants and other infrastructure, but only if the following two cumulative conditions are met: (i) they enable the use of renewable and low-carbon gases and (ii) emit less than 380 g of CO2 of fossil fuel origin per kWh of electricity. The period of protection for such investments which replace already existing investments, as well as for pipelines capable of transporting safe and sustainable renewable and low-carbon gases, including hydrogen, would end ten years after the amendments take full or provisional effect, but no later than in 2040.

With the proposal announcement coming days after Germany's energy giant RWE

declared that it will seek EUR 1.4 billion in an ECT arbitration from the Netherlands as compensation for phasing out coal from the Dutch energy mix, the timing of the EU's take on EASE in ECT was perfect. However, the overall architecture of the EU submission begs at least two important questions.

First, the proposal does not specify what exactly the emissions threshold of 380 g of CO2 from fossil fuels per kWh of electricity shall mean. While it is generally inferred that setting the emissions value at 380g would cover gas-fuelled electricity generation but exclude coal-fired installations, the absence of specific designations to that aim creates space for uncertainty.

Second, the relationship between the proposed periods of treaty protection for particular types of high-emission investments and the ECT sunset clause is unclear. As the envisaged solution to gradually extinguish the protection of such investments is not intended to replace the ECT's sunset provision, the relationship between the two regimes may logically be interpreted as follows. Upon expiration of the protection periods ending in 2030 or 2040 the material scope of the ECT would automatically narrow, with only low-carbon investments remaining protected. A decision by a treaty member to withdraw from the ECT upon expiration of these deadlines would then trigger the 20-year sunset period, during which only low-carbon investments made in the territory of the exiting treaty member would remain protected by the ECT.

Intra-EU ECT Arbitrations: The Puzzle Persists

The latter of the above two questions inevitably touches upon the broader, ongoing debate as to whether the ECT should apply in intra-EU arbitrations (see blog coverage here). Should the ECT modernisation talks collapse, an exodus of members leaving the treaty is expected, for whom the sunset period would begin to run. If the modernisation succeeds under the EU proposal, the existing high-emission energy investments will still remain protected – albeit temporarily, but long enough for investors to adapt. Gas power plants and stations – which especially MS in the CEE view as the indispensable intermediary step in the process of transitioning to emissions-free technologies – would remain protected for several more years.

For the EU, a third scenario is likewise conceivable: some EU MS decide to stay in

the ECT, others decide to go. If that happens, what impact would it have on the EU's membership in the ECT? If the EU itself remains an ECT member – what consequences would this entail for the MS leaving the ECT, which would remain bound by the Charter indirectly via their EU membership? Italy's departure from the ECT in 2016 has already set a precedent for this situation, although the actual extent to which Italy (and potentially other MS who might follow its steps) will remain indirectly restrained by the ECT through their membership in the EU following the expiration of the sunset period is unclear.

Intra-EU efforts so far have not eliminated the possibility for EU investors to initiate arbitration proceedings under the ECT against EU MS. While the EC stated in 2018 that the CJEU judgment in the *Achmea* case should also apply to proceedings initiated on the basis of the ECT – this position being later supported by the 2019 Declaration of the majority of MS – such steps are of only declaratory nature and are not legally binding for arbitral tribunals which themselves decide on their own jurisdiction in ECT disputes. Other MS – most notably Sweden – stated that it is too early to declare intra-EU application of the ECT incompatible with EU law. This latter view is supported by national courts of certain MS, perhaps most notoriously exemplified by Spain's string of loses before Swedish courts where it asked to set aside arbitral awards issued on the basis of the ECT.

The preamble to the May 2020 Agreement on the Termination of Bilateral Investment Treaties, acknowledging the political impasse on the ECT stated that the Agreement "does not cover intra-EU proceedings on the basis of Article 26 of the Energy Charter Treaty. The European Union and its Member States will deal with this matter at a later stage". Perhaps the meaning of 'later' will be forced upon the MS by the ECJ, whom Belgium and a Swedish court requested recently to opine on the compatibility of the ECT with the EU treaties, and whose advocate general advised that the ECJ extends *Achmea* onto intra-EU ECT proceedings.

Still, notwithstanding a possible future EU-wide consensus to exclude ECT from serving as a basis for intra-EU arbitrations, arbitral awards rendered in such disputes would still be enforceable in non-EU jurisdictions (except, perhaps, when non-EU judges are exceptionally keen on international comity). To prevent such situations, the exclusion of the application of the ECT to intra-EU disputes would have to take a different form – most likely that of an explicit exclusionary provision being added to the body of the ECT itself. The EU has thus far not advocated such a proposal, arguably due to the EC's insufficient negotiation mandate. But even if

such an amendment to the ECT was to be made, it would not eliminate the risk of treaty shopping. If successful, however, the modernisation of the ECT under the EU proposal could hopefully set a trend for other investment protection agreements to follow and exclude protection for high-emission investment in energy sectors (and arguably other sectors, too).

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