Investment arbitration against climate policy: An introduction to the Energy Charter Treaty

Background document for the Greens/EFA Ecological Cluster meeting - 20.04.2021

Background information

- The Energy Charter Treaty (ECT) is an international agreement concluded in the mid-1990s. The treaty currently applies to 53 countries, from Western Europe to Central Asia to Japan, as well as to the EU and the European Atomic Energy Community.
- The treaty includes ISDS (investor to State Dispute Settlement), the infamous arbitration tribunals that were at the heart of the Green's critique of TTIP and CETA. The Energy Charter Treaty therefore gives companies in the energy sector enormous powers to sue states in international investment courts, for uncapped amounts (past cases went up to several tens of billions dollars), for example if governments decide, for instance, to stop new oil or gas pipelines, withdraw drilling permits or exit coal. No other international trade or investment agreement in the world has triggered more investor lawsuits than the Energy Charter Treaty**.** [1]
- The ECT includes many rules – including on energy transit and trade – but the provisions regarding protections for foreign energy investments are its cornerstone.
- Amending the treaty requires unanimity of contracting parties, but there is no agreement among member countries that the treaty needs to be reformed at all.
- A modernisation process is currently being discussed (see below) and the Commission has a mandate from Council to update the ECT. The next round of negotiations is foreseen for June 2021. There is no end-date for the negotiations.
- The European Parliament in October 2020 adopted an amendment to the EU Climate Law which states that "the Union shall end protection of investments in fossil fuels in the context of the modernisation of the Energy Charter Treaty." This was an extremely tight vote, with 341 in favour, 339 against and 13 abstentions. Against were EPP, ECR, ID and about 15 Renew MEPs.

State of play - 'modernisation' negotiations unlikely to succeed

In July 2019, the Commission received a mandate from the Council to start negotiations on "modernising" the ECT. The mandate was published by the Commission on May 28, 2020. So far, four negotiation rounds have taken place, with the next one planned for June 2021. Text-based negotiations started in March 2021. The EU is the main driver of this process.

The EU's main proposal concerns the definition of the economic activities protected under the Treaty. The EU's position is to exclude **future** investments in fossil fuels from the definition. It however contains broad loopholes for certain gas power plants (emitting less than 380g of CO2 of fossil fuel origin per kWh of electricity, a level that is well above the threshold of what the relevant EU legal framework, the Taxonomy, is about to consider as an economic activity that is significantly harmful for the environment) and also pipelines. The EU also proposes to expand the scope of investment protection to "low carbon and renewable" hydrogen - mostly meaning produced with nuclear energy as well as for biomass based energy irrespective -of the underlying characteristics of biomass production. Existing coal, oil and gas investments would be covered for another 10 years after the entry into force of the amended version of the treaty.

[1] While just 19 cases were registered in the first 10 years of the agreement (1998-2007), 102 investor lawsuits are known to have been filed during the last decade (2010-2019), representing an increase of 437 per cent in the numbers of known filed cases. This trend is likely to continue. Outstanding ECT claims where this information is available (only 25 out of 52 cases) have a collective value of US$28 billion

Amending the treaty requires unanimity of contracting parties, but there is no agreement among member countries that the treaty needs to be reformed at all. Some countries like Japan, or Kazakhstan have indicated their opposition to the modernisation. Others like Turkey expressed their opposition to phase out of fossil fuel protections. No ECT member state has proposed removing the mechanism from the ECT or requiring investors to bring their claims in local courts first.

Greens/EFA main messages / calls until now

1. The ECT is a powerful tool in the hands of large oil, gas and coal companies to dissuade governments from making the transition to clean energy. It largely shift the risks and costs associated with regulatory changes from investors to taxpayers. The treaty is also an incredible lobby tool, giving energy companies leverage in their advocacy efforts. The exposure to ISDS claims, together with the uncertain and unpredictable outcomes of ISDS cases and the staggering amounts involved, affects the regulatory space of governments in ways that would be inconceivable under domestic legal systems.

2. There is no evidence that the Treaty has positive effects, notably as regards the protection of investments related to renewable energy production. Investors can and should rely on the guarantees already existing within the EU legal order that are considered as among the most protective in the world. Moreover, although a certain number of cases have been brought by claimants to protect their investors in renewable energies, such cases are dwarfed by the economic size and impact of claims brought regarding fossil fuels related investments (more on this below). Furthermore, there is evidence that some Member States have curtailed their regulatory ambitions on phasing out fossil fuels on concerns of being sued under the ECT and other Bilateral Investment Treaties.

3. A complete treaty overhaul is needed to bring the ECT in line with the Paris Agreement and thwart the danger of its investment protection provisions. The EU reform proposal on the table is the best-case scenario in the negotiations, but it is already lacking ambitions from a Green perspective. There is therefore no sign of contracting parties coming to an ambitious agreement in a reasonable timeframe.

4. We call on Commission[2] and Council to urgently prepare the scenario of ending the EU's ECT membership. The Greens were initially supportive of the Commission-led efforts for a meaningful ECT reform in principle - with clear conditions on exclusion of fossil fuels and the ISDS provisions. As mentioned above, the Commission's position for the modernisation endeavour falls short on both fronts. In addition, we do not see any progress in the negotiations and think that a reform that requires unanimity of all ECT members is very unlikely. Member States should also exit and **adopt an agreement that excludes investor claims between them.** If possible this exit and the follow up agreement should take place in a coordinated manner with other ECT member parties, like the UK and Switzerland.

What's next? Issues to be discussed during the cluster meeting

-> How do we get the Commission and Council to switch to an exit strategy?

- There is no timetable or deadline for the ongoing negotiations on the modernisation of the ECT. Furthermore, there is no sense of urgency among negotiators.

[2] The Commission should also already prepare an legal proposal to be endorsed by EU and Member States to rule out 'intra EU' ECT related lawsuits as such claims do not seem consistent with the EU legal order (see point below on ECT and its compatibility with EU law).

- Our call could be in 2 steps: call for the Commission to set itself a deadline to assess progress in the negotiations and call for a coordinated withdrawal process if not enough progress has been achieved by the given date.
- This would require a revision of the ECT negotiation mandate given by the Council to the Commission (to include a deadline by which the EU and EU Member States will launch a coordinated withdrawal in case no political agreement is reached in the modernization negotiations regarding the exclusion of fossil fuels). Such revision could be initiated by a Commission recommendation. Alternatively, a group of Member States, including those with Green governments could request and put on the Council agenda a revision of such mandate.

-> What leverage does the EP have with the ongoing trilogues on the climate law?

- Climate law trilogues are coming to an end and it is not clear if the EP amendment related to the ECT will be included in the final deal.
- The EP could use its leverage in these negotiations to push for the inclusion of a declaration from the Commission and the Council on the ECT along the lines of the EP amendment mentioned above.

-> **What is the situation in the Council and how can we influence Member States?**

- Some Member States such as France and Spain have expressed publicly openness as regards considering a withdrawal.
- Others such as Luxembourg are open to the idea of setting a deadline for achieving meaningful progress. June 2021 was mentioned in a webinar.
- The position of many other Member States is not explicit, although a clear majority supported the Commission negotiating directives that as outlined above are not only problematic on substance but also lack any deadline for achieving results.

-> What more can we do as Greens/EFA to raise the profile of this topic in our respective Member States?

ANNEX - FREQUENTLY ASKED QUESTIONS

1. What is the process to withdraw from the ECT?
Parties to the ECT may withdraw at any time by written notification to the Secretariat. Italy has decided to withdraw, and officialised it in its Budget Law in 2015. While countries can still be attacked by investors 20 years after withdrawal, at least new investments are not protected anymore.

2. 20 years of protection for investments, even after exit: what is the « sunset clause »?
The question of the "sunset clause" (or "survival clause") is key to decide to exit the treaty, or to modernise it. The ECT (like almost all investment treaties) contains a clause which states that existing investments stay protected for 20 years after exit. The Commission hopes to neutralise this clause though the modernisation process, but the chances of success are minimal. A large number of known ECT lawsuits, (66 per cent) are however brought by an investor from one EU Member State against the government of another EU member. To mitigate this problem, the withdrawing countries should adopt an agreement that excludes investor claims within this group of countries.

A coordinated exit of EU Member States and possibly other mind-like countries, accompanied with a treaty to neutralise the sunset clause would protect us from most cases, and prevent EU-based fossil fuel investors to use the treaty against other contracting parties.

3. Is ECT protecting investments in renewables?
Yes, but the amounts are dwarfed by the protections it gives to fossil fuel investments. The fossil infrastructure protected by the Energy Charter Treaty in the EU, Great Britain and Switzerland is worth 344.6 billion euros. This is more than twice the total annual budget of the EU and corresponds to 660 euros per resident. Three-quarters of the protected fossil infrastructure are gas and oil fields (€126 bn) and pipelines (€148 bn).

To reach targets under the Paris Agreement, governments have to take rapid, decisive action to reduce the extraction and consumption of fossil fuels. This includes closing down coal mines and power stations, reducing consumption of oil and natural gas, as well as cutting fossil fuel subsidies. Meanwhile, the ECT shields investors from government actions that could reduce the value of their investment. While investments in renewables are covered, there is no evidence that a treaty like the ECT actually increases investments. They are other policy tools much more adapted to support investments in green energy.

4. Does EU law allow the Energy Charter Treaty (ECT) to be used in disputes between investors established in a Member States against another Member State?
The question of whether the ECT can be used in disputes involving an EU investor incorporated in a Member State against another Member State (so-called "intra-EU" disputes) has been much-debated since the Court of Justice of the European Union (CJEU) decision in the Achmea case in 2018[3]. In this case, CJEU decided that ISDS provisions in bilateral investment treaties (BITs) between Member States are illegal under EU law. The question remained open on whether this conclusion is, beyond BITs, valid for all ISDSs involving an EU company and a EU Member State and in particular for ISDSs in the context of a plurilateral treaty such as the ECT.

An Advocate General of the Court of Justice of the European Union (CJEU) addressed the ECT question in an opinion published on 3 March in the ongoing case regarding the validity of an ECT arbitration between Moldova and an Ukrainian investor. The Advocate General

[3] See the following article for an overview of the Achmea case law: http://arbitrationblog.kluwerarbitration.com/2018/03/07/the-judgment-of-the-cjeu-in-slovak-republic-v-achmea/

argued that ECT based ISDSs in intra-EU disputes are indeed not allowed under EU law. This is because the arbitral tribunal resolving the dispute would likely have to interpret EU law without being part of the EU legal order, in which the Court of Justice of the European Union has the final say in cases of diverging interpretations of the law. It is expected that the Court will issue its ruling on the case by the summer on the basis of such opinion. The Court tends to follow the opinion of the Advocates Generals, therefore, if the Court confirms such opinion, Member States would be forced to end the applicability of the ECT amongst each other by means agreement amongst themselves to rule out such intra-EU disputes.

Such situation represents a positive development, but would still not prevent investors established in non-EU ECT members such as the UK, Switzerland or Japan to lodge lawsuits against EU Member States, having in mind that as acknowledged by the EU negotiating directives[4] the current treaty contains a wide definition of investors and investments allowing the setting of mailbox or shell companies that lack any substantial business activity in the country where they are incorporated and that could therefore be established for the sole purpose of lodging ECT related lawsuits against EU Member States. As mentioned in the previous section, in the absence of a meaningful reform of the ECT, the risk involved by such potential lawsuits related to already existing investments will not be prevented either by a coordinated withdrawal of EU Member States and of the EU itself, given the above mentioned sunset clause, but at least the withdrawal would avoid such kind of lawsuits for new investments.

5. What about ongoing flagship cases?

The following links provide a description on flagship ECT related cases:

- RWE vs Netherlands : In February 2021 RWE has filed an arbitration claim against the Netherlands, seeking compensation for the Dutch decision to phase-out electricity production from coal by 2030. Another owner of a Dutch coal-fired power plant, Uniper, started legal proceedings on the basis of the ECT in December 2019 but has not requested arbitration to date.
- Rockhopper vs Italy In 2017 UK-based oil and gas company Rockhopper sued the Italian Government over its refusal to grant a concession for oil drilling in the Adriatic Sea.

The refusal came after the Italian Parliament banned new oil and gas operations near the country's coast amid concerns for the environment, earthquake risks, and impacts on tourism and fishing. Rockhopper is demanding up to US$350 million, seven times the amount it actually spent on developing the project. Remarkably, the claim was registered 16 months after Italy's exit from the ECT took effect. The case is pending.

- Vattenfall vs Germany on the nuclear exit was settled last month. See Reuters : Germany to pay nuclear operators 2.6 billion euros for plant closures (March 5, 2021)

6. Can states sue energy companies thanks to the ECT?

No, it is a one-way system only.

[4] see : https://data.consilium.europa.eu/doc/document/ST-10745-2019-ADD-1/en/pdf