

DO NOT RESUSCITATE

HOW ENERGY CHARTER TREATY REFORM COULD RESURRECT A CLIMATE MONSTER

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KEY POINTS

The Energy Charter Treaty (ECT) is an international trade agreement that protects foreign investors in the energy sector. It grants companies the power to sue governments through Investor-State Dispute Settlement (ISDS) for actions which harm their profits, including climate policies. On 24th of June 2022, an agreement in principle on ECT reform was concluded. Contracting Parties now have until the 22nd of November 2022 to consider whether to adopt the outcomes or withdraw from the Treaty. We have analysed the agreement in principle and come to the following conclusions:

- Reform of investment protection is insufficient to allow countries to pursue Paris-compatible climate action: fossil fuel assets continue to be protected for too long; Investor rights remain very broad; No reform of the controversial Investor-State Dispute Settlement (ISDS).
- Expansion to new technologies increases risks of compensation claims in relation to the transition to 100% renewable energy.
- Signing off on the reform would breathe new life into a dangerous agreement, making it likely that new countries will join and spread ECT risks to the global south.
- A coordinated withdrawal reduces overall risk of arbitration when compared to remaining in a reformed ECT.

1. Reform of investment protection is insufficient

FOSSIL FUELS PROTECTED FOR TOO LONG:

One of the EU's core ambitions for the reform has been the 'definition of economic activity in the energy sector', which defines the energy sources that benefit from the ECT's investment protection. Under the new agreement fossil assets will continue to be protected indefinitely in 23 Contracting Parties (CP). In the EU and UK, existing fossil investments will be protected for 10 years after the amendment enters into force - at least until 2034 but quite likely longer.

The ECT is currently being used by a number of fossil fuel firms to challenge fossil fuel phase-outs. The EU wanted to prevent such claims so that the ECT would no longer undermine the Paris Agreement; however such cases continue to be possible throughout this 10+ years phase-out. [Paris-compatible energy scenarios](#) show that in order to limit global warming to 1.5°C, we must stop burning coal by at least 2030, gas by 2035 and oil by 2040. Phase-out decisions to meet these timelines would have to be taken many years before investment protections end, posing a great risk of litigation under the ECT.

Two examples illustrate the dangers of protecting fossil fuels until at least 2034: In order to fulfil their obligations under the Paris Agreement, the Netherlands decided in 2019 to phase-out coal power generation by the end of 2030. In 2021, two coal companies, Uniper and RWE, started an ECT claim to receive ca. €2.4 billion compensation, i.e. they challenged the decision years before it was supposed to come into effect.

Similarly, German coal companies received extra compensation for the coal phase-out for an agreement not to sue under the ECT. The German coal phase-out will only take place in 2038, yet companies were able to use the threat of an ECT claim to receive extra compensation now. Under the current timeline of protecting fossil fuel investments until at least 2034, all important decisions to decarbonise the energy sector, which tend to be taken at least a decade in advance, are at risk of being subject to ECT claims.

BROAD EXEMPTIONS FOR NEW GAS INVESTMENTS

The reformed ECT continues to protect new fossil gas power plants emitting less than 380g of CO₂ per kWh of electricity until 31 December 2030 or even until 2040 under certain circumstances. This is inconsistent with the EU taxonomy, which classifies power plants that emit more than 270g of CO₂/kWh as 'significantly harmful'. Transport of fossil gas through pipelines will also continue to be protected until 2040 if the pipelines are 'hydrogen-ready'. These exemptions for new gas investments ignore the new reality after Russia's invasion of Ukraine and the resulting energy crisis and could lead to expensive compensation claims when states accelerate the phase-out of fossil gas.

DEBUNKING A MYTH: IS THE CHOICE BETWEEN 10 YEARS AND 20 YEARS?

The European Commission is arguing that the reformed ECT is better than a withdrawal because of the so-called sunset clause, which means that states can still be sued for 20 years after leaving the agreement. This is misleading.

- **10 years is a false promise:**

The phase out period for existing fossil fuel investment protection will only start after ratification by three-quarters of the ECT's 53 CPs. This process took 12 years last time the ECT was amended. The ratification process of the CETA agreement has been ongoing for longer than 8 years. The reform route guarantees 10 + x years of continued protection for fossil investments.

- **20 years could be reduced to 1 year:**

If several countries withdraw jointly, they can neutralise the sunset clause. [Legal experts are proposing to conclude an inter-se agreement](#), in which countries declare the sunset clause not to apply between themselves. This would bring 20 years down to 1 year (a withdrawal becomes effective one year after a CP gives notice).

- **10, 15 or 20 years - it matters little:**

The science is clear that decisions taken in the decade to 2030 will determine whether we can limit climate change to 1.5°C. With increased frequency of climate emergencies and the accelerating costs of fossil fuel imports, it is clear that the EU and its member states will have to legislate their fossil fuel phase-outs much before 2034 in any case.

NO FOSSIL FUEL PHASE-OUT OUTSIDE OF EU AND UK:

Outside of the EU and the UK there will be no requirement to end fossil fuel investment protection at all. This means that investments into coal, oil and gas can continue to receive legal protections under the ECT indefinitely.

Countries that have not implemented a fossil fuel carve-out can demand that EU and UK fossil investments be no longer protected in their territories (“reciprocity”); only three countries have asked for reciprocity so far (Japan Switzerland and Turkey). From a climate perspective, this outcome is a clear failure for the EU since no Contracting Party will end investment protection for fossil fuels in a Paris Agreement aligned timeline, including the EU itself.

NO REFORM OF ISDS:

The European Commission considers Investor-State Dispute Settlement (ISDS) “not acceptable” and “inadequate”. It no longer concludes international agreements that contain it. The European Parliament called for ISDS to be excluded from the Energy Charter Treaty altogether in its recent report on the future of EU Investment Policy. Despite the EU’s commitments on ISDS it remains unchanged after the reforms.

INVESTOR RIGHTS ARE STILL VERY BROAD AND CONTINUE TO RESTRICT THE RIGHT TO REGULATE:

Changes to investment protection standards are insufficient to preserve countries’ right to regulate. According to environmental law experts, it is very doubtful that the reformed ECT will in practice safeguard states’ ability to legislate climate and energy policies in the public interest. The modernised ECT reaffirms a state’s right to regulate but arbitrators have in the past interpreted similar reaffirmations as only applicable when they are not in conflict with investors’ rights, rendering them meaningless. In a recent case against Columbia, the arbitration panel even disregarded an environmental safeguard clause.

Investors’ rights continue to be very broad, including the most controversial Fair and Equitable Treatment (FET) standard. It is doubtful that these changes will have a material impact on the way that the ECT is interpreted by arbitrators. A recent publication, ‘New Treaties, Old Outcomes’, by the legal scholar Wolfgang Alschner suggests that attempts to reform old treaties to safeguard states’ policy space have tended to fail. He finds that arbitral tribunals often interpreted new treaties just as they did the old ones, ignoring exceptions and clarifications, and even bringing back phased-out protections through the back door. The new agreement fails to fundamentally redress the balance of states’ rights against investors and cannot therefore give us the confidence that states will have the policy space to take Paris-compatible climate action. These broad substantive rights as well as the unchanged ISDS make it likely that the reformed ECT continues to be incompatible with EU law, as a recent legal analysis by the University of Amsterdam demonstrates.

2. Expansion to new technologies increases risks of compensation claims resulting from the transition to 100% renewable energy

LOCKING IN RISK AROUND NEW TECHNOLOGIES:

The new text of the ECT expands investment protection to new technologies including hydrogen, biomass and CCS. Irrespective of how beneficial these technologies might be for the transition to climate neutrality, any expansion of investment protections is both dangerous and unnecessary. The International Energy Agency (IEA) Net Zero report underlines that the ability of states to reform their regulatory frameworks will be crucial in implementing the clean energy transition. Renewable energy cases under the ECT have almost always involved changes in subsidy schemes. As this study highlights, Spain has been sued over 50 times by investors in solar energy following changes to its subsidy regime. In this context states may suffer from regulatory chill; a reluctance to introduce policies to encourage renewable energy, for fear of costly arbitration.

THE ECT CAN ADVERSELY DISTORT COMPETITION FOR THE RENEWABLES SECTOR:

In Germany lignite operators are receiving billions of Euros in compensation due to the country's coal phase-out. 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.

EXCLUSIVE RIGHTS FOR FOREIGN INVESTORS:

Agreements like the ECT provide exclusive rights to foreign investors over domestic ones. This is problematic as about 75% of global investment in renewable energy is domestic. Since the Komstroy ruling by the CJEU, 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.

RENEWABLE ENERGY FEDERATIONS ARE TURNING THEIR BACK ON THE ECT:

SolarPower Europe, the most powerful solar industry group in the EU, recently left the ECT's Industry Advisory Panel and the European Renewable Energy Federation issued a [statement](#) calling on the EU to withdraw from the ECT.

INVESTMENT PROTECTIONS DO NOT DRIVE INVESTMENTS IN RENEWABLE ENERGY:

The assumption of proponents is that investment protection leads to more investments; however, there is a lack of evidence for this claim as a [comprehensive Organisation for Economic Co-operation and Development \(OECD\) study](#) found. 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.

Staying in even a reformed 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.

EXAMPLE - HYDROGEN

Under the new ECT, all forms of hydrogen, even those derived from fossil fuel derived electricity will be protected. Only the EU, UK and Switzerland exempted certain forms of hydrogen but will protect hydrogen made from renewable energy, gas and nuclear power plants indefinitely. Protecting gas and nuclear derived hydrogen is obviously problematic for the transition to a 100% renewable energy system but even protecting green hydrogen could lead to expensive compensation claims. The EU's Hydrogen Strategy foresees investments of between 320 billion and 458 billion euros until 2030. The extensive investment protection in the ECT creates a number of possible scenarios in which governments risk arbitration based on regulatory changes which inadvertently impact the financial prospects of this rapidly growing sector. For instance, the profitability of hydrogen plants is largely determined by the cost of energy, electrolyzers and capital. Actions that increase the price of these factors could be challenged in arbitration tribunals. Changes to support schemes may also be open to challenges.

EXAMPLE - BIOMASS

While biomass counts as a renewable technology in the EU, these plants can often have negative social and environmental impacts including health issues from emissions and deforestation, where wood is being burnt. If states wish to raise social and environmental standards for biomass plants which increase operating cost, for instance by introducing stronger emission standards or forbidding the use of certain feedstocks such as whole trees, they could face legal challenges. Over €6.5 billion per year is paid in subsidies to biomass facilities by the EU and the UK. Changes to these subsidy schemes could also potentially trigger ISDS claims.

3. Geographical expansion will continue - spreading ECT risks to the global south

THE ENERGY CHARTER SECRETARIAT HAS AN EXPANSIONIST POLICY:

The Energy Charter Secretariat is actively advertising ECT membership with the unproven claim that it helps to attract urgently needed investments and could solve energy poverty. 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 policies comply with ECT rules. Once they have submitted these reports, they can apply for approval by the other Contracting Parties to become a member. This stage has been put on hold while ECT reform is ongoing but if the reform is signed off, it is expected to restart with new energy. The underlying assumption is that the reformed ECT could be deployed to support climate action and tackle rising energy prices in the global south. This hope is utterly false.

UNACCEPTABLE RISKS FOR DEVELOPING COUNTRIES:

Once a country becomes a member, all existing and future investments that are covered by the scope of the agreement would be protected. This creates a huge risk of arbitration not only in relation to fossil fuel infrastructure but also much needed renewable energy investments. From a climate and development perspective, it would be concerning to see more countries signing up to this dangerous investment agreement that many EU countries are hoping to escape from. There are substantial concerns about the capacity of developing countries to defend themselves against energy corporations that threaten them with multi-billion Euro compensation claims.

ALTERNATIVES TO THE ECT:

International energy cooperation and renewable energy investments are more important than ever. Yet, basing these on an outdated and flawed framework like the Energy Charter Treaty is a recipe for disaster. There are better alternatives to facilitate and safeguard renewable energy and renewable hydrogen investments in non-EU countries. Investors can either purchase risk insurance or they could benefit from insurance programmes provided by their home states. For dispute settlement, investment agreements could provide for state-state arbitration mechanisms as for instance included in World Trade Organisation agreements.

CONCLUSION:

Coordinated withdrawal is better than reform

ECT proponents want us to believe that the choice is between an unreformed ECT and a slightly improved one. They paint a misleading picture of a straightforward transition to a de-risked agreement. **In fact, marginal gains in some areas are outweighed by increased risks associated with expansions to new technologies and geographies.**

The agreement fails to match what is needed for the climate too. The 10 year phase-out is a false promise which masks the potential for a much longer continuation of fossil protection. Even under the most generous estimations of the phase-out timeline fossil investments will be protected until at least 2034 - long after the big decisions for a Paris-compatible energy transition need to be made.

This table compares a Reformed ECT against a Coordinated EU withdrawal that neutralises the sunset clause. It demonstrates that a coordinated withdrawal of the EU and its member states reduces the overall risk of arbitration cases, when compared with the 10 year phase-out secured by the EU.

	Future foreign investments in the EU - after 2023		Existing foreign investments in the EU - before 2023		Future EU investments in other contracting parties		Existing EU investments in other contracting parties	
	REFORMED ECT	EU WITHDRAWAL - ABOLISH SUNSET CLAUSE	REFORMED ECT	EU WITHDRAWAL - ABOLISH SUNSET CLAUSE	REFORMED ECT	EU WITHDRAWAL - ABOLISH SUNSET CLAUSE	REFORMED ECT	EU WITHDRAWAL - ABOLISH SUNSET CLAUSE
COAL & OIL	Not protected	Not protected	Lose protection 10 years after the entry into force (i.e. at the earliest in 2034)	Protected until 2043 (in relation to contracting parties that remain in the ECT)	Protected indefinitely (except in Japan, Turkey and Switzerland)	Not protected	Protected indefinitely (except in Japan, Turkey & Switzerland)	Protected until 2043
GAS	Some gas assets (power plants, infrastructure and pipelines) protected until 2040	Not protected	Lose protection 10 years after the entry into force (i.e. at the earliest in 2034)	Protected until 2043 (in relation to contracting parties that remain in the ECT)	Protected indefinitely	Not protected	Protected indefinitely	Protected until 2043
HYDROGEN & NEWLY ADDED MATERIALS, PRODUCTS & TECHNOLOGIES	Protected indefinitely	Not protected	List of materials protected indefinitely	Protected until 2043 (in relation to contracting parties that remain in the ECT)	Protected indefinitely	Not protected	Protected indefinitely	Not protected

ADOPTING A REFORMED ECT WILL GREENWASH IT AND STIFLE THE CONSIDERABLE MOMENTUM FOR A WITHDRAWAL, WHICH IS BETTER THAN THE REFORM IN SEVERAL RESPECTS:

- By neutralising the sunset clause, the period for fossil fuel firms to sue could be reduced to 1 year, rather than 10 + x years.
- A withdrawal opens the possibility for EU accession countries, neighbours like the UK or Switzerland or other contracting parties to join the neutralisation of the sunset clause. This would further reduce the risk of ISDS claims.
- The EU is a major funder of the ECT and coordinated withdrawal could undermine the whole treaty. This could unlock the stalled process for wider investment policy reform - the latest IPCC report reminded us of the importance of this, when it warned of the chilling effect of ISDS on climate policies.
- There wouldn't be any expansion to new technologies or geographies.
- Future investments would no longer be protected.

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