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ECT Modernisation Perspectives: Big Shoes to Fill? Governing Foreign Energy Investments in an Energy Charter Treaty Lacuna

James McGlaughlin (McNair International) · Tuesday, May 9th, 2023

Much has been written already about the future of the Energy Charter Treaty ("the ECT") – or perhaps lack thereof. Briefly, attempts to modernise the ECT began in earnest in 2017 with the aim of better aligning the treaty's substantive provisions with its contracting parties' climate law obligations. On 24 June 2022, those discussions culminated in the ECT contracting parties reaching an "Agreement in Principle." The modernised ECT text forming the basis of the Agreement is notable in one key respect: it does not remove fossil fuel investments from the ECT's scope of investment protection. The modernised definition of protectable "investments" is drafted broadly to include "every kind of asset" without differentiating between those that further or hinder the transition to green energy. While the modernised text proposes to incorporate a flexibility mechanism granting full discretion to its contracting parties to decide whether to exclude fossil fuel investments from ECT protection, and if so, on what basis, to date only two parties (the UK and the EU) have said they would trigger that mechanism on limited terms.

This has prompted a series of ECT contracting parties to announce their intention to withdraw from the ECT: Germany, Slovenia, Poland, The Netherlands, France, Spain, Luxembourg and Denmark. The EU Commission is also reported to have issued guidance to EU Member states on 7 February 2023, describing a coordinated EU exit from the ECT as nothing short of "unavoidable". Therefore, what started out as an attempt to modernise the ECT may lead to its demise altogether. This will remain to be seen when the ECT contracting parties finally vote on the modernised text (a vote that has been twice postponed, from November 2022 to April 2023, and now indefinitely).

In the meantime, now is a sensible time for investors and host states to consider how foreign energy investments might be governed in a potential ECT lacuna. This post considers three such frameworks: the international legal framework; regional legal frameworks; and domestic legal frameworks.

Potential Gap Fillers – International, Regional and Domestic Legal Frameworks

At the outset, it is worth reminding that not all foreign energy investments can be governed by the ECT. While indeed sizeable, the ECT's current signatory list counts 54 contracting parties (including the eight states that announced their intention to withdraw). Foreign energy investments

therefore fall outside the ECT's jurisdiction where neither the home state of the energy investor nor the host state of the energy investment are ECT contracting parties.

Yet, irrespective of whether the ECT is inapplicable for jurisdictional reasons or is voted into oblivion, the key question remains: how can foreign energy investments be governed outside the ECT framework?

International Legal Framework

International investment law will apply to foreign energy investments that fall within the jurisdiction of an investment treaty other than the ECT. Such a treaty can take the form of a bilateral investment treaty or, more commonly, a free trade agreement with specific investment protection provisions (for example, the Investment Protocol of the African Continental Free Trade Area). International investment law is far-reaching in both respects. According to the UNCTAD's statistics at the time of writing, 2,218 bilateral investment treaties and 362 treaties with investment provisions are currently in force. However, states' recent treaty-making practices suggest a rise in multilateral investment treaties as the preferred public international law instrument to govern foreign investments.

Notwithstanding the type of treaty that applies, the extent to which it has potential to govern energy investments will depend on its precise content and scope. Broadly, 'first generation' investment treaties (mostly pre-dating 2010) typically contain more expansive (and at times vaguely-worded) standards of investment protection. By contrast, the investment protection standards contained in 'new generation' investment treaties (mostly post-dating 2010) tend to be much more precise and restrictive, sometimes pre-conditioning investors' right to receive investment protection upon their fulfilling certain obligations. For example, the newly-concluded Colombia-Venezuela bilateral investment treaty (which was concluded on 3 February 2023 and has not yet entered into force) completely omits the fair and equitable treatment standard altogether despite its prevalence in 'first generation' treaties.

Regional Legal Frameworks

Irrespective of whether the ECT or another investment treaty applies, foreign energy investments may be governed by a regional legal framework. The availability of such a framework will depend on the region in which the foreign energy investor invests, and each framework will set out different requirements that must be met by the foreign investors.

Assuming for present purposes that a foreign energy investor invests in the EU having successfully passed the EU screening requirements for foreign direct investments, the EU's legal framework would offer the investor, among other things, free movement of capital, fundamental rights protected by the Charter of Fundamental Rights of the European Union (including access to justice, non-discrimination), protections provided under general principles of EU law (including proportionality, the protection of legitimate expectations), and a body of energy sector-specific legislation. The investor would be able to enforce its rights through EU member state courts, and also before the Court of Justice of the European Union (CJEU) through preliminary rulings or infringement proceedings.

To the extent those regional rights could also be enforced under an international investment treaty concluded between (at least) two EU member states, foreign energy investors may experience a game of 'tug-and-war' between the regional and international legal frameworks, with each trying to assert their jurisdiction over the other. To mitigate this scenario, EU member states entered into the "Agreement for the Termination of all Intra-EU Bilateral Investment Treaties" with the aim of excluding the application of intra-EU investment treaties in favour of EU law. That aim has only be realised in part. Despite leading to the termination of over 124 intra-EU bilateral investment treaties, all signatories to the Agreement remain bound by the ECT (with the exception of Italy, which withdrew from the ECT in 2016), such that the ECT and EU legal frameworks continue to apply in parallel – for the time being, at least.

This has given rise to instances of tension between ECT tribunals and EU member state courts. In *RWE v. The Netherlands*, for example, the courts of the investor's home state (Germany) declared the ECT claim inadmissible as a matter of EU law (see here), while the ICSID tribunal entertaining the ECT claim warned The Netherlands not to "aggravate" the dispute further by involving the German courts (at para. 91). This example – and indeed various others – underlines the need for coordination between simultaneously applicable regional and international legal frameworks. Otherwise, foreign energy investors' rights risk falling through the cracks.

Domestic Legal Frameworks

Finally, foreign energy investments may be governed by the domestic legal framework of the host state. The framework can comprise investment-specific legislation or be a standalone investment contract between the foreign energy investor and host state. While the substantive content will vary with each state, domestic frameworks commonly protect investors against changes in regulation that might affect foreign investments, particularly as regards tax law and tariff regimes. If the host state were to violate such protections, the ensuing energy investment dispute would likely be resolved by the host state's courts or through arbitration (subject to the parties' consent).

Domestic legal frameworks can therefore provide a useful – if not vital – layer of governance, particularly in circumstances where international and regional legal frameworks are either inapplicable or insufficient. However, it can be risky for investors to rely solely on domestic legal frameworks to govern their foreign energy investments.

One risk is that the domestic legal framework is not suitably robust. For example, Bolivia, having terminated most (if not all) of its bilateral investment treaties, governs foreign investments domestically through Law No. 516 on Investment Promotion dated 4 April 2014. While that law guarantees equal treatment for domestic and international investments, it is otherwise scant in terms of substantive investment protections. Some states may not have any specific domestic legislation dedicated to protect foreign energy investments, much less those related to the energy sector. This is the case for a number of EU member states, including Belgium, Germany and Poland. Another risk stems from the fact that domestic legal frameworks are suspectible to unilateral reforms, such that energy investors can find themselves at the whim of newly-elected governments which are keen to overhaul the energy policies of their predecessors. The Spanish renewable saga serves as a prime example in that respect.

Concluding Remarks

In a potential ECT lacuna, it will likely take more than one pair of shoes to govern foreign energy investments. International and regional legal frameworks will supplement and mitigate risks associated with domestic legal frameworks, while the residual layer of governance provided by domestic legal frameworks will help investors overcome any tension between competing international and regional frameworks. Whether any or all of these legal frameworks are capable of applying to a foreign energy investment will need to be considered on a case-by-case basis, both at the outset and throughout any investment project.

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

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