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Modernisation of the Energy Charter Treaty

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An article considering the ongoing efforts to modernise the Energy Charter Treaty, focusing on the issues of investment protection and dispute resolution, as well as the options being explored to "green" the treaty. This article looks at the various proposals for reform and potential outcomes.

Background to the Energy Charter Treaty

The Energy Charter Treaty (ECT) is a multilateral investment treaty, which creates a legal framework for energy trade, transit and investment between its contracting parties. It is unique in being the only legally binding instrument for multilateral, intergovernmental cooperation in the energy sector. The broad aims of the ECT are to promote energy security, create more open and competitive energy markets and to encourage cross-border investment and trade in the sector.

The ECT came into existence following the end of the Cold War with the initial aim of fostering cooperation in the energy market between former Soviet countries, central and eastern European states and western Europe. It was signed in December 1994 and entered into force in April 1998.

The ECT currently has over 50 signatories, including Japan, the UK, the European Union, Euratom and all EU member states, except for Italy (which has withdrawn from the treaty following a plethora of renewable energy claims brought against it), and there is ambition to expand its membership further. Some parties apply the treaty provisionally (pending ratification) such as Russia did until 2009 when it gave notice of withdrawal from provisional application. Russia will be subject to the provisional application of the ECT's investment protection and investor-state dispute settlement (ISDS) provisions until 2029 due to the ECT's "sunset clause" (see Withdrawal). Russia's withdrawal may have been partly due to a desire to avoid future investor claims under the treaty such as those famously brought by the former Yukos shareholders who were awarded $50 billion (plus costs and interest), the highest known investment treaty award to date (see Legal update, Majority shareholders in Yukos awarded US$50 billion). It has also been suggested that Russia was dissatisfied with the outcome of the negotiations regarding a proposed Transit Protocol to the ECT, which started in 1999 and had not yet concluded by 2009.

The ECT is a controversial instrument. It is, at once, heavily supported and heavily criticised. Current supporters back the treaty as a vital way of attracting investment for the clean energy transition, while detractors view the treaty as an outdated and harmful instrument that protects fossil fuel investments. It has been praised as a means of promoting a global rule of law in the energy space, and criticised, to an equal degree, as having a chill effect on the freedom of contracting parties to regulate in the public interest.

It is generally accepted that the ECT requires a degree of modernisation to reflect:

- Changes in international investment treaty practice since it was concluded nearly thirty years ago.
- The general ISDS reform process being undertaken by the United Nations Commission on International Trade Law (UNCITRAL) Working Group III.

Importantly, modernisation is also needed to support the global transition to low-carbon energy.

However, proposals to effect change include making clarifications to the treaty by protocol, amending the treaty (see Amendment process) and abrogation of the treaty in its entirety.

Modernisation of the treaty

The launch of modernisation discussions was confirmed at the Energy Charter Conference in 2017, with an approved list of topics for modernisation agreed the following year (see Key areas of modernisation). In 2019, the "Modernisation Group" was established to conduct negotiations. See Legal updates:

- Energy Charter Treaty: European Commission Recommendation for Council Decision authorising negotiations on modernisation of ECT.

- Energy Charter Treaty: Council gives a mandate to the European Commission to begin negotiations on the modernisation of the Energy Charter Treaty and adopts corresponding negotiating directives.
- Energy Charter Conference approves policy options for modernisation of ECT.

Several rounds of negotiation have taken place, including four rounds in 2021, with a further eighth session scheduled in November. The EU is at the forefront of the modernisation efforts and has presented the most significant and detailed proposals so far (see EU text proposal for the modernisation of the Energy Charter Treaty (28 May 2020), discussed in Legal update, European Commission releases draft proposals for amended ECT, and EU additional submission to its text proposal for the modernisation of the Energy Charter Treaty (February 2021)).

However, on 2 December 2020, the European Commission (EC) confirmed that although it considers a reformed ECT the best possible outcome, it may consider recommending that the EU and its member states withdraw from the ECT entirely if core EU objectives are not met within a reasonable timeframe (see Legal update, European Commission confirms potential EU withdrawal from ECT if EU core objectives not attained in reasonable time). Notwithstanding this, the ECT's "sunset clause" (Article 47(3)), which provides for the continued application of the treaty's provisions to existing investments for a period of 20 years following a contracting party's withdrawal, may significantly reduce the immediate utility of this action, unless all ECT parties agree to disapply the sunset clause (see Withdrawal).

Little information has been shared publicly regarding the detail of the negotiations (see ECT: Modernisation of the Treaty). The most informative publication on the positions of the contracting parties remains the October 2019 Energy Charter Conference decision setting out suggested policy options in respect of modernisation for approval and comment by the different members (see Energy Charter Conference: CCDEC201908 - STR Policy Options for Modernisation of the ECT (6 October 2019)).

Following the sixth round of negotiations in July 2021, the EC commented that "substantial progress" had been achieved (see Legal update, Sixth round of negotiations on modernisation of ECT concludes and EC: Energy Charter Treaty: substantial progress achieved in modernisation negotiations (12 July 2021)). However, various news reports have, conversely, suggested that little progress has been made and that some EU countries are now calling for a co-ordinated exit from the treaty. This is also amidst increasing pressure from environmental groups and NGOs calling on Europe and the UK to withdraw (see reuters.com: Talks to reform energy pact blocking climate action face 'failure' (7 July 2021) and Legal update, 278 organisations including NGOs send open letter on ECT reform).

A seventh round of negotiations took place from 28 September to 1 October 2021, though little detail has been published regarding the extent of progress made in those discussions, see Legal update, Communication on the seventh round of ECT modernisation negotiations issued.

For a tracker of developments in the modernisation process, see Practical Law Arbitration: What to expect: tracker: Possible revisions to the ECT.

Key areas of modernisation

The list of topics subject to modernisation negotiations is relatively lengthy, covering 25 different areas of potential reform (see Energy Charter Treaty: Modernisation of the Treaty: List of topics). Many of these issues (though certainly not all) fall into the following broad categories of proposed modernisation:

- Investment protection.
- Dispute resolution.
- "Greening" the treaty.

Investment protection

The investment protection provisions of the ECT are contained in Part III (Investment Promotion and Protection) and create obligations on contracting parties to observe certain standards towards foreign energy investors of other contracting parties. These include:

- The obligation to provide fair and equitable treatment (Article 10).
- Prohibition on unlawful expropriation of investments (Article 13).
- Dispute resolution provisions that allow for ISDS through, among other things, international arbitration (Article 26).

The central tension in the ECT's investment protection provisions is between providing sufficient security to investors to attract capital for energy projects and ensuring contracting parties are not unduly limited in regulating in the public interest (for instance, to meet environmental or public health policy objectives).

The United Nations Conference on Trade and Development (UNCTAD) noted in its International Investment Agreements (IIA) Reform Accelerator, which aims to modernise and reform existing IIAs, that "old-generation" IIAs were established in a different era which did not face the same degree of global challenges (for instance, in respect of public health (as illustrated

in the COVID-19 pandemic), national security and the environment). It comments that older treaties (which, by inference, include the ECT) tend to create unqualified, broad obligations that can see arbitral tribunals adopt expansive interpretations. This, in turn, may at times stymie the ability of contracting parties to regulate responsively to meet escalating global challenges, a tendency often referred to as "regulatory chill". See UNCTAD: IIA Reform Accelerator (November 2020).

While the list of topics in the modernisation negotiations covers several provisions relevant to investment protection, this article will focus on the (heavily intertwined) issues of the fair and equitable treatment (FET) standard, indirect expropriation and contracting parties' right to regulate. For further discussion of the other provisions under the ECT related to investment protection, see Practice note, Investment arbitration under the Energy Charter Treaty: Investment promotion and protection.

For more information on securing investment protection and investment treaty arbitration, see Practice notes, Securing investment protection and Investment treaty arbitration: overview.

FET

The FET standard is undefined in the ECT. However, numerous investment tribunals have created sub-standards that aim to clarify it, including the requirement for contracting parties to act transparently and in good faith, and to refrain from arbitrary or discriminatory measures. See Practice notes, Investment arbitration under the Energy Charter Treaty: Promotion, protection and treatment of investments and Fair and equitable treatment in international investment law.

In UNCTAD's IIA Reform Accelerator, the FET clause was identified as one of the eight IIA provisions most in need of reform. The report noted that the FET clause is by far the most invoked IIA provision in ISDS, with claimants alleging a violation of FET in over 80% of known ISDS cases. In its review of ISDS decisions in 2019, UNCTAD noted that, while old-generation treaties tend to use minimalist, open-ended FET provisions, most of the recent IIAs opt for FET clauses that use a closed list of party obligations, sometimes retaining the "fair and equitable treatment" language or omitting it entirely (see UNCTAD: Review of ISDS decisions in 2019: Selected IIA reform issues (January 2021) and Blog, Next generation of investment treaties).

Various ECT members, including the EU, Turkey and Georgia, have called for the FET standard to be clearly defined in the ECT to avoid over-expansive and inconsistent interpretations.

The issues to be resolved in respect of the FET standard in the ECT include:

- Whether a list of breaches of the FET standard should be included (and whether that list should be exhaustive or open).
- Whether FET should be aligned with the "minimum standard of treatment" under customary international law or go beyond it (see, for further information on this standard, Practice note, Fair and equitable treatment in international investment law: FET and minimum standard of treatment). However, as noted in the UNCTAD IIA Reform Accelerator, "the exact contours of customary international law remain elusive, and a reference to this concept could engender significant uncertainties for both, [s]tates and investors".
- Whether (and what level of) protection should be offered for investors' legitimate expectations as part of the FET standard.
  - The concept of legitimate expectations broadly covers the expectations of investors, created at the time the investment is made by the conduct of the host party, which the investor legitimately acts in reliance upon (for example the host's direct or indirect representations, contractual undertakings or its regulatory framework). Energy projects require significant, upfront investment, which is recouped over time, so investors have a very strong interest in maintaining the continuity of investment conditions, upon which the financial viability of their project depends.
  - Investors' legitimate expectations have been treated by arbitral tribunals as a core component of the FET standard (see, for example, *Electrabel SA v Hungary, ICSID Case No. Arb/07/19* discussed in Legal update, ICSID tribunal rejects Electrabel's ECT claim against Hungary for stranded costs). However, the varying approach of tribunals as to what can give rise to such expectations has created significant uncertainty in respect of the breadth of the FET standard and how much regulatory space it leaves contracting parties. For further discussion of the contradictory tribunal decisions on this point, see Practice notes, Investment arbitration under the Energy Charter Treaty: Promotion, protection and treatment of investments and Fair and equitable treatment in international investment law: Lack of protection of investor's legitimate expectations.
  - Interestingly, UNCTAD has noted, in its IIA Reform Accelerator, that more recent IIAs do not incorporate investors' legitimate expectations in closed lists defining the FET standard (legitimate expectations are not referred to in the FET provisions of old-generation treaties either). Instead, some treaties address legitimate expectations as a separate provision, specifying circumstances which give rise to such expectations and stipulating that they may be taken into account

when assessing breaches of the FET standard. In this approach, legitimate expectations are not in and of themselves a stand-alone obligation.

Members of the ECT take different views on the amendment of the FET standard. For example, the EU and Turkey propose a closed list of what would constitute a breach of FET while Switzerland supports an open-ended list and Japan does not see amendment as necessary. In the EU's proposal, it suggests the FET standard should be limited to:

- Denial of justice in criminal, civil or administrative proceedings.
- Fundamental breach of due process, including a fundamental breach of transparency in judicial and administrative proceedings.
- Manifest arbitrariness.
- Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief.
- Abusive treatment such as harassment, duress or coercion.

In respect of investors' expectations, the EU has put forward wording that would mean a tribunal may take into account, when applying the above FET obligation, whether a host party made a specific representation to an investor upon which it relied in making or maintaining an investment. This would mean the protection of legitimate expectations would not constitute a stand-alone obligation in and of itself.

Following the sixth round of negotiations in July 2021, the contracting parties agreed that this topic would be subject to more extensive debate (see Legal update, Sixth round of negotiations on modernisation of ECT concludes).

Indirect expropriation

Article 13 of the ECT refers to the obligation on contracting parties not to subject investors to "a measure or measures having effect equivalent to nationalisation or expropriation" (indirect expropriation) unless they are:

- For a public purpose interest.
- Non-discriminatory.
- Carried out under due process of law.
- Accompanied by prompt, adequate and effective compensation.

UNCTAD in its IIA Reform Accelerator highlights "indirect expropriation" as one of the eight IIA provisions most in need of reform. It notes that about 70% of known ISDS cases include an allegation of indirect expropriation and that such provisions have been used to challenge not only targeted measures but legislative and regulatory instruments of general application which have an alleged negative effect on the value of an investment.

As such, it has been suggested that a clearer line between indirect expropriation and legitimate policymaking is required to permit sufficient regulatory space to IIA contracting parties. In the IIA Reform Accelerator, UNCTAD notes the approach taken by more recent IIAs, including:

- Establishing criteria to be met for a finding of indirect expropriation.
- Defining what measures do not constitute indirect expropriation.
- Omitting an explicit reference to indirect expropriation, though it is noted this may be "perceived as considerably reducing the protective value of the agreement".

Many of the contracting parties to the ECT have acknowledged the need for clarification of what constitutes indirect expropriation. The EU, for example, has proposed that only regulatory measures which are "manifestly excessive in light of their objective" can amount to indirect expropriation and that such measures must substantially deprive the investor of the fundamental attributes of its investment. It further proposes wording clarifying that the sole fact that a measure increases costs for investors cannot in and of itself constitute expropriation.

While details are not forthcoming, a public statement on the sixth round of negotiations noted that the contracting parties had "considerably progressed" the definition of indirect expropriation (see Legal update, Sixth round of negotiations on modernisation of ECT concludes).

For further consideration of indirect expropriation, including under the ECT, see Practice note, Expropriation in international investment law.

Right to regulate

One of the central pain points in modernising the ECT is finding an acceptable balance between eliciting investor confidence, by, for example, protecting an expectation of reasonable regulatory stability, and preserving the freedom of contracting parties to regulate in the public interest without being unduly limited by the threat of legal action. Tribunals have taken varying approaches as to when a change in the regulatory framework may breach the FET standard or amount to an indirect expropriation (see Practice notes, Investment arbitration under the Energy Charter Treaty: Promotion, protection and treatment of investments, Fair and equitable treatment: Lack of stable and predictable framework

for investments and Expropriation in international investment law: direct and indirect expropriation). Views from tribunals on the acceptable margin of regulatory change include:

- The legal framework of a state is, by definition, subject to change and a reasonably informed investor knows that laws can evolve with the perceived political or policy dictates of the time (see *AES Summit Generation Limited and another v Republic of Hungary (ICSID Case No. ARB/07/22*) discussed in Legal update, ICSID decision on relationship between ECT and EU law).
- The stability of the regulatory framework should be considered in the specific context of what can be expected in a certain state and any reliance by the investor should be based on appropriate due diligence (see *Mamidoil Jetoil Greek Petroleum Products Société Anonyme S.A. v Albania (ICSID Case No. ARB/11/24*) discussed in Legal update, ICSID tribunal rejects claims of expropriation, fair and equitable treatment, unreasonable and discriminatory treatment and most constant protection and security).
- The FET standard protects investors from a radical or fundamental change to legislation (see *Novenergia II - Energy & Environment (SCA), SICAR v Kingdom of Spain (SCC Case No. 063/2015)*).

The potential for disputes in this area continues to grow, with the emergency measures taken in response to the COVID-19 pandemic, in addition to action taken to meet sustainability commitments, having the potential to further engender ISDS. The trend towards more regulatory or restrictive policy measures has significantly accelerated in the wake of the pandemic (see Blog, Investment protection and COVID-19: who will pick up the tab? and Blog, The investment treaty implications of COVID-19 responses by states). In respect of environmental measures, in 2021 arbitration was commenced under the ECT in reaction to the Netherlands' actions to phase out coal (see *RWE AG and another v Kingdom of the Netherlands (ICSID Case No. ARB/21/4)* and *Uniper SE, and others v Kingdom of the Netherlands (ICSID Case No. ARB/21/22)*).

As part of the modernisation discussions, the EU has proposed:

- A new article in Part III, explicitly reaffirming the "right to regulate" to achieve "legitimate policy aims" which includes protection of the environment and protection of public health.
- Clarifying that the investment protection provisions of the treaty should not be interpreted as a commitment by a contracting party that it will not change the legal and regulatory framework even if this negatively impacts the investment (a "non-stabilisation" clause, akin to article 8.9 of the EU-Canada Comprehensive Economic and Trade Agreement (CETA)).
- Clearer rules on how the withdrawal or refusal of subsidies interacts with investment protection provisions.
- Clarification that the application of the EU's state aid law does not constitute a breach of investment protection standards (for a recent example of the interaction between the EU's state aid law and the ECT, see Legal update, Commission opens in-depth state aid investigation arbitration award in favour of Antin to be paid by Spain).

See Legal update, European Commission releases draft proposals for amended ECT *and* EU text proposal for the modernisation of the Energy Charter Treaty.

Other contracting parties have expressed support for an explicit right to regulate provision, but different considerations are at play, with Georgia referencing a right to regulate for "essential security" and Azerbaijan making specific reference to "sovereignty over its energy resources".

Based on the communication published on the sixth round of negotiations, much progress is still required, with the published statement noting, "the Modernisation Group continued to consider the introduction of treaty language preserving the 'Right to regulate'" (see Legal update, Sixth round of negotiations on modernisation of ECT concludes).

For further information on the procedural mechanisms, substantive defences and counterclaims available to states when defending investment treaty claims, see Practice note, Defending states in investment arbitration.

Dispute resolution

The ECT is the most widely invoked instrument in investor-state arbitration, representing over a fifth of cases (see, for further information, Legal update, ECT investment arbitration statistics outlined in International Energy Charter annual report).

Article 26 of the ECT provides that an investor may, following a cooling-off period of three months, submit a dispute for resolution, at the investor's option, to:

- The courts or tribunals of the contracting party in the dispute.
- A previously agreed dispute settlement procedure.
- International arbitration:
  - Ad hoc under the UNCITRAL Rules (see Practice note, Ad hoc arbitrations without institutional support and UNCITRAL Arbitration Toolkit).
  - Under the International Centre for Settlement of Investment Disputes (ICSID) Arbitration Rules or the ICSID Additional Facility Rules (see Practice notes, ICSID arbitration: a step-by-step guide and

Procedure in ICSID Additional Facility arbitration and other ADR mechanisms).

– Under the arbitration rules of the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) (see Practice note, SCC Arbitration (2017 Rules): a step-by-step guide).

See Practice note, Investment arbitration under the Energy Charter Treaty: Dispute resolution.

The ISDS mechanism, that is, the ability of a foreign investor to resolve disputes directly with a host party through international arbitration has become increasingly controversial and is currently the subject of various reform initiatives (see UNCITRAL Working Group III: tracker).

The aim of the ISDS provisions is to provide recourse to foreign investors who may otherwise not have any meaningful options if forced to rely on diplomatic protection or the judicial system of the host party (see Practice note, Investment treaty arbitration: overview).

However, the ISDS system has attracted significant criticism, with most of the principal issues of concern arising from the nature of arbitration itself (see Blog, ISDS: the worst, except for all the others). These include:

- A perceived lack of transparency due to arbitration generally being held in private and being confidential.
- The lack of consistency in arbitral decisions arising from the lack of precedent in investment treaty arbitration.
- Perceived arbitral bias and lack of independence in party nominated tribunals. For example, in the case of *Eiser Infrastructure Limited and another v Kingdom of Spain (ICSID Case No. ARB/13/36)*, a EUR128 million award in favour of the investor was annulled after Spain showed there was an improper undisclosed business relationship between the arbitrator appointed by the claimant and the claimant's expert, creating a perceived lack of impartiality and independence in the arbitrator (see Legal update, Spain successfully annuls EUR128 million ICSID award made under ECT). For further discussion of arbitrator requirements and challenges, see Practice notes, Selection of party-nominated arbitrators: Impartiality and independence, Challenges to arbitrators in ICSID arbitration and Challenges to arbitrators as well as Blog, Arbitrator bias: lessons from sports arbitration.
- Limited options for appeal on substantive issues in dispute, and none under the ICSID Rules (see Practice note, ICSID arbitration: a step-by-step guide).
- The perceived use of the system by foreign investors to challenge legitimate domestic policies (note, for example, the numerous recent cases brought by renewable energy investors against Spain).

In 2020, 97 members of the European Parliament (which has a total of 705 members) issued a statement concluding "ISDS provisions need to be scrapped or fundamentally reformed and limited".

IIAs concluded more recently tend to reduce access to ISDS by, for example:

- Limiting the number of treaty provisions that are subject to ISDS.
- Excluding policy areas from ISDS.
- Limiting time periods to submit claims.
- Omitting the ISDS mechanism all together.

See, for further information, Legal update, UNCTAD publishes World Investment Report 2021.

UNCITRAL is currently working on comprehensive reform of the ISDS regime, exploring the reform options of strengthening alternative dispute resolution (ADR) mechanisms, including investor-state mediation, developing a code of conduct for adjudicators, procedural rules to address frivolous claims, as well as an appellate mechanism (see UNCITRAL Working Group III: tracker).

In the context of this work, the EU is pursuing the establishment of a permanent multilateral investment court (MIC) to address the perceived problems of ISDS, which it would want to apply to the ECT (see European Parliament: Multilateral Investment Court: Overview of the reform proposals and prospects (January 2020)). Under the MIC, the EU aims to establish a system that is permanent and independent (with stringent ethics and impartiality requirements and an independent mechanism for the appointment of full-time adjudicators), that provides predictability through consistent case-law and allows for an appeal mechanism. The EU expects under this system proceedings will be shorter and more cost-effective as there will be no need to appoint arbitrators, and that it should provide increased predictability of interpretation, which, in turn, may reduce the number of investment disputes. See Legal update, European Commission authorises negotiations to establish multilateral investment court. Challenges in the establishment of the court include the compatibility of the reform option with the current ISDS regime (ICSID Convention, New York Convention and investment treaties), the structure and financing of such a system and how to ensure balanced representation in the composition of the court.

Transparency

Currently there is no transparency requirement under the ECT regarding ISDS, although arbitrations under the ICSID Rules (which the ECT provides for as an option in Article 26) are subject to greater transparency than

arbitrations under other arbitral institution rules, with cases and awards published on the ICSID website and the right for third party submissions.

However, many recent IIAs include an obligation to apply UNCITRAL rules on transparency (for further discussion on applying the UNCITRAL transparency rules, see Practice note, Arbitrating under the UNCITRAL Rules 2010 and 2013: a step-by-step guide: Transparency Rules and the Mauritius Convention).

Various proposals have been put forward by ECT members, on the basis that greater transparency could allow more consistent arbitral practice. However, positions vary, for example, while Switzerland and the EU are in favour of the incorporation of UNCITRAL transparency rules, Georgia does not support this, and proposes a specific transparency regime for the ECT.

In the second round of modernisation negotiations, it was stated that generally the contracting parties felt the modernisation group should further explore the possibility of increasing transparency, but, when considering the incorporation of UNCITRAL rules on transparency, some delegations stressed "the need for maintaining a balance between transparency on the one hand, and other legitimate interests on the other" (see Legal update, Communication on second round of negotiations for modernisation of ECT published).

In the seventh round of negotiations, it was reported that discussions on the issue of transparency "made progress on the basis of compromise proposals" (see Legal update, Communication on the seventh round of ECT modernisation negotiations issued).

Dismissal of frivolous claims

A key criticism of the dispute settlement provisions of the ECT is that they do not provide appropriate safeguards to quickly dismiss or avoid frivolous claims. While the ICSID and SCC arbitration rules, two of the three investor-state arbitration options offered to investors under Article 26(4) of the ECT, do provide the possibility for rapid dismissal of unfounded claims (ICSID Arbitration Rule 41(5) and SCC Article 39(2)), the UNCITRAL arbitration rules do not.

Amendments that have been proposed to address the issue of frivolous claims include:

- The introduction of a statute of limitations clause.
- A mechanism for early dismissal of frivolous claims ("preliminary objection").
- Security for costs provision.
- Disclosure of third party funding, having regard to the ongoing work of UNCITRAL on third party funding regulation (see Legal update, UNCITRAL Working Group III releases draft paper on third-party funding in ISDS). See also Practice note, Third-party funding for international arbitration claims: overview.

Of relevance is the work of UNCITRAL Working Group III on ISDS reform, which includes reviewing options to minimise frivolous claims (see UNCITRAL: Procedure to address frivolous claims, including summary dismissal).

In the fifth round of modernisation negotiations, while fuller details are not public, it was noted that the contracting parties "advanced the discussion on the prevention and early disposal of frivolous claims" and that "common ground" was identified in respect of introducing relevant provisions for security for costs and third party funding. See Legal update, Communication on fifth round of negotiations for modernisation of ECT published. The issue of frivolous claims was further discussed on the basis of "compromise proposals" at the seventh round of negotiations (see Legal update, Communication on the seventh round of ECT modernisation negotiations issued).

Intra-EU arbitration

Various tribunals have considered the interrelationship between the ECT and EU law, the key issues of contention being:

- Whether the applicable law is that of the ECT (as was held in, for example, *AES Summit Generation Ltd and another v Republic of Hungary (ICSID Case No ARB/07/22)* discussed in Legal update, ICSID decision on relationship between ECT and EU law) or whether EU law prevails over the ECT (*Electrabel SA v the Republic of Hungary (ICSID Case No. Arb/07/19*) discussed in Legal update, ICSID tribunal further clarifies hierarchy between EU law and ECT in investor-state energy disputes).
- Whether the arbitration of intra-EU disputes is incompatible with the Treaty on the Functioning of the European Union (TFEU), in that such disputes should be under the jurisdiction of EU courts.

On 6 March 2018, in *Slowakische Republik v Achmea BV, C-284/16*, the ECJ held that an ISDS clause in a bilateral investment treaty (BIT) between the Netherlands and Slovakia was incompatible with EU law (see Legal update, ECJ: Arbitration clause in intra-EU BIT incompatible with EU law). Beyond its impact on intra-EU BITs, the decision put in doubt the validity of the arbitration provisions in the ECT in the case of intra-EU disputes. However, a string of tribunal decisions has determined that *Achmea* does not apply to the ECT and is limited to intra-EU BITs (for example *Vattenfall AB and others v Federal Republic of Germany (ICSID Case No. ARB/12/12)*, discussed in Legal update, ECJ ruling in Achmea does not apply to ECT cases (ICSID), and *Rockhopper Italia S.P.A., and others v Italian*

Republic (ICSID Case No. ARB/17/14)). In fact, all known investment tribunal decisions have rejected the view that Achmea applies to the ECT.

The EC, however, strongly holds the view that *Achmea* **does** apply to the ISDS provisions of the ECT (see Legal update, European Commission says Achmea applies to ECT as well as intra-EU BITs). Further, in January 2019, representatives of 22 EU member states issued a declaration in which they recognised that all ISDS provisions in all intra-EU BITs are incompatible with EU law (and therefore inoperable) and that this also applies to the ISDS provisions in the ECT, see Legal update, EU member states issue declaration recognising consequences of Achmea. Following this declaration, on 5 May 2020, 23 EU member states signed an agreement terminating all intra-EU BITs. The agreement is silent regarding the ECT but indicates that separate arrangements will be put in place (see Legal update, Agreement to terminate intra-EU BITs signed by 23 EU member states).

On the 3 March 2021, AG Szpunar, in an opinion supporting *Achmea*'s application to the ECT, opined that intra-EU investors are sufficiently protected under EU law, making it unnecessary for them to have recourse to an external judicial system. See Legal update, ECJ's Advocate General Szpunar opines that ECT arbitration provision is incompatible with EU law and Blog post, Finishing the Achmea-job: how the European court gradually suffocates the ECT (7 April 2021). In September 2021, the ECJ agreed with AG Szpunar's opinion, finding that Article 26 of the ECT is incompatible with EU law insofar as it permits EU investors to bring investment disputes against EU member states before an international arbitral tribunal. The ECJ reasoned that the EU legal system precludes EU member states from submitting disputes concerning the interpretation or application of EU law, of which, according to the ECJ, the ECT is a part, to any settlement mechanism other than those provided by EU treaties. At present, it appears that the impact of the ECJ decision is likely to be most significant for non-ICSID, intra-EU arbitrations seated in an EU member state, that are subject to the domestic law of that state and EU law, as opposed to ICSID ECT arbitrations which sit outside national legal regimes (see *Republic of Moldova v Komstroy LLC (successor in law of Energoalians) (Case C-741/19)*, discussed in Legal update, Investor-state arbitration clause in ECT incompatible with EU law when applied to intra-EU disputes (ECJ) (Full update)). However, successful enforcement of intra-EU ICSID awards in the EU will likely be problematic.

For a detailed discussion of the interrelationship between EU law and the ECT, see Practice notes, Investment arbitration under the Energy Charter Treaty: Dispute resolution: Objections based on conflicts with EU law and Jurisdiction and admissibility in investment arbitration: overview.

The modernisation negotiations are silent on the intra-EU issue, except that the EU's proposed modernisation text was accompanied by the statement that "the amendments to the ECT set out by the EU in its proposal do not affect the Commission's view[...] that the ECT does not contain an investor-to-state arbitration mechanism applicable to investors from one EU Member State investing in another" (see EC: Commission presents EU proposal for modernising Energy Charter Treaty (27 May 2020)).

In December 2020, Belgium requested the ECJ to opine on whether the arbitration provision in the draft modernised ECT will apply to intra-EU disputes and whether it would, as such, comply with EU law (see Legal update, Belgium seeks opinion on applicability to intra-EU disputes of ISDS provision in modernised ECT).

A further consideration from the UK perspective is that, following Brexit and the UK becoming a third country, views have diverged as to how UK-EU investment disputes will interact with *Achmea*, given that they are no longer "intra-EU". The UK-EU Trade and Cooperation Agreement does not contain an ISDS mechanism (and has limited investor protection provisions) so an effective ECT is arguably especially important for the attractiveness of the UK's investment environment post-Brexit. The EU has issued a notice of infringement against the UK for failing to terminate its BITs pursuant to the January 2019 declaration, so the enforceability of the ISDS provisions under these agreements is more controversial (see Legal update, EU Commission gives notice of infringement proceedings against Finland and UK for failure to terminate intra-EU BITs and Blog, From genesis to apocalypse: As Belgium heralds the end of the uncertainty on intra-EU BITs, has the UK missed an opportunity in a post-Brexit world?).

"Greening" the treaty

One of the most contentious issues in respect of the ECT is its role in the green transition.

Detractors have criticised the use of the ECT's ISDS provisions by fossil fuel investors to take action against governments that are introducing measures to combat climate change. For example:

- In 2017, a case was brought against Italy following its decision to introduce a general ban on oil and gas exploration and production near the country's coastline (see *Rockhopper Exploration Plc, and others v Italian Republic (ICSID Case No. ARB/17/14)*).
- More recently, two claims were brought against the Netherlands in reaction to the measures it is taking to phase out coal power by 2030 (see *RWE AG and*

another v Kingdom of the Netherlands (ICSID Case No. ARB/21/4) and *Uniper SE and others v Kingdom of the Netherlands (ICSID Case No. ARB/21/22)*).

Concerns are growing that the threat of arbitration invoked under the ECT could have a detrimental impact on environmental policy making. This is of particular relevance as countries seek to meet their obligations under climate change legislation developed through the United Nations Framework Convention on Climate Change (UNFCC), the Kyoto Protocol and the Paris Agreement (see Climate change toolkit), amidst increasingly stark warnings around the effects of climate change (see Legal update, IPCC AR6: first working group (2021) report on physical science basis of climate change) and the role of fossil fuel investors in the transition to net-zero (see Practice note, Energy transition in the oil & gas sector: overview and reuters.com: End new oil, gas and coal funding to reach net zero, says IEA (18 May 2021)).

On 12 October 2020, members of the European Parliament submitted a question to the EC on the timeline of the modernisation process, in which they stated that the ECT "undermines any regulatory attempt to change the crashing course of fossil fuel consumption and forces EU citizens to pay for the life insurance of fossil fuel investors". It noted the tension between the European Green Deal, which sets the goal of carbon neutralisation by 2050, and the ECT which it estimated could protect EUR2.15 trillion in fossil fuel investments by 2050 against public policies to phase them out (see Renegotiation of the Energy Charter Treaty: alignment with the Paris Agreement before the 2021 COP and next steps envisaged by the EU (europa.eu)).

An Investigate Europe report from February 2021 has stated that that the value of the fossil fuel infrastructure protected by the ECT in the EU, the UK and Switzerland is EUR344.6 billion. It noted that the UK had the highest exposure in Europe with fossil fuel infrastructure worth more than EUR140 billion. In July 2021, more than 400 environmental organisations, charities and campaigners called on the UK government and other European countries to withdraw from the ECT "by the UN climate change conference COP26 at the latest" (see Westlaw: UK urged to quit treaty letting energy companies sue states for taking climate action (7 July 2021)).

Supporters of the treaty maintain that it is "energy neutral" and does not favour the protection of fossil fuels over renewables, reflecting rather than determining the underlying energy investment mix. Further, the ECT has also been held up as a key tool in the green transition, providing reassurance for investors in renewables that they will be protected, particularly in countries where the rule of law may be perceived as weaker, and so playing an important role in attracting the investment needed for the world economy to transition to net zero. Urban Rusnák, Secretary-General of the Energy Charter Secretariat, has commented that if the ECT modernisation talks fail, the world's ability to meet the goals of the Paris Agreement would be threatened, noting that the ECT, in protecting investment, is complementary to the Paris Agreement (see bordelex.net: Interview: A new Energy Charter Treaty as a complement to the Paris Agreement (18 June 2020)).

Various approaches have been posited to address concerns around the ECT's role in the green transition, including:

- Amendment of the treaty to remove or modify fossil fuel protections and explicitly protect renewables.
- A market solution, where the energy mix protected under the treaty organically shifts towards renewables.
- A co-ordinated withdrawal from the treaty (see Withdrawal below).

Amendment of the ECT

Ensuring alignment between the ECT and the transition to a low-carbon economy is one of the key areas of the modernisation talks under the umbrella of "Sustainable development and corporate social responsibility". The EU has stated one of its key aims is to "ensure the ECT better reflects climate change and clean energy transition goals and facilitates a transition to a low-carbon, more digital and consumer-centric energy system, thus contributing to the objectives of the Paris Agreement and our decarbonisation ambition."

Protection of renewables

An important issue is the current uncertainty around whether certain renewables and green energy solutions, namely hydrogen and carbon capture, utilisation and storage (CCUS), are protected under the treaty. Commentators have suggested that the treaty can be interpreted to cover both hydrogen and CCUS. The key provisions when determining the scope of the ECT's jurisdiction over a particular energy source or product include:

- The list of energy materials and products under Annex EM I.
- The protected activities under Article 1(5) ("economic activity in the energy sector").
- The covered assets under Article 1(6).

It is also important to take note of Article 19 of the ECT ("Environmental Aspects") which enshrines the principles of:

- Each contracting party taking into account its obligations under international agreements concerning the environment.
- Each party striving "to minimise in an economically efficient manner harmful Environmental Impacts", including having particular regard to using renewable energy sources, promoting the use of cleaner fuels and employing pollution-reduction technologies.

Arguments have been made that the inclusion of "electrical energy" and "coal gas, water gas, producer gas and similar gases" under Annex EM I covers the production of hydrogen, particularly in the favourable context of Article 19.

CCUS is not explicitly mentioned in the treaty, though arguments have been made for the interpretation that Article 1(5) which defines protected "economic activity in the energy sector" would cover CCUS on the basis that the explanatory note to the article expressly includes "removal and disposal of wastes from energy related facilities".

However, leaning on a favourable interpretation of the treaty arguably does not provide investors in these technologies sufficient certainty, and so proposals are being put forward to explicitly include these energy forms in the treaty (see EU text proposal for the modernisation of the Energy Charter Treaty (February 2021)).

For further information on hydrogen and CCUS, see Practice note, Downstream gas industry: the role of hydrogen and Practice note, Carbon capture, utilisation and storage and negative emissions technologies: overview.

Protection of fossil fuels

In addition to calls for more explicit incorporation of renewable products and technologies, there is also vocal support for fossil fuels being removed entirely from the ECT's scope of protection (for example, the 8 December 2020 letter from the Institutional Investors Group on Climate Change to members of the European Council). However, those who oppose this approach cite the need for fossil fuels to be part of the energy mix in the mid-term to support a sustainable green transition and to maintain energy security.

In 2021, the EU put forward a modified proposal for ECT modernisation, adopting a more restrictive stance on the protection of fossil fuels. In its proposal:

- The investment protections under the ECT would cease to apply to existing fossil fuel investments ten years after the amendment enters into force (but no later than the end of 2040).
- Future fossil fuel investments would be excluded from investment protection after the amendment enters into force, with the exception of:
  - natural gas-fuelled power infrastructure investments, which are protected until the end of 2030, if they emit less than 380g of CO2 per kWh of electricity and can use low-carbon gases; and
  - infrastructure of this type that replaces more-polluting coal, which will benefit from protection ten years after the treaty amendment takes effect (until the end of 2040 at the latest).

See reuters.com: EU to seek fossil fuel phase-out in energy charter treaty talks: document (16 February 2021) and EU text proposal for the modernisation of the Energy Charter Treaty (February 2021).

Broader reforms to the treaty

The EU's modernisation proposal also contains various other sustainable provisions, notably an article in Part IV meaning that each signatory would have to effectively implement the UN Framework Convention on Climate Change and the Paris Agreement. This would be backed up by a state-to-state dispute mechanism. Detractors have argued this may have a dissuasive effect on further states joining the ECT, whereas supporters have welcomed the possibility of giving the Paris Agreement a state-to-state enforcement mechanism.

Market shifts

An alternative position to amending the treaty is to allow market forces to take their natural course, on the basis that, as the prices of renewables fall and become competitive with fossil fuels, investment capital will naturally move away from fossil fuels towards renewables (further hastened by domestic environmental laws). Solar PV, for example, is reportedly now cheaper than new coal- or gas-fired power plants in most countries (see reuters.com: Solar the new 'king of electricity' as renewables make up bigger slice of supply: IEA (13 October 2020)).

Further, since 2013, more arbitration cases under the ECT relate to investment in renewables than fossil fuels, potentially suggesting a shift in the ECT's protections towards renewables (see ECT: Cases: Statistics).

However, under this approach, existing (and new) fossil fuel investments continue to create uncomfortable ISDS exposure for contracting parties, which is likely to increase as further measures are taken to meet international environmental goals.

Amendment process

One of the key complexities of modernising the ECT is that the adoption of an amendment (subject to very limited exceptions) requires unanimity among the

ECT contracting parties (under Article 36(1)(a)). This is despite the fact that even after adoption, an amendment will not become binding on a contracting party until that contracting party ratifies the amendment. Even a contracting party which has no intention of ratifying an amendment can block the unanimity required for the amendment to be adopted. Japan's last stated public position, for example, is that it sees no reason to amend the ECT.

Amendments require ratification by three-quarters of the membership before they enter into force among the parties which have ratified (for example the ECT trade amendment in 1998 only came into force in 2010, this being a comparatively limited amendment to update the ECT to align with WTO rules).

Another way of updating the ECT is by protocol. This approach is more limited in that a protocol cannot contradict the treaty, only complement, supplement, extend or amplify it. The adoption of a protocol requires a three-quarters majority of members rather than unanimity (and, again, a protocol will only bind the contracting parties which ultimately go on to ratify it). A protocol could be useful for clarifying the FET provisions and extending protection to hydrogen and CCUS, but is unlikely to be a reliable basis for removing protection from fossil fuels, for instance.

Withdrawal

A number of news reports have noted that certain EU members are calling for withdrawal from the treaty and the EU has indicated it may consider withdrawal if core EU objectives are not met. However, under Article 47 of the ECT, following withdrawal the investment protection and ISDS provisions of the ECT continue to apply to investments made prior to withdrawal for a period of 20 years (the "sunset clause"), creating a lengthy period of exposure for contracting parties. The impact of the sunset clause has been seen in the case of Italy, which withdrew from the treaty in 2016, and has faced at least seven arbitration claims under the sunset clause.

Commentators have suggested a potential option is an *inter se* agreement between a subset of ECT contracting states (for example the EU member states) modifying the sunset clause so as to disapply it between those parties.

This option may be problematic insofar as it is an amendment to the ECT which would need to be adopted unanimously by the ECT contracting parties as explained above, although the Vienna Convention on the Law of Treaties (Article 41) may also be relevant.

Next steps

The stakes for the modernisation talks are high, with the Secretary-General of the ECT commenting in an interview, "If the modernisation process fails, I don't see a future for the Treaty." (See bordelex.net: Interview: A new Energy Charter Treaty as a complement to the Paris Agreement (18 June 2020)).

The public communications on the progress of the talks have provided little detail as to the substance of negotiations, and while progress has been indicated in some areas (for example considerable progress has reportedly been made on the definition of indirect expropriation), other areas appear to be at a much more nascent stage (the introduction of right to regulate language and the definition of FET) (see Legal update, Sixth round of negotiations on modernisation of ECT concludes).

While the EC has stated it is strongly committed to pursuing modernisation talks, it has confirmed that if its core objectives (namely, reform of the investment protection provisions and alignment with the EU's climate objectives) are not achieved within a reasonable timeframe, it may consider withdrawal. However, the Commission has not further elaborated on what it considers to be a reasonable timeframe (see Legal update, European Commission confirms potential EU withdrawal from ECT if EU core objectives not attained in reasonable time). COP26 is likely to be an inflection point, sharpening focus further on what the talks have achieved and how expeditiously they can be concluded.