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ECT Modernisation Perspectives: Revamping International Investment Law: A Comparative Look at Substantive ISDS Reform in the ECT and Beyond

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The modernization of the Energy Charter Treaty (ECT) has been debated among scholars, with some supporting it and others criticizing the process and outcome. The vote on the modernization was postponed indefinitely due to ongoing debates about the Treaty's future, including various withdrawals from it. The modernization process encapsulates broader reform efforts and attempts to balance protecting foreign investment while preserving host state sovereignty. This post compares the Modernized ECT with other ISDS reform processes, namely the United States-Mexico-Canada Agreement (USCMA) and the 2023 Colombia-Venezuela BIT, to provide insights into how State Parties are addressing criticisms of ISDS and responding to the need for investment protection. The post offers a comparative analysis of significant approaches to ISDS reform in these treaties. Notably, The USCMA and ECT share a comparable revision process involving multiple parties and input from civil society actors. This allows the treaties to be updated to meet the present market demands. Similarly, the Venezuela Colombia BIT and the modernized ECT illustrate how states with anti-ISDS policies have responded to the need for substantive reform in ISDS. This post presents a topical analysis of these treaties, focusing on key definitions in investment treaties, their approach to investment arbitration, standards of protection and, sustainability and the environment in ISDS.

I. Narrow Definitions of Investor and Investment

The definition of "investment" in the modernized ECT (art. 1.6), the Colombia-Venezuela BIT (art. 2.a), and the USCMA (art. 14.1) is quite restrictive. All three impose specific conditions on investments, such as the commitment of capital, the expectation of profit, a particular duration, and the assumption of risk. (i.e., the *Salini Test*). Each Treaty, however, imposes different additional requirements for investments to be protected. While the Modernized ECT only requires compliance with national law for investments to be covered by the Treaty – the Colombia-Venezuela BIT provides protection only for investments acquired directly by investors and with funds that do not originate from the host state and expressly excludes sovereign debt instruments and commercial loans (art. 2.a). The latter limitation potentially excludes the protection of assets owned by state-owned enterprises. Moreover, article 1.6 of the ECT and Article 14.1 of the USCMA do not protect as "investments" judicial and administrative decisions and arbitral awards claims to money that arise solely from commercial contracts or the extension of credit connected with such commercial contacts.

With the purpose of preventing abuse of legal personality to take advantage of investment treaty protection, both the ECT (art. 1.7) and the Colombia – Venezuela BIT (arts. 2. b(i), 2. f(i)) limit the definition of "investor" by excluding from protection dual nationals holding the nationality of the host state. The Modernized ECT goes even further, excluding the protection of individuals who have permanent residency in the respondent State Party. In turn, the USCMA does permit investment claims from dual nationals; however, these investors will be considered nationals of the State of their dominant citizenship, and natural persons who are citizens of one Party and permanent residents of another will be regarded as nationals of the Party of which they are a citizen (art. 14.1). What the three treaties agree on is that – for their investments to be protected – investors need to meet the requirements of the substantial business activities test (art. 1.7(ii) ECT, art. 14.14.1(b) USCMA (denial of benefits)) or important commercial activities test (art. 2. b(ii) BIT; see also, art 13 (denial of benefits)), by demonstrating that they conduct commercial activities in the host state. These requirements aim to prevent abuse by precluding the use of shell companies that have no actual activity in their country of incorporation, created solely to obtain protection under the treaties.

II. Limited Access to Investment Arbitration

The extensive access to ISDS offered by first-generation IIAs raised concerns among civil society about the potential for investors to undermine host states' public policies and regulatory autonomy. In response to this, several Latin American States and the EU have tried to curtail access to ISDS by renegotiating IIAS and enforcing national anti-ISDS policies. Notably, Venezuela denounced the ICSID Convention in 2012, the EU banned intra-EU investment disputes in 2021, and when discussing the USCMA, Mexico negotiated a very restrictive Annex D on ISDS.

To limit ISDS among EU Member States, the modernized ECT provides that dispute settlement provisions shall not apply to members of the same Regional Economic Integration Organizations (REIOs) (draft articles 17, 26 and 27). Notably, at the moment, the only REIO member of the ECT is the EU, and – under this scheme – intra-EU investment disputes will be resolved before the national courts of the host country. Along the same line, the USCMA has established an escalated dispute resolution system whereby investment disputes will have to first be tried at national courts and can only afterward be brought at the international level if, after 30 months of attempting to use local remedies (article 14.D.5). In contrast, Annex -E designates specific sectors as a "covered sector," providing a more advantageous dispute resolution process for government contracts in areas such as oil and natural gas, power generation services, telecommunications, transportation, and infrastructure (Annex 14-E, para. 6.b). Covered sector investors are also not required to seek recourse from domestic courts before initiating arbitration; however, the standards under which investors can bring their claims are limited to (i) direct expropriation (art.14.8), (ii) violation of national treatment (art. 14.4), (iii) or for violations of the most-favored-nation (MFN) (art.14.5) (Article 14.D.3). Lastly, it's worth mentioning that although Canada is a member of the investment chapter of the Treaty, it has chosen not to participate in the dispute resolution system.

The Colombia-Venezuela BIT also limits access to ISDS, requiring a six-month period of amicable negotiations before commencing any arbitration proceeding (art.12.b). In addition, investors must also waive their right to domestic proceedings, and a "fork in the road" clause applies (arts.12.b(ii), and 12.d). Finally, Parties may agree that investment disputes be resolved before a binational arbitration center created by them (art. 12b). The binational arbitration center is a proposal similar to that of the EU to establish a multilateral investment court to handle investment disputes. Arguably, these arbitration centers would serve the interests of the State Parties by appointing arbitrators to preside over investment cases, ensuring proper application of EU law and the constitutions of Colombia and Venezuela, respectively.

III. Narrow Standards of Investment Protection

On a substantive level, the three treaties follow the global trend of narrowing investment protection, with several provisions being drafted as a response to the interpretation in previous arbitral awards of investment protection clauses.

Concerning ***expropriation***, the modernized ECT (art. 13), the USCMA (Annex 14-B, para. 3) and the Colombia Venezuela BIT (art.7.c, art. 5.a) provide specific criteria to determine what constitutes expropriation and exclude non-discriminatory regulatory actions and measures aimed at protecting legitimate policy goals, such as public health, safety, and the environment, from breaching these standards. These exceptions allow host states considerable ***flexibility to regulate*** on these areas. (art. 14.16 USCMA)

Regarding the ***most favored nation treatment*** (MFN) standard, the modernized ECT (art. 10 (8)(i),(ii)) and the USCMA (Article 14.5 and 14.D.3) limit this standard to substantive treatment, and both treaties specifically rule out the importation of dispute settlement provisions from third treaties. While the Colombia – Venezuela BIT does not include an MFT standard, it does include ***a national treatment standard*** which, contrary to the common use, operates as a ceiling clause, noting that investors will not receive unjustified, more favorable treatment. (art. 6.a)

Additionally, the modernized ECT includes protection for ***legitimate expectations*** under article 10.2, but protects under the FET standard only "clear and specific representation or commitment…upon which the Investor reasonably relied in deciding to make or maintain the Investment." For its part, article 14.6(5) of the USCMA completely excludes claims based on legitimate expectations from the minimum standard of treatment and notes that investment-backed expectations will only be recognized in the context of expropriation when they are reasonable, taking into account written express assurances by the host country (Annex 14-B.3). Finally, the Colombia – Venezuela BIT explicitly leaves out the fair and equitable treatment standard and, consequently, any claim legitimate expectations.

IV. Sustainability and Environment in ISDS

The Modernized ECT (article 19) contains a comprehensive provision on sustainable development and environmental protection requiring contracting parties to comply with their human rights obligations and commitments under the UNFCCC and Paris Agreement; the USCMA is much more limited in this regard, barely mentioning standards of corporate social responsibility such as the OECD Guidelines for Multinational Enterprises in its investment chapter. Further, article 14.16 of the USCMA provides that State Parties are allowed to take measures to safeguard the environment, health, or regulatory objectives. The Colombia – Venezuela BIT contains an almost verbatim provision mirroring this article of the USCMA (art.14 BIT). The language in the latter treaties seems insufficient to address the ongoing climate emergency and is probably difficult to enforce in practice. Notwithstanding the USCMA containing a whole Chapter on the Environment, there is no enforcement mechanism to require compliance with the provisions therein. Additionally, prior experience has suggested that the most important environmental effects in IIAs arise from provisions contained in investment, agriculture, regulatory harmonization, and competition chapters. The lack of strong commitments of the USCMA in Chapter 31 concerning environmental protection reflects the political momentum where the Treaty was negotiated alongside the shifting policies of the United States concerning environmental protection, leading to the country denouncing the Paris Agreement in 2021.

Despite ongoing criticism, the flexibility mechanism in the ECT allowing contracting Parties to exclude the protection of fossil fuels is a huge step toward a greener investment protection regime. Moreover, the Treaty protects clean energy by incorporating a particular dispute settlement mechanism for sustainable development disputes. While not enough to address the current climate emergency, it leaves flexibility and regulatory freedom for the contracting Parties to do so. It is, therefore, probably not a treaty modernization mishap, but it is the lack of political will of State Parties to address climate change through the avenues laid out in the modernized Treaty.

V. Conclusions

This post has identified three global trends in the substantive reform of investment arbitration: narrower definitions, narrower standards of protection, and limited access to ISDS. These reforms aim to balance the protection of foreign investment with the preservation of host state sovereignty and the prevention of system abuse by investors. Although the three treaties include provisions for environmental protection, these are still either insufficient or lacking. The only provisions that might be expected to have a tangible impact are those included in the Modernized ECT. However, procedural and institutional reforms can only go as far as their mandate allows, and the success of these reforms ultimately depends on the willingness of states to address reform in international investment law, including adopting modernized treaty outcomes.

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

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