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ECT MODERNISATION SEVEN TESTS FOR A PRO-CLEAN INVESTMENT ENERGY CHARTER TREATY

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The Energy Charter Treaty modernisation process is coming soon to an end. The political context around these negotiations has drastically changed since 2018. This document suggests three overall objectives for the ECT modernisation in this new context and puts forward seven political tests to assess whether the EU can consider the agreement sufficient to mobilise investment into the global energy transition.

3 OBJECTIVES for a modernised ECT

1. Supporting an accelerated shift to decarbonisation and energy resilience.
2. Creating greater trust and certainty in this transition for foreign investors.
3. Maintaining and strengthening fair and reliable relationships with EU partners.

7 TESTS for a pro-clean investment ECT

1. Clearly delimiting investment protection language.
2. Well-balanced expropriation rules.
3. Exclusion of letterbox companies and other cheats.
4. Full alignment with multilateral reform negotiations.
5. Carving out fossil fuels.
6. Protecting only reliable and proven energy solutions.
7. Ensuring consistency with climate and environmental agreements.



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The Energy Charter Treaty (ECT) came into force in 1994 and is currently ratified by 48 countries, mostly in Europe and Central Asia. Its purpose is to protect private foreign investments from regulatory or political interferences, including through arbitration panels capable of awarding multi-billion dollar compensations (ISDS). A negotiation to ‘modernise’ the agreement was launched in 2018. The Commission’s intention is to reach an agreement on the main principles by 24 June 2022.

A drastically new political context

The political context around these negotiations has drastically changed since 2018.

- > The Russian invasion of Ukraine has intensified the economic insecurity already felt post COVID. Restoring an international system that creates investment certainty will therefore be critically important.
- > EU partners are scrutinising EU actions not only based on the security offered to EU companies, but also on whether they support a more sustainable recovery outside of Europe too.
- > The ongoing war in Ukraine also raises profound energy security concerns around fossil fuel imports and investments.
- > Successive reports from the International Panel on Climate Change (IPCC) and the International Energy Agency (IEA) have highlighted the need to drastically accelerate the energy transition to meet the Paris Agreement goals. This requires shifting trillions of euros into clean energy investments and away from fossil fuels.
- > There is a broad EU consensus on the need to upscale renewable energy and energy efficiency deployment, but less agreement on how to achieve this. The **REPowerEU** Communication from 18 May 2022 aims to accelerate the energy transition in Europe further.

A barrier to clean energy deployment

Clean energy deployment has become a critical energy security concern for the EU and many of its partners. There is a great need to strengthen investors’ certainty in the policies that accelerate such deployment.

In this new context, the current ECT stands as a barrier against this shift. It leads to an unbalanced system. By design, it mostly protects investments that are



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typically associated with the old energy world and increases uncertainty around clean investments for several reasons:

- > The ECT language is highly unclear and open-ended, making it open for abuse by fossil fuel litigators while blurring the space available for policies that provide certainty to clean investors.
- > Cases are mostly confidential, and tribunals are not bound by previous jurisprudence. Therefore, outcomes are more likely to be dictated by respondent or claimant capacities rather than impartial judgements. Overall, 92% of claimants in fossil fuel cases are from high-income countries, making this risk very clear.¹
- > The imprecise language, the confidentiality and the lack of reliable jurisprudence undermine the policy space for countries to build strong long-term frameworks that create certainty and trust among investors, such as long-term plans to phase-out coal power in Europe.²
- > Clean energy investors need “clear and unambiguous signals” of countries’ commitment to the energy transition to shift their investments.³ If governments foot the bill for stranded assets, this signal is blurred.
- > Global rates of investor-state litigation relating to energy policies have increased, adding to the political tensions around the energy transition and holding much-needed progress on policy innovation – including through trial and error.
- > Evidence already suggests that fossil fuel investors will not back out of using the ECT and similar agreements, as proven by the threat of litigation against the halting of Nord Stream II.⁴
- > Fossil fuel companies already represent 20% of global investor-state litigation, adopting similar tactics as Big Tobacco to slow down regulations.⁵ Such litigation under the ECT could add up to €20 billion to the price tag of the energy transition in the EU just to compensate fossil fuel asset holders.⁶
- > The IPCC’s latest report has identified investment litigations as a significant barrier to efforts to phase out fossil fuels. Overall, the ECT creates a strong ‘regulatory chill’ that erodes the commitment to the energy transition.

¹ Lea Di Salvatore, [Investor–State Disputes in the Fossil Fuel Industry](#).

² Megan Darby, [Coal generator uses investment treaty to fight Netherlands coal phaseout](#).

³ Financial Times Editorial Board, [Governments should not foot the bill for stranded assets](#).

⁴ Yamina Saheb, [An energy investment treaty has been holding Nord Stream 2 hostage](#).

⁵ Kyla Tienhaara, [Regulatory chill in a warming world](#).

⁶ Kyla Tienhaara et al., [Investor-state disputes threaten the global green energy transition](#).



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Three political objectives for a modernised ECT

In light of these developments, we consider the EU should assess the ECT negotiations' outcome against **three main political objectives**:

1. To support an accelerated shift to decarbonisation and energy resilience.
2. To create greater trust and certainty in this transition for foreign investors.
3. To maintain and strengthen fair and reliable relationships with EU partners.

The current ECT achieves **none** of the objectives above:

- > It is a roadblock for an accelerated phase-out of natural gas and oil.
- > It includes a grossly “inadequate” ISDS system that does not provide enough certainty for foreign investors in the transition.⁷
- > It is not a fair basis for our partners to embark on the energy transition, which is essential to jointly achieve net zero.

The goal of reforming the ECT is to enable the agreement to play a credible and fair role on the road to net zero, and in supporting sustainable development. Drastically reforming the ECT would by itself be a very clear signal to our partners that the EU is aiming at such a credible and fair clean energy system. The opposite is also true. Any negotiator needs to be able to step away from the table. The ECT is not fit for purpose as it stands – **no ECT would be better than a bad ECT.**

Seven tests for a pro-clean investment ECT

Based on the three political objectives above, we propose seven tests to measure whether the ECT modernisation can be considered sufficiently acceptable in June. The benchmarks should be considered as a full package, and **if any test is not fully met EU Member States should prepare for a coordinated withdrawal.**

1. Clearly delimiting investment protection language.

The modernised ECT should exclude any unclear language that provides open-ended protection that investors can abuse through litigation, strongly limiting the scope of “Fair and Equitable Treatment” to protection against gross denials of justice.

⁷ Cecilia Malmström, **A contribution to the conversation about reform of investment dispute settlement.**



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2. Well-balanced expropriation rules.

The modernised ECT should strongly limit claims of indirect expropriation, which investors can abuse to undermine any policy that affects their business models, by establishing very high thresholds when interpreting it.

3. Exclusion of letterbox companies and other cheats.

The modernised ECT shall include a clear definition of what constitutes a 'substantive business activity' to qualify as a relevant investor, aiming to fully exclude letterbox companies and limit shareholders' rights to claim losses.

4. Full alignment with multilateral reform negotiations.

The modernised ECT shall supersede its dispute resolution system to reflect the EU proposals for a multilateral system presented at UNCITRAL Working Group III and ICSID negotiations.

5. Carving out fossil fuels.

The modernised ECT shall carve out protection for all fossil fuel investments (i.e., coal, natural gas, petroleum, and petroleum products) after the entry into force of the amended agreement, but no later than 2025.

6. Protecting only reliable and proven energy solutions.

The ECT protects the legitimate expectations of energy investments. Thus, it shall not be extended to unreliable, unproven, or dubious energy solutions that have unclear economic and climate benefits, such as biofuels, CCUS or non-renewable hydrogen.

7. Ensuring consistency with climate and environmental agreements.

The modernised ECT shall clearly recognise that any policy or decision by the signatories taken to fulfil their commitments under the Paris Agreement should not constitute a breach of investors' protection (Part III of the ECT).



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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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