Kluwer Arbitration Blog

ECT Reform: The Final Countdown

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Negotiations towards a modernized Energy Charter Treaty (ECT, Treaty) ended on 24 June 2022, with the States Parties reaching an agreement in principle following discussions towards reform that began in November 2017. While the final text of the modernized Treaty has not yet been published, the Secretariat of the ECT in June issued a public communication summarizing the main proposed changes to the Treaty. The final text will be released in August 2022, and the proposal will be voted on by the Conference in November 2022. If approved by three-quarters of the Contracting Parties, the modernized ECT will enter into force 90 days after its ratification. At KAB, we have been closely monitoring the ECT reform and modernization process. Building on the Blog's prior coverage of the ECT modernization process, this post highlights a few of the most noteworthy modifications to the ECT proposed through the agreement in principle and considers their implications for investment disputes moving forward.

1. Investment Protection

Some of the core changes brought about in the proposed amendments relate to the substantive standards of protection afforded to investors and their investments under the ECT. The agreement in principle targets changes for several such standards. This section discusses the key changes proposed related to the fair and equitable treatment (FET) obligation in the ECT, the States Parties' right to regulate, and the most-favoured-nation treatment clause.

Fair And Equitable Treatment (FET)

FET is the most frequently invoked protection in ECT claims and the most frequent standard under which tribunals have found ECT breaches. As of June 2022, investors have filed FET claims in 24.7% of the 83 ECT publicly available awards. Further, of the 43 cases in which ECT tribunals found Treaty breaches, 65% were for FET violations. Hence, any change to this standard will have important impacts in future ECT cases.

Prior to the modernization of the ECT, commentators and tribunals noted that the language of Article 10(1) of the ECT was unclear, producing debates as to the scope of protection provided to investors and their investments under this clause. For some commentators, the current language of Article 10(1) may be interpreted as a catch-all provision that encompasses legitimate expectations and non-discrimination, among others, thus, trumping a State's right to regulate and causing

regulatory chill. Tribunals on the other hand, have discussed whether Article 10(1) sets forth an objective and self-contained FET standard or refers instead to a narrower protection corresponding to the minimum standard of treatment under customary international law (*see Belenergia v. Italia*, ¶¶567-69).

As a response to the lack of clarity of the FET protection, the modernized ECT proposes to refine the FET standard by providing a list of specific measures that infringe this protection. The proposed amendments would also clarify the situations in which legitimate expectations can be protected under the FET clause, thus potentially restricting the grounds under which investors can bring claims for the breach of this standard. Such adjustments are consistent with reforms being undertaken by States outside of the ECT context, which have seen States increasingly specify more clearly what exactly FET clauses will apply to including through similar list approaches.

Right to Regulate

States commonly invoke their right to regulate to justify changes to their internal legal framework. Some commentators, such as Ortino, describe the interpretation of the right to regulate under FET – including the ECT's current Article 10(1) – as "*muddy*" (p.33). He argues that tribunals have failed: (a) to take a clear position on whether the FET requires regulatory stability in the strict sense; (b) to address the precise conditions from which the obligation to provide a stable legal framework arises; and (c) to clarify the kind of regulatory change that would qualify as a breach of the FET provision (p.33).

This is exemplified by the 51 ECT cases in which Spain has been a respondent, which have seemingly adopted different interpretations of the scope of the right to regulate under circumstances that involve similar facts. While some tribunals have ruled that an investor is not entitled to have a legitimate expectation to a stable regulatory framework (*see e.g. Charanne v. Spain*, at ¶499), other tribunals have noted that certain actions and assurances by the government create legitimate expectations, that if infringed, imply FET breaches. (*see e.g. Masdar v. Spain* at ¶¶494, 521)

The modernized ECT aims to clarify the Contracting Parties' right to regulate by including a stand-alone article that refers to a state's power to regulate *vis-à-vis* investors in the interest of legitimate public policy objectives, including climate change, protection of public health, safety, public morals, and the maintenance of peace and security. While the vast majority of treaties refer to the right to regulate as a regulatory carveout (s*ee e.g.*, TPP at art. 9.16, Netherlands Model BIT at art.2), very few investment agreements – like the modernized ECT – directly affirm the parties' right to regulate (though see also, EU- Vietnam FTA at art. 13.2). Under the second category, States have broader regulatory space that will likely limit future investment disputes related to regulatory measures similar to those filed against Spain. Arguably, the language of the modernized ECT asserting the host State's right to regulate will also limit arbitral discretion to interpret am investors' legitimate expectations vis-à-vis the stability of the State's legal framework, thus again reaffirming domestic regulatory power and autonomy.

Most Favoured Nation (MFN) Clause

The MFN clause has been invoked in several ECT cases to import more favourable investment or substantive standards from other treaties. The proposed revisions to the ECT narrow the scope for such arguments by clarifying that the MFN standard does not extend to dispute settlement

procedures and that substantive provisions in other international agreements do not constitute "treatment" to be accorded under the modernized ECT. Hence, the revised MFN protection would allow states to retain the capacity to make distinctions between investors for legitimate purposes (see *MNSS v. Montenegro*, at ¶362) and will further limit the use of comparator treaties to import either substantive protections (*see Accession Mezzanine v. Hungary*, at ¶73-4) or dispute settlement procedures (*Plama v. Bulgaria* at ¶223), and will only apply where there is proven discriminatory treatment.

2. Exceptions for Regional Economic Integration Organizations

In the last decade, the European Union (EU) has taken steps to regulate investment law between EU Member States. From the mandatory termination of all intra – EU BITs, to the complete ban of *ad hoc* investment agreements among EU Member States, the relationship between EU law and investment arbitration has been controversial.

The modernized ECT proposes to address this fragmentation by expressly modifying the application of certain provisions of the ECT in relation to Regional Economic Integration Organizations (REIO) such as the EU and/or their members.

First, a proposed exception to the application of Article 7 (freedom of transit of energy materials) prevents further clashes between EU Law and the ECT. In principle, this article of the ECT would collide with the principles of the EU single market enshrined in article 26 of the TFEU; hence, this exception would apparently overcome such friction. Similarly, Article 29 of the ECT on trade with non-WTO members does not apply in the mutual relations among parties that are members of the same REIO, thus again, respecting the EU internal single market.

Second, a proposed exception to the application of articles 26 (investment dispute settlement) and 27 (disputes between Contracting Parties) would allow the EU to carve out arbitration among its members under the ECT, thus, in principle, rendering ECT ISDS consistent with the intra-EU ISDS ban set forth by the Court of Justice of the European Union (CJEU) in *Slovakia v. Achmea*, *Moldova v. Komstroy* and *Poland v. PL Holdings* (coverage here, here, here and here).

3. Transparency in Dispute Settlement

The modernized ECT intends to provide for enhanced transparency in the conduct and outcome of proceedings. It incorporates the 2014 UNCITRAL Rules on Transparency as part of the Treaty and adds supplementary measures to enhance disclosure of proceeding documents and full access to hearings of investment proceedings. Moreover, as with the amended ICSID rules, the modernized ECT will require mandatory disclosure of third-party funding.

4. Towards Greener Investment

The ECT has been criticized for allegedly protecting fossil fuels investments (coverage here). Interestingly, of the 150 cases brought under the ECT, 60% refer to protection of renewable

energies and only 33% concern fossil fuels. Of the fossil fuel cases, in 50% tribunals have found ECT breaches, while the rest have been either dismissed or settled. Whether or not the criticisms are valid, the modernized ECT is intended to further advance environmental objectives in the following ways.

First, the modernized ECT proposes to protect new energy materials through its investment protection provisions, including among others, materials such as hydrogen, biomass, biogas, and synthetic fuels.

Second, the modernized Treaty will establish a *"flexibility mechanism"* that allows the Contracting Parties to exclude the protection of fossil fuel investment within their territories. This exclusion does not operate *ipso lege*, but depends on the will of Contracting Parties, which may opt to carve out fossil fuel protection depending on their energy and climate goals, with the UK and the EU being the first contracting parties to exercise this right.

Third, the modernized ECT will introduce a review mechanism that will allow Contracting Parties to review the flexibility mechanism and the list of protected investments every five years to react to technological and policy developments in the energy sector.

Fourth, the modernized ECT will introduce additional treaty language that reaffirms the obligations of the Contracting Parties under the UNFCCC and the Paris Agreement.

Fifth, it will introduce a particular dispute settlement mechanism applicable to disputes between the Contracting Parties regarding the interpretation and application of the provisions on sustainable development, with the possibility of referring this matter to a conciliator.

The addition of sustainable development provisions in the modernized ECT is a unique feature that separates the Treaty from other multiparty agreements and addresses civil society's criticisms of the existing approach to ISDS in the instrument, with some commentators even arguing that the modernized ECT is the "greenest investment treaty of them all".

Conclusion

With countries from Africa and Asia joining, the ECT is turning into a global charter. The modernized ECT aims to redefine some of the most common investment protection standards in ISDS and narrow the circumstances in which investors can seek protection under the Treaty, in order to address the Contracting Parties' concerns and civil society's resistance against ISDS. The modernized Treaty also will encourage transparency and sustainable development, arguably granting higher legitimacy to ISDS under the ECT. Yet, it is still to be seen whether the Contracting Parties will approve the modernized version and how investment disputes develop under these new rules.

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