Kluwer Arbitration Blog

Expert Roundtable: The Energy Charter Treaty at a Crossroads

Martina Magnarelli (Seven Summits Arbitration), Alessandro Monti (University of Copenhagen), and Matteo Fermeglia (Hasselt University) · Friday, November 18th, 2022

The Centre for International Law and Governance, University of Copenhagen, in cooperation with Hasselt University and Seven Summits Arbitration, recently hosted an expert roundtable on "The Energy Charter Treaty (ECT) at a Crossroads". The discussion, moderated by the three authors of this post, focused on the relationship between investor-state dispute settlement (**ISDS**), investment protection, modernization of the ECT, and climate change mitigation This post highlights key themes from the discussion, drawing on the insights of the distinguished academics, practitioners, and representatives of the corporate sector who took part, such as Freya Baetens (Oxford University), Anja Ipp (Climate Change Counsel, CCC), Greg Lourie (ICC International Court of Arbitration), Martin Dietrich Brauch (Columbia Center on Sustainable Investment), Giacomo Lorenzo (Deminor) and Tomáš Linhart (Siemens Energy).

I. The Modernization Process: Challenges and Achievements

The discussions highlighted the challenges and achievements associated with the ECT modernization process. Speakers emphasized the necessity of reforming the ECT: a treaty that in 1998 sought energy investment liberalization "at all costs". The discussion engaged closely with the challenges that the ECT poses to climate goals. It was stated that the ECT (i) does not distinguish between high and low emission investments, (ii) has resulted in 150 ISDS cases, including those brought by fossil fuels investors, who were awarded damages for hundreds of millions of dollars, and (iii) leaves decarbonization policies to the will of individual contracting parties (**Contracting Parties**).

It was stated that to adequately respond to current challenges, the revised text should (i) align the treaty with more recent trends in investment treaty-making—practical examples included the investment chapters of EU's Free Trade Agreements (**FTAs**) and the 2019 Netherlands Model BIT—and (ii) cater to international climate goals. The speakers engaged particularly with the revision of the Fair and Equitable Treatment (**FET**) clause and of the definitions of "investment" and "investor" in the agreement in principle reached by the Contracting Parties on 24 June 2022 (not fully available at the time of the roundtable, but announced through an official press-release). As to substantive reforms, it was suggested (as then reflected in the text rendered public after the roundtable) that a modernized FET clause could take the wording of that in the EU – Canada

Comprehensive Economic and Trade Agreement (**CETA**) on legitimate expectations as a model. It was further noted that arbitrators enjoy broad interpretative powers when treaties are broadly worded, which may shift key decisions on climate mitigation from governments to the discretion of arbitral tribunals. One panelist argued that arbitrators should already be guided by climate considerations when adjudicating ECT disputes through the application of other rules and principles of international law (Article 26(6) ECT).

The focus then shifted to the Contracting Parties' agreement in principle on the exclusion of the application of Article 26 ECT to members of the same Regional Economic Integration Organization (**REIO**) in their mutual relations. This raised the issue of the EU's general objection to any judicial body—other than a European domestic court or the European Court of Justice (**ECJ**)—interpreting or applying EU law. One panelist referred to the alternative proposal to allow arbitral tribunals to file a request for preliminary ruling under Article 267 TFEU. Another panelist commented that, in light of *Achmea*, subsequent developments like *Komstroy* and—for certain practitioners—the *Green Power* award, were not surprising. Prospects of enforcement had already become narrower. The panelists agreed that the agreement to exclude the application of Article 26 ECT (ISDS clause) between members of the same REIO (such as the EU) should settle the controversial issue of intra-EU investment disputes.

It was observed, however, that the announced modernized ECT arguably missed the opportunity to provide arbitral tribunals with more interpretative guidance, and to distinguish between investments supporting the energy transition and those fostering investment in fossil fuels (which world leaders have pledged to reduce at the COP26 last year). The next topic was the challenges faced by companies in the energy transition and their role in supporting customers in the process. Energy companies seek to replace fossil fuels by greener sources, but the pace of technology advancements, as well as the scarce availability of alternatives to wind and solar power (e.g., hydrogen) and of zero-emissions suppliers, are considerable barriers.

It was expressed that by failing to deal with ISDS, costs allocation, and damages calculation, the ECT contracting parties did not reap the full potential of the modernization. One panelist referred to the Rockhopper v. Italy award to criticize the arbitral tribunal for determining the quantum of damages based on the investor's loss of profit, regardless of the environmental justification behind the challenged measure. Yet, the multilateral nature of the ECT rendered its revision a matter of compromise. The panel stressed, nevertheless, that the text agreed in principle aligns the ECT with modern (treaty) practice on third-party funding and requires the disputing parties to disclose the existence and identity of a funder to exclude conflicts of interest. It was noted that the funding of intra-EU disputes would arguably already diminish prior to the entering into force of the modernized ECT, given the risks related to jurisdictional objections and narrower prospects of enforcement in and outside the EU after *Achmea* and *Komstroy*.

II. The Modernization Process: Future Possibilities

The panelists assessed whether some (bolder) alternatives could have been considered, bearing in mind the challenges and need for compromise with which the Contracting Parties were confronted.

The speakers agreed that treaty reforms often have less impact on ISDS decisions than one may expect, due to the broad formulation of investment treaty provisions. One panelist referred to case-

law on environmental exceptions (e.g., *Eco Oro v. Colombia*) and to arbitral tribunals' "gymnastics" when justifying their dismissal. Reference was made to a recent CCC's study that stresses, inter alia, the limited role played so far by environmental clauses under the ECT. As a solution, it was suggested that the treaty should include provisions on the States' right to regulate that are as specific as possible and make compliance with clear obligations for investors a mandatory precondition for treaty protection. The speakers emphasized the general need to carefully balance the rights and obligations of foreign investors and host States, as established in recent treaties, and it was suggested that treaties could include a reference to the Hague Rules on Business and Human Rights Arbitration.

The discussion then turned to the issue of "flexibility" as opposed to a strict carve-out of fossil fuels investments from treaty protection. The panelists questioned whether the negotiators had any leeway to agree on a strict exclusion of protection for fossil fuels investments. One discussant considered "flexibility" a second-best option, and likely the only one politically feasible. Another discussant argued that a strict approach is the only one that should be pursued in the long run, due to the need to abandon fossil fuels to achieve climate neutrality goals. Yet, the same speaker acknowledged the need to address technological and geopolitical barriers.

Lastly, the panelists balanced the pros and cons of a withdrawal from the ECT against the alternative of its modernization. One discussant considered the announced amendments to the ECT to be insufficient—because the "flexibility" mechanism would offer inadequate support to the energy transition—and advocated for withdrawal or termination. Reference was made to the UN Special Rapporteur on Human Rights and Climate Change, who in his report to the United Nations General Assembly of 26 July 2022 recommended to terminate the ECT. By contrast, another discussant argued that to reduce claims from fossil fuels investors modernization is a better solution than withdrawal and referred to the ECT sunset clause. Besides, it was affirmed that the termination of the ECT would deprive renewable energy investors of treaty protection, too.

III. Short-Term and Long-Term Perspectives

In light of the challenges, achievements and possible alternatives discussed earlier, the speakers ventured in prognoses regarding the more immediate future, as well as long-term perspectives.

The panel stressed the lack of sense of urgency during the ECT modernization process. Hence, it found that no meaningful developments are likely to occur in the short-term given the lengthy process of ratification, despite the need to expedite the global fight against climate change. Some speakers referred to the initiatives of some EU Member States to withdraw from the treaty.

The panel further considered that, although no publicly-known ISDS cases under the ECT concerned a climate change-related domestic measure so far, disputes like the one raised by RWE against the Netherlands are likely to set the tone of investment disputes on the long-run.

IV. Conclusion

The modernized ECT is scheduled to be adopted by the Energy Charter Conference on 22 November 2022. In the meantime, after the expert roundtable, the draft text on which the

Contracting Parties tentatively agreed on 24 June 2022 became publicly available. It remains to be seen what the final text will look like and whether it will deliver on the promise of a modernized treaty consistent with the goals of enhanced climate action. Lessons can be learned either way for future treaty-making.

The views of the speakers do not represent those of the institutions to which they are affiliated, nor those of the hosts.

This entry was posted on Friday, November 18th, 2022 at 8:39 am and is filed under Achmea, ECT Modernisation, European Court of Justice, European Union, Fair and Equitable Treatment, fossil fuels phase out, Investor-State arbitration, ISDS Reform, right to regulate, Treaty Making
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.