



MARCH 2021

MEDIA BRIEFING

ENERGY CHARTER TREATY REFORM

Information on the 4th negotiation round, March 2-5

WHY IS THE ENERGY CHARTER TREATY UNDERGOING A REFORM?

The Energy Charter Treaty (ECT) is an international agreement signed in 1994. It **protects foreign investments in the energy sector** and allows investors to challenge state measures in an investor-state dispute settlement (ISDS) mechanism.

Since **investors can claim vast amounts of money in compensation** and the costs of defending against such disputes are high, even the threat of an ISDS claim under the ECT can [prevent countries from pursuing ambitious climate policies](#) and **other legitimate policy objectives** in the public interest. One recent example is the compensation claim by [RWE in relation to the Dutch coal phase-out](#).

The treaty is currently undergoing a reform, referred to as “modernisation”. **Certain provisions** in the treaty are **simply outdated** nearly 30 years after the treaty was conceived. Additionally, there is also an awareness with some of the ECT members, in particular the EU, that the treaty in its current form is problematic because it **restricts countries ability to regulate and speed up the green transition of the energy sector**.

However, **the reform will fail** to ensure that the ECT no longer constitutes an obstacle to the clean energy transition and the attainment of internationally agreed climate targets because:

- There is **too much opposition** from other contracting parties.
- There is **too little ambition** on all sides, including the EU.
- **Important issues are not even being discussed**.

WHY CAN'T THE ONGOING REFORM PROCESS SOLVE THESE ISSUES?

The ECT would need very substantial reforms to allow countries to transform their energy systems in line with the Paris Agreement and the European Green Deal without risking compensation claims. Firstly, **the Investor-State Dispute Settlement (ISDS) system would have to be removed** and, secondly, **the protection for fossil fuels would have to**

be ended. Neither of these objectives will be achieved in the ongoing reform process because these options are not even on the negotiation table.

ISDS, which allows investors to use private arbitration panels, instead of having to use national courts, has come under intense criticism in the past years due to multiple problems: lack of impartiality of judges and a lack of transparency being amongst the main issues. Even the **EU recognises that the ISDS system under the ECT is “outdated”** and would like to bring it in line with the Investment Court System (ICS), with improved procedural rules in comparison to ISDS, used in more recent EU investment agreements, such the Comprehensive Economic and Trade Agreement (CETA) with Canada. However, **changes to the ECT’s ISDS system will not even be discussed.** The EU has tried to add ISDS reform to the 25 negotiation topics but Japan has repeatedly rejected this attempt ([here](#) and [here](#)) and adding new topics requires unanimity. This means that one of the [EU’s top objectives for reform](#) is unattainable.

The **reform will also not end investment protection for fossil infrastructure**, a demand, which the European Parliament recently expressed in its [proposal for a European Climate Law](#). The EU is currently the only contracting party that is [proposing a gradual phase-out](#) but even this proposal sadly lacks the required ambition. Under this proposal [most fossil infrastructure would continue to be protected far into the 2030s](#). But legislation to phase out coal, gas and oil will have to be implemented now, not in 10 or 20 years time, making such policies liable for investor-state disputes under the ECT.

Even if the EU’s proposal would be fully accepted by other contracting parties - which seems unlikely (see below) - **the ECT would continue to hinder countries from phasing out coal, gas and oil in a Paris-compatible time frame.**

CAN THE REFORM SOLVE THE ECT’S INCOMPATIBILITY WITH EU LAW?

The ECT’s compatibility with EU law is in doubt for two separate reasons. Firstly, the European Commission has consistently argued that **ISDS cases between an EU investor and an EU Member State (“intra-EU” ISDS cases) are incompatible with EU law** and it has intervened in ISDS proceedings to challenge the jurisdiction of tribunals.

In its [Achmea judgement](#) in 2018, the Court of Justice of the European Union (CJEU) considered that the use of ISDS in disputes between EU member states could hinder the efficacy of EU law and undermine fundamental values of the EU, such as the principles of sincere cooperation and mutual trust. So far, the ECT tribunals have been able to reject such arguments against intra-EU application because they are not bound by EU law. The **modernisation will not resolve this issue as it is not even being discussed.**

Secondly, the CJEU set certain **minimum requirements for international treaties providing for investment arbitration** in its [Opinion 1/17](#) on the CETA agreement. It ruled that the system must 1) guarantee the impartiality of judges; 2) provide for an appeal mechanism; 3) guarantee that arbitration panels only interpret the agreement itself, not EU or national law. **The ISDS mechanism in the ECT doesn't fulfil either of these requirements, nor will modernisation address this** because a reform of the ISDS mechanism is not even on the agenda.

The lack of compatibility between the two legal regimes will therefore not be solved by the modernisation process and thus, **a reformed ECT will continue to be incompatible with EU law**, which could become a hindrance for its ratification if the CJEU is asked for an opinion.

HOW LIKELY ARE SUBSTANTIAL CHANGES TO THE ECT?

Changes to the ECT must be approved unanimously by all contracting parties and some of them have little appetite for reform. **At the beginning of the negotiations, [Japan stated on all 25 negotiation topics that they don't see a need for any changes](#)** and also other contracting parties like Kazakhstan and Azerbaijan are reluctant to agree to changes in key areas. **This makes an ambitious reform extremely unlikely.**

The [leaked progress report](#) from December 2020 shows that **major divergences remain** on issues that are important to the EU's objective to tighten the investment protection provisions of the treaty, for example the definitions of "investment" or the "fair and equitable treatment" protection standard, which is currently formulated in a very open-ended way, leaving [tribunals significant leeway](#) in interpreting investors' rights.

The EU is also likely to face **resistance for a [proposal submitted on 15 February 2021, to gradually phase-out investment protection for fossil infrastructure](#)**, even though the proposal is very weak in our assessment (see above). So far, **[no other contracting party has voiced support for it](#)**, whereas several expressed their willingness to further expand the list of economic activities that would be protected under the treaty, [increasing the risk of future ISDS challenges](#). **Not even one of the EU's closest allies, the UK, seems to be in favour of phasing out protection for fossil investments.** In the answer to a parliamentary question, the [UK government stated](#) in January 2021 that it had "not made a policy decision to seek the exclusion of fossil fuel investments from coverage by the ECT".

Will the EU achieve what it set out to do?

The **EU formulated [three objectives for this reform](#)**: Firstly, to revise some of the ECT's investment protection provisions. Secondly, to ensure the ECT better reflects climate change and clean energy transition goals. Thirdly, to reform the ECT's ISDS mechanism.

As discussed above, the first and second objective cannot be achieved both because there is **too much opposition** from other contracting parties and the EU itself put forward proposals that **lack the required ambition**.

The third objective, **ISDS reform, is unattainable** because the issue is not even discussed in the reform.

So, **even measured against the EU's own objectives, the reform of the ECT has been a failure** and other policy options should be considered as soon as possible.

WHAT OPTIONS ARE THERE OTHER THAN THE REFORM?

Considering the reform cannot remove the ECT as an obstacle to the clean energy transition, the EU and EU Member States need to **jointly withdraw from the ECT**, ideally together with neighbouring EFTA countries, the UK and Balkan accession states. This should happen **as soon as possible because investments taken after withdrawal are no longer protected under the ECT**.

Given that even today, a majority of new investments in the energy sector are in fossil fuels, not renewable energy, the sooner we withdraw, the fewer fossil fuel investments will fall under the protection of the treaty. This is particularly important **to avoid a lock-in in fossil gas technologies and infrastructure**.

However, withdrawing from the ECT alone is not enough, as the treaty contains a so-called **“sunset clause”, which allows existing investors to sue governments for 20 years after they have withdrawn from the ECT**. To mitigate this problem, the withdrawing countries should adopt an agreement that excludes investor claims within this group of countries. This option is well described in [this legal article](#).

WHAT HAS BEEN THE TIMELINE FOR THE REFORM AND WHAT IS HAPPENING NEXT?

Contracting parties agreed in 2018 on [25 reform topics](#) and decided [to commence negotiations in December 2019](#). The first negotiation round took place in July 2020 and two further rounds took place in September and November 2020.

The EU agreed on its [negotiation position for 24 of the 25 negotiation topics in May 2020](#). A [negotiation position](#) for the final negotiation topic, the Definition of Economic Activity in the Energy Sector, followed in February 2021.

The Energy Charter Secretariat issued a [progress report](#) on 25 November 2020, which was leaked to the press in December. This report revealed that proper negotiations had not really

started and major divergences between contracting parties remain, making substantial changes very unlikely.

It was hence decided to hold [four more rounds of negotiations](#) in 2021: **2-5 March**, 1-4 June, 6-9 July, 28-30 September and 9-11 November. As far as we know, there is still no public communication with regards to the content of these negotiation rounds.

However, according to information obtained by CAN Europe, the upcoming round will discuss various provisions in relation to investment protection (definition of investor, investment, fair and equitable treatment, right to regulate etc.) and most importantly the [definition of economic activities in the energy sector](#) that benefit from the protection of the treaty.

CONTACT

Cornelia Maarfield

Trade and Climate Project Manager

cornelia@caneurope.org

+49 170 8765 271