

TOXIC ELEMENTS OF THE ENERGY CHARTER TREATY REFORM

**WHY THE EU MUST WITHDRAW TO AVOID A
GREATER DISASTER FOR THE CLIMATE**

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KEY POINTS



Marginal gains in some areas of the ECT are outweighed by increased risks associated with expansions to new technologies and geographies.



A reformed ECT could harm and not help accession countries in the Global South to regulate their energy markets in the public interest, adapt to and mitigate climate change.



Adopting a reformed ECT will greenwash it and make the real solution - withdrawal - much harder to realise.

EXECUTIVE SUMMARY

The Energy Charter Treaty (ECT) is widely recognised to be incompatible with the objectives of the Paris Climate Accord. Fossil fuel companies are using it to sue states in a private, parallel justice system when their profits are affected by regulations or court decisions. The latest IPCC report therefore warns that the ECT and similar agreements can have a chilling effect on climate policies. States might avoid taking the necessary urgent steps to phase-out fossil fuels if threatened by expensive legal action and the prospect of having to pay uncapped amounts in compensation.

The European Commission and Member States have recognised the ECT as outdated and seek to modernise it as part of a reform process, which started in 2018 and is drawing to a close this year. Both the EU and other ECT Contracting Parties now have to assess the outcomes of this reform and decide: Shall we stay or shall we go?

In a briefing in March 2022 CAN Europe analysed the outcomes of the reform and explained why they are insufficient to achieve the EU's own objectives for ECT reform. However, proponents of the treaty now argue that even though the reform outcomes are limited, they nevertheless provide for some improvements compared to the old ECT and that it is therefore better to sign off on the reform.

This briefing argues that Contracting Parties should not fall into the trap of reforming the ECT and recognise that adopting those outcomes would spell a disaster from a climate perspective:

- 1** Reform would make the ECT more dangerous because it expands the list of energy materials and products that are protected under the ECT's flawed Investor-State Dispute Settlement (ISDS) and hence increase the risk of arbitration claims against states regulating the transition to 100% renewable energy.
- 2** There are dozens of countries in the Global South that are in the process of joining the ECT. Accessions have been put on hold while the reform is ongoing. However, once the reform has been approved, it is expected that many of them will join the ECT in the false hope of increasing foreign direct investments in energy but actually severely limiting their policy space to phase-out fossil fuels and regulate their energy markets in the public interest.
- 3** Thirdly, the reform doesn't fix the many flaws of the Treaty. Adopting it nevertheless would greenwash the ECT and stifle the growing momentum to implement the only real solution: A coordinated withdrawal of ideally all EU Member States, the EU itself, EU Accession states and other close allies in Europe and beyond.



TOXIC ELEMENT 1

Expansion to new technologies



The Energy Charter Treaty (ECT) protects investments in relation to certain energy materials and products that are explicitly mentioned in Annex EMI and EMII of the Treaty. The energy materials and products currently named there are nuclear energy, fossil energy sources, including coal, fossil gas and oil, electrical energy and “fuel woods”.

As part of the ongoing reform process, this list of protected energy materials and products is meant to be expanded. The EU is the only contracting party that made their proposal public and is calling to include: “low-carbon hydrogen”, renewable hydrogen, biomass, biogas, undenatured ethyl alcohol of an alcoholic strength by volume of 80% vol or higher, methanol and formic acid. Reportedly, other ECT Contracting Parties have additionally called to include synthetic fuels, Carbon Capture and Storage (CCS) and other forms of hydrogen.

It is currently unknown which of these proposals have been agreed upon. What is clear though is that some of these energy materials and technologies have an unproven or even doubtful benefit for the clean energy transition. “Low-carbon hydrogen” for instance would qualify hydrogen made from burning fossil gas and from nuclear energy eligible to be protected. In a previous analysis we discussed some of the downsides of protecting these technologies in the light of ISDS risks in relation to future regulations.

However, irrespective of how *beneficial* these technologies are for the transition to climate neutrality, we argue that this expansion of the list of protected energy materials is both dangerous and unnecessary.

Why is ISDS dangerous for renewables?

Agreements containing ISDS like the ECT are well recognised for causing regulatory chill, which could also harm renewables. The International Energy Agency (IEA) underlines in its Net Zero report that states’ ability to regulate will play an increasingly important role in implementing the clean energy transition. Such state action includes the provision of support schemes and incentives for new technologies. Almost all ECT-based claims in relation to renewable energy investments so far concern changes in subsidy schemes. Faced with high risks of arbitration claims, states may be reluctant to introduce new public policies and incentive schemes.

Secondly, the ECT can cause adverse impact on the renewables sector by distorting competition. This can for instance be observed in Germany, where lignite operators are receiving billions of Euros in compensation, to a large degree because in return they waived their rights to sue Germany under the ECT. Green Planet Energy, a renewable energy provider, is complaining to the European Commission regarding this overcompensation. They argue this unjustified state aid disadvantages renewable energy firms in several aspects.

Thirdly, agreements like the ECT provide exclusive rights to foreign investors, discriminating against domestic ones. This is particularly problematic as about 75% of global investment in renewable energy is domestic. Since the Komstroy ruling by the Court of Justice of the European Union, it is confirmed that EU investors cannot make use of the ECT against EU countries. This means non-EU investors will now de facto enjoy privileged protection when investing in the EU compared to domestic/EU investors.

And last but not least, renewable energy federations are also turning their back on the ECT: SolarPower Europe recently left the ECT's Industry Advisory Panel and another group, the European Renewable Energy Federation, issued a statement claiming that the ECT hinders the European Green Deal and the EU should withdraw from it.

Why is it unnecessary?

The assumption of proponents is that investment protection leads to more investments. However, there's a lack of evidence for this claim as a comprehensive Organisation for Economic Co-operation and Development (OECD) study found. On the contrary, investors in renewable energy infrastructure evidently consider other factors relating to a country's regulatory and investment framework far more important. In a 2019 Bloomberg New Energy Finance ranking of the most attractive countries in the Global South for investments in renewable energy, India came first even though it recently terminated most of its investment treaties and developed a new model that significantly reduces rights provided to investors. Third ranked Brazil has never signed a treaty that would allow investors to sue the country in private arbitration tribunals. The existence of investment treaties was not among the 167 indicators that the study deemed relevant to include. Similarly, the IEA's renewable energy investment reports do not mention investment treaties when talking about what is needed to increase investment in renewables.

In conclusion, keeping the ECT would harm more than help the renewable energy sector. There are no evident benefits of providing investment protection for renewable technologies but very tangible and significant risks associated. Expanding this flawed system to more energy materials would massively increase the risk of ISDS cases against states implementing policies to fulfil their Paris obligations.



TOXIC ELEMENT 2

Expansion to the Global South



The ECT already has 53 contracting parties. A long list of countries from Africa, Asia and Latin America signed the International Energy Charter in 2015. Legally speaking it is just a non-binding document that outlines general principles in international energy cooperation. In practice, however, signing this Charter makes them observers in Energy Charter processes and is the first step for countries to become a full member of the Energy Charter Treaty.

The Energy Charter Secretariat is the driving force behind this geographical expansion. The Secretariat is actively reaching out to governments around the world, advertising the ECT with the unproven claim that it would help countries to attract urgently needed investments and solve energy poverty. At the same time, risks in relation to ISDS are played down.

At least 15 countries are currently working on their accession reports, which are necessary to demonstrate their energy systems comply with ECT rules. Once they have submitted these reports, they can apply to become a member. This request needs to be approved by the other Contracting Parties.

It is this approval stage that has currently been put on hold while ECT reform is ongoing. The underlying assumption is that the reform will modernise the ECT to such an extent that it is fit for the challenges of the 21st century, including climate change and rising energy prices. This hope is utterly false.

International energy cooperation is more important than ever. Yet, basing this on an outdated and flawed framework like the Energy Charter Treaty is a recipe for disaster. Expanding the ECT would put even more countries into a regulatory straightjacket that many EU countries are hoping to escape from.

The Netherlands is currently being sued for legislating a coal phase-out, Italy is being sued for refusing a permit to drill for oil and Slovenia is facing charges for introducing a fracking moratorium. In the past, Germany had to water down environmental restrictions on a coal-fired power plant because it was being threatened by expensive compensation claims from Vattenfall. How are developing countries with much lower public funds meant to defend themselves against fossil fuel corporations that threaten them with multi-billion Euro claims in compensation and expensive legal claims that take many years to resolve?

Once a country becomes a member, all existing and future investments that are covered by the scope of the agreement would be protected. As the reform fails to introduce a general carve-out for fossil investments, it means that existing fossil infrastructure would be protected. There could also be legal challenges in relation to renewable energy investments, when countries pursue legitimate public interest objectives. From a climate, social and development perspective, it would be a nightmare to see more countries signing up to this dangerous investment agreement.

There are better alternatives to facilitate and safeguard renewable energy and renewable hydrogen investments in non-EU countries against political risks. In particular, investors can either purchase risk insurance or they could benefit from insurance programmes provided by their home states. For dispute settlement, investment agreements should use state-state arbitration mechanisms as for instance included in World Trade Organisation agreements.



TOXIC ELEMENT 3

Greenwashing would stall the real solution



The EU went into the reform with the right intentions and objectives. It wanted to update the ECT's investment protection provisions with the EU's reformed approach and most importantly, it wanted to bring the ECT in line with the Paris Agreement and the European Green Deal.

After many years of preparing this reform and two years of negotiations, it is clear that the EU's objectives have not been met. Moreover, the need to phase out fossil fuels and move to a 100% renewable energy system has grown massively in the light of the war on Ukraine and increasing energy prices driven by fossil fuel dependence. Our in-depth analysis shows that the reformed ECT would continue to be an obstacle to the fulfilment of the Paris Agreement and its highly controversial Investor-State Dispute Settlement mechanism would remain untouched.

Moreover, a recent study from the University of Amsterdam's Centre for European Law and Governance finds the ECT in conflict with the EU Treaties. The European Commission is trying to fix EU law incompatibilities as part of the current modernisation process but the text proposal of the EU of May 2020 would not fully remedy these incompatibilities (even if it was accepted in its entirety by other ECT contracting parties), according to the study.

It is therefore unsurprising that there is growing momentum for a withdrawal from the ECT. According to leaked cable reports, Germany, Spain and Poland have all said they're unhappy with the outcomes of the ongoing reform and urge the Commission to look into withdrawal. France has been critical of the reform process from the start and Italy has already left the ECT in 2015.

In the European Parliament, the ECT has no friends either. In a plenary debate in March 2022, Members from all political colours urged the Commission to prepare for withdrawal. The Chair of the European Parliament's Trade Committee, Bernd Lange (Social Democrats), criticised the lack of progress in negotiations and described the ECT as **"a shackle on our leg for our energy policy"**. Together with the Chairs of the European Parliament's Internal Market Committee, Anna Cavazzini (Greens), and Environment Committee, Pascal Canfin (Liberals), he wrote a letter to the European Commission and Council, "to underscore the urgency to make rapid and coordinated plans for withdrawal".

It is time that ECT Contracting Parties heed their words. Withdrawal is the only viable option to align the ECT with the EU's international and internal climate obligations and solve its incompatibility with the EU Treaties. We call on the EU and its Member States to ideally take this step jointly with as many allies as can be found. This group of countries should also neutralise the 20-year sunset clause amongst one another. But countries should also consider an individual withdrawal as it would set a strong political signal both to remaining ECT member states and to those considering accession, that this dangerous Treaty is a remnant of the fossil past, and therefore must be left behind.



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