Kluwer Arbitration Blog

ECT Modernisation Perspectives: An Update

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From 20-26 July last year, this Blog ran a series on the Energy Charter Treaty (ECT) modernisation process. The Energy Charter Conference (the Conference) had recently established a Modernisation Group (the Subgroup) to conduct the modernisation negotiations, and the series aimed to provide updates to readers on various aspects of that process. At the time of the series, the Conference had just finished its first formal round of modernisation negotiations. Fast forward a year later to this update and a second (8-11 September 2020), third (3-6 November 2020), fourth (2-5 March 2021), fifth (1-4 June 2021), and sixth (6-9 July 2021) negotiation round have been conducted. This post provides an update on these latest rounds, to provide a snapshot of where the modernisation process is up to. As the post highlights, while things have moved forward since our series last year major divergences remain unresolved.

Is the ECT Moving Closer towards Protecting Cleaner, Greener Energy Investments?

The ECT has come under intense scrutiny and criticism for allegedly protecting the fossil fuel industry, on the one hand, and undercutting sovereignty, on the other. The criticism can be summarised as follows:

> *"The ECT is an antithesis to the Paris Agreement, allowing fossil fuel companies to sue countries over their climate policies rather than strengthening the global response to climate change. … It protects all investments in the energy sector, including coal mines, oil fields and gas pipelines. Any state action that harms a company's profits from these investments can be challenged outside of existing courts, in international tribunals consisting of three private lawyers. Governments can be forced to pay huge sums in compensation if they lose an ECT case."*

The ECT modernisation process has continued to bring these issues into sharp focus. One key issue has been the connection between the environmental objectives that have become a focus in the modernisation process, and the definition given to the

concept of "economic activity in the energy sector" (EAES). This defines which economic activities may benefit from investment protection under the ECT. It has been suggested that such concept could be redefined, for example, to exclude protection for fossil fuel investments. A more detailed overview of the concept of EAES in the ECT is available here. The negotiations have continued to focus on potential innovations to the scope and coverage of the ECT in this regard. During the fifth negotiation round, for example, it was suggested that there was a "*need to amend the relevant provisions [on EAES] in light of the Contracting Parties' individual climate goals and their specific energy mixes*". It was further noted that various proposals had been put forth, yet, "while there are different proposals on the definition of economic activity in the energy sector, all proposals favour the transition to a low carbon consumption society".

In future negotiating rounds, a particularly relevant question will remain how best to balance investment protection with broader environmental goals. While adjustments to the definition of what constitutes an EAES might bring some degree of recalibration, States parties to the negotiations are also considering broader reform options. This includes, *inter alia*, the possibility for reforming the treaty to more objectively acknowledge goals related to sustainable development, the environment, climate change, and corporate social responsibility (CSR). The summary of the second negotiation round indicates, for example, that:

> "*The discussions included comments and proposals on the right to regulate, relevant multilateral environmental agreements, climate change and the clean energy transition such as the Paris Agreement, international standards of labour protection, responsible business practices, the conduct of environmental impact assessment and good governance (transparency).*"

The EU, in particular, has been characterized as a key stakeholder capable of making the ECT "the greenest investment treaty of them all". The European Commission has indicated as part of the modernisation process its determination to reform investment protection standards and ISDS, on the one hand, while including new provisions on sustainable development and climate change, on the other. The Commission has stated that "*[o]ne of the objectives of this reform is to align the ECT with the Paris Agreement and the objectives of the Green Deal*". Such mission is manifested in, for example, suggested definitional changes. The Commission is committed to pursuing the modernisation negotiations but has indicated that it will not abandon "core EU objectives, including alignment with the Paris Agreement". It has even indicated that it may withdraw from the ECT altogether if these "core EU objective[s]" are not achieved.

The crux of the matter is whether the ECT, in its current form, "restricts countries' ability to regulate and speed up the green transition of the energy sector", or unduly privileges and protects coal and other dirty energy sources. At the same time, the origins and purpose of the ECT must not be forgotten. It is a treaty designed foster energy cooperation and to ensure the protection of energy investments. How then

should the treaty be reformed so that the move towards a cleaner, greener treaty does not unintentionally undercut the investment protection needed to promote and attract energy (including green energy) investments? Such balancing and reconciliation is a daunting task.

Changes to Substantive and Procedural Investment Protections: What is Needed and What has Been Achieved?

Authors on this Blog have previously discussed possible reforms to the ECT's denial of benefits clause, the fair and equitable treatment provision, as well as possible reforms to the valuation approaches adopted by ECT tribunals. These issues have continued to dominate the focus of the ECT modernisation process in subsequent negotiation rounds. In the third negotiation round, for example, the Subgroup discussed *inter alia* the definitions of investor and investment, the incorporation of a right to regulate clause, and the scope of the treaty's most constant protection standard. So, too, in the fourth negotiation round, the Subgroup discussed *inter alia* possible adjustments to the treaty's fair and equitable treatment, denial of benefits, indirect expropriation, most favored nation protection, and umbrella clauses. The parties "*continued to clarify similarities and differences in their positions with a view to advance negotiations to the drafting of compromise proposals*". Reportedly, good progress was made and the Secretariat was mandated "*with the drafting of draft compromise proposals to be considered during one of its next negotiation rounds in 2021"*. The sixth negotiation round focused on several of these proposals, with the Subgroup reportedly making considerable progress on reforms to the definitions of "investment" and "investor", "indirect expropriation" and denial of benefits. As the draft text being proposed and discussed has not been publicly released, it remains to be seen whether such adjustments largely replicate the *status quo* or result in significant innovations.

Authors on this Blog have also widely discussed possible ISDS reform, much of which is relevant with respect to the ECT. The ECT modernisation process has engaged in each negotiation round with possible ISDS reforms. This includes, for example, provisions to regulate frivolous claims, third party funding, security for costs, increased transparency, etc. The negotiation rounds have indicated the intention of ECT States Parties to reflect on the discussions taking place in UNCITRAL and ICSID vis-à-vis such reform options. The EU, for example, has indicated that its "*ultimate goal is to make a future multilateral investment court applicable to disputes under the ECT*". Meanwhile, however, Japan, Kazakhstan, Azerbaijan and other States have indicated reluctance to agree to such reforms. As with every negotiation in a multilateral setting, give-and-take is key. As the ECT Secretary-General has stated: "Undermining the ECT modernisation process through unrealistic requirements might be dangerous as such calls could easily become a self-fulfilling prophecy".

ECT Reform: Impossible or Imaginable?

We provide this update on ECT modernisation efforts with a moderately optimistic

feeling. Serious discussions have been undertaken and compromises are likely to slowly emerge. Indeed, even at the outset of the modernisation process, sceptics predicted that the Contracting Parties would not be able to agree on a list of topics for negotiations, yet they did. Now, sceptics claim that reform is "extremely unlikely". One thing is – at least – as clear now as it was when our ECT series was published last year: "*certain provisions in the treaty are simply outdated*" and, as Dr. Baltag explained, "*[m]ost Contracting States to the ECT are in favor of modernisation. The disagreement, if any, will be on the wording of the provisions*."

It is therefore hoped that ECT States Parties can come together to improve the treaty. If not, the ECT stands only to fail. As the ECT Secretary-General said: "*The stakes are high. If the modernisation process fails, I don't see a future for the Treaty*." Yet, the dismantling of the ECT could itself "*seriously hamper the ability of the world to meet the Paris climate targets. The Paris Agreement does not protect investment. The Energy Charter Treaty does. It's a complement to the Paris agreement*." The bottom line is this: the ECT is still important, it has an important role to play, but it needs to "modernise" to meet the demands of the future.

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