Kluwer Arbitration Blog

ECT Modernisation Perspectives: An Introduction

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The Energy Charter Treaty ('ECT') opened for signature in 1994, entered into force in 1998, and now boasts some 50 member States. The ECT has since given rise to some 130 investor-State arbitrations, making it "the most frequently invoked international investment agreement". This high use, coupled with a perception that the ECT is frequently invoked in aid of protecting fossil fuel investments, has meant that the ECT has attracted scrutiny and criticism, as well as calls for reform. The Energy Charter Conference has therefore agreed to initiate an ECT modernisation process. The first formal round of modernisation negotiations was held earlier this month. As the ECT Secretary-General has remarked, "The stakes are high. If the modernisation process fails, I don't see a future for the Treaty." To mark the start of these significant negotiations, our series this week will provide different perspectives on the progress and prospects for reform of this important multilateral treaty. Today, we start with an introduction to the ECT and the reform process, and provide a snapshot of the posts you will see throughout the week.

The ECT Modernisation Process

In 2018, the Energy Charter Conference appointed a Subgroup on Modernisation, which developed a list of topics for potential modernisation/reform. The list contemplates a range of potential reforms, including:

- various definitional modifications (including to the notions of 'investment' and 'investor');
- insertion of a 'right to regulate' clause and sustainable development and corporate social responsibility rules;
- substantive reforms, including to the ECT's fair and equitable treatment, protection and security, expropriation, and umbrella clauses;
- various procedural amendments, including to the rules governing frivolous claims, transparency, and security for costs; and
- amendments to the valuation rules and rules related to third party funding.

The Energy Charter Ministerial Conference approved these topics in November 2018, also adopting a declaration recognising "the importance of the modernisation of the Energy Charter Treaty to guarantee that it keeps providing balanced rules to protect investments that ensure stable energy supply, energy access, and a sustainable energy future". Modernisation negotiations focus on this list of 25 approved topics and various policy options put forward by States parties.

In November 2019, the Energy Charter Conference established a Modernisation Group to conduct modernisation negotiations. It was agreed that negotiations would take place for approximately 4 days every 3 months, with the Conference to assess progress in December 2020. Most, but not all, ECT States have supported the need for modernisation. Japan, for instance, has indicated its view that "it is not necessary to amend the current ECT provisions", with Luxembourg urging the "parties/secretariat to conduct sound impact assessments on any and all major changes that will be proposed in the modernized Treaty". The details of the various proposals are not yet fully elaborated in public documents. As negotiations progress, it is to be hoped that more concrete proposals will emerge to allow for sustained engagement by other stakeholders – including civil society organisations – and that sufficient transparency and time will be provided to allow for the types of assessment contemplated by parties like Luxembourg.

Towards Cleaner, Greener Energy Investments?

In addition to the topics identified by the Subgroup on Modernisation, various member States have also indicated their particular reform agendas. The EU, for instance, has noted its view that "[t]he objective of the Modernised ECT should be to facilitate investment in the energy sector in a sustainable way", such that "[t]he Modernised ECT should reflect climate change and clean energy transition goals and contribute to the achievement of the objectives of the Paris Agreement". The EU is not alone in these aspirations. Albania, for example, has indicated that it is "open to discuss the possibility to align the modernisation process of the ECT with the Energy Transition/Decarbonisation Processes and Contracting Parties' Climate Change Commitments". Azerbaijan, too, has adopted a view that the modernisation process should give "[p]articular attention… to key components such as sustainable energy issues, including energy efficiency and alternative energy".

One way in which States have contemplated encouraging cleaner and greener energy investments is via amendments to the ECT's definitional provisions. This includes amending Article 1(5)'s definition of "economic activity in the energy sector". The EU notes that "[s]uch economic activity is associated with products and materials that are largely fossil fuels-related", and "may not cover new trends in investment, in particular with regard to renewable energy nor the energy efficiency tools and on-going digitalisation of the energy sector". It therefore proposes modifying the ECT to ensure that it "allows addressing the challenges and opportunities of the transition to a safe and sustainable low-carbon, more digital and consumer-centric energy system". Some States have made concrete textual proposals to support such an aim. Albania, Azerbaijan, Luxembourg and Turkey, for instance, have each proposed modifying Article 1(5)'s definition to "cover new investment trends and technologies" to align the ECT with "the contracting parties' commitments in the fight against Climate Change". States have also sought to make the ECT more climate-friendly by modifying its provisions to recognise a State's "right to regulate". Albania, Georgia, Switzerland and Turkey, for instance, each note the possibility of including a separate "right to regulate" provision. Luxembourg, too, envisages scope for a "right to regulate", connecting this proposal to "the energy transition process and the specific context of implementation/fulfilment of the Paris Agreement contracting parties' commitments".

The modernisation process also contemplates including specific sustainable development and corporate social responsibility provisions. The EU, for instance, has issued negotiating directives focussing on several reform objectives, including modernising investment protections to

incorporate sustainable development and corporate social responsibility provisions into the ECT. States have flagged the potential to include such provisions in the treaty's preamble, or as stand-alone provisions. Luxembourg has proposed, for instance, incorporating a "stand-alone article with reference to Climate Change Commitments, Decarbonisation process, Corporate Social Responsibility and Sustainable Development instruments", including references to specific instruments containing the content for such standards. The negotiating documents are unclear as to whether the intention would be to merely refer to such standards, or to otherwise impose obligations on investors to comply with them. Switzerland, for instance, expressly contemplates "the possibility of including a non-binding language in the Treaty referring to the responsible business conduct", whereas the EU appears to envisage making such standards obligatory through domestic law.

Changes to Substantive Investment Protection Obligations

The modernisation process also encompasses potential reforms to the ECT's investment protections. As Georgia notes, "the interpretation of various legal concepts of investment protection under the ECT have greatly evolved since the conclusion of the ECT; therefore, the modernisation of the Treaty is necessary and timely". Albania, Georgia and Turkey, for instance, have each proposed revising the ECT's most-favoured-nation clause to prevent investors from invoking more favourable dispute settlement provisions from other investment treaties. Switzerland has indicated its opposition to such a proposal, save that it agrees that "[i]t should not be possible that procedural and substantive provisions from other agreements that were concluded before are used in a dispute". The ECT States have also identified numerous possible reforms to the ECT's "fair and equitable treatment" obligation (covered in detail as part of our series), protection and security provision (with most States focussing on restricting the potential for the provision to be invoked to secure *legal* protection) and umbrella clause (with most States focussing on clarification of the scope of commitments that will be covered by the clause). Protection from expropriation is also a topic for possible modernisation, with State comments indicating the need for a clearer definition of "indirect expropriation" and "rules about the compensation for expropriation".

Reform of Investor-State Dispute Settlement

The modernisation process also encompasses possible reforms to ECT investor-State arbitration. The States parties have indicated their intent to integrate such reforms with other ongoing reform discussions, including those in the UNCITRAL, ICSID and OECD contexts. The EU, for instance, has referred to ongoing multilateral initiatives for reform of investor-State dispute settlement processes, including its intent to ensure any future multilateral investment court applies to ECT investor-State disputes. Turkey similarly invokes parallel reform efforts. It supports, for instance, drafting a declaration on third party funding, potentially referencing UNCITRAL discussions. This would include an obligation for parties to arbitration proceedings to disclose whether they have received third party funding and, if so, its source. Georgia, too, emphasises that "due regard" should be given to the work of UNCITRAL and ICSID in developing an ECT mechanism for security for costs and regulation of third party funding. Georgia proposes, however, the development of an ECT-specific transparency regime for arbitration, noting that it "does not

support straight incorporation of UNCITRAL Rules on Transparency in the ECT". This differs to other States' positions, with Switzerland for instance proposing an ECT "declaration to refer to the application of the UNCITRAL Rules on Transparency in arbitral proceedings". Save perhaps the EU's approach, most reform proposals focus upon modifying the investor-State dispute settlement arrangements already in the treaty. Given that the Energy Charter Secretariat is an active promoter of investor-State mediation, it will be interesting to see whether new detail on dispute settlement options (or even requirements to resort to non-arbitral means of settlement) will feature in the reform discussions.

A Preview of Our ECT Modernisation Series

Given the modernisation process's scope, our contributors this week offer several perspectives on the various proposals under consideration by ECT States. As you will see, the ECT modernisation process highlights the tensions and complexities associated with the reform of international investment treaties, the different viewpoints regarding the desirability of particular reforms, as well as the difficulties produced by the interaction between different investment regimes and other bodies of law.

The series begins tomorrow with a post by the ECT Secretary-General, Dr. Urban Rusnák, setting out the lineage of the reform process and the conditions needed for its success.

Our next three posts will focus on reforms to the ECT's substantive provisions. In Wednesday's post, Dr. Crina Baltag and Professor Loukas Mistelis examine the possible reform of the ECT's denial of benefits provision. On Thursday, Ylli Dautaj and Per Magnusson examine the proposals concerning reform of the ECT's substantive investment protection obligations, focussing on the possible reform of the ECT's fair and equitable treatment provision. On Friday, Munia El Harti Alonso and Naimeh Masumy examine possible reforms for the valuation approaches used in ECT investor-State disputes.

The following two posts examine the relationship between the ECT and other bodies of law. On Saturday, Jan Kunstyr and Ondrej Svoboda consider the connections between the ECT State-State arbitration mechanism and international environmental law. On Sunday, Dr. Aikaterini Florou considers the evolving relationship between the ECT and European Union law.

We hope that this series offers you some useful insights, and that you will enjoy hearing our contributors' different perspectives on the features of the ECT modernisation process, as well as the tensions and limits becoming evident now that the negotiations have begun.

To read our coverage of the ECT Modernisation process to date, click here.

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