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A Case For The Green Investment Regime Under The ECT

By **Amy Frey and Simon Maynard** (October 16, 2023, 12:22 PM BST)


Amy Frey


Simon Maynard

The Energy Charter Treaty, or ECT — an international multilateral framework for energy cooperation that provides for investor-state disputes in the sector — is meant to mark its 30th birthday in 2024.

However, a slew of countries recently unveiling their intention to exit or review the agreement is not making the anniversary feel particularly celebratory.

In September, the U.K. joined the chorus of countries announcing a review of their memberships, becoming the latest jurisdiction from the ECT's 50-plus signatories to signal displeasure at the mechanism, following the likes of France, Germany, Spain and the European Union. The treaty's future is now hanging in the balance.

The cause of the sudden mass rejection of the ECT, after almost three decades, appears more political than legal.

The language from those unhappy with the ECT has a similar pattern: They argue it is an outdated product of the Cold War; it does not support the transition to cleaner, cheaper energy sources; it restricts a country's sovereign right to regulate; it is not aligned with EU climate law and commitments under the Paris Agreement; and it is not a viable option for the EU.

But how did we get here?

What does the ECT provide?

The ECT "provides a multilateral framework for energy cooperation that is unique under international law," according to its website.

The treaty's provisions focus on four broad areas:

- The creation of a common and mutually beneficial energy policy on investment, transit and trade among post-Cold War nations to align the development and diversification of energy supplies;

- The provision of "non-discriminatory conditions for trade in energy materials, products and energy-related equipment based on WTO rules, and provisions to ensure reliable cross-border energy transit flows through pipelines, grids and other means of transportation";

- "The promotion of energy efficiency, and attempts to minimise the environmental impact of energy production and use"; and

- "The protection of foreign investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable) and protection against key non-commercial risks," along with the "teeth" of an enforcement mechanism at the level of international law.[1]

It is the last of these that has provoked the most controversy.

Article 26 of the ECT provides for investor-state disputes settlement, which allows an investor of one ECT contracting party to sue another for damage sustained to its investment in that party's energy sector.

An investor can do so where the party acts contrary to any of the comprehensive investment protections provided for in the ECT. These include prohibition against uncompensated expropriation, as well as a guarantee of fair and equitable treatment.

This is commonly interpreted to mean that the party must, among other things, provide a stable and predictable legal framework, respect the investor's legitimate expectations and refrain from any discriminatory or arbitrary treatment.

Famously, since 2011, Spain has been subject to over 50 claims under the ECT, arising from the overhaul of its incentive scheme for renewable energy investments, with investors using these provisions successful to claim, thus far, over $1.2 billion in damages from the state.

It is not just Spain that has been displeased by this development.

Despite being a signatory itself to the ECT, the EU has long argued that the ECT should not apply to so-called intra-EU disputes, i.e., disputes between an EU member state and an investor of another member state, essentially on the basis that EU law should have primacy over the ECT — a position that has been almost unanimously rejected by international investment tribunals.

Modernizing the treaty: The ECT goes green.

Although Spain has received multiple claims of allegedly harming the renewable energy sector, controversy has also arisen in respect of the ECT because of the protection it is perceived to offer to fossil fuel investments.

In that regard, on June 24, 2022, a provisional agreement to reform the ECT affirmed the "urgent need to effectively combat climate change."

The proposed revisions to the ECT included changes to ensure that international climate law is considered as part of the international law applicable between the contracting parties, including by:

- Introducing new provisions to "reaffirm the respective rights and obligations of the contracting parties" under key multilateral instruments such as the U.N. Framework Convention on Climate Change, and the Paris Agreement; and

- Incorporating new provisions emphasizing the contracting parties' right to regulate in the "interest of legitimate public policy objectives," which may "include the protection of the environment, including climate change mitigation and adaptation."

Importantly, these innovations will require an impact assessment of any new energy investment project to be carried out and made public. Such assessments shall address the effects of the project on population and human health, biodiversity, environment and climate, and cultural heritage.

They also provide for a "flexibility mechanism," which will allow contracting states to "exclude investment protection for fossil fuels in their territories."

The EU and the U.K. reportedly both intended to apply this carve-out "including for existing investments after 10 years from the entry into force of the relevant provisions and for new investments made after 15 August 2023."

In tandem with these amendments, the revised ECT will expand its coverage of renewable and energy transition technologies. However, its adoption date is currently uncertain.

Could the sun be setting for the ECT?

Since its conclusion in 1998, five contracting parties — Italy, Poland, Germany, France and Luxembourg — have withdrawn from the ECT, in large part due to the concerns mentioned above and despite the changes proposed to modernize the treaty.

The EU, the U.K. and other European states have announced that they also are considering exiting the ECT, rather than signing up to the modernized version of the treaty.

These are unfortunate developments in international law and policy, and they raise the question of why an alliance forged during the uncertainty of the post-Cold War world cannot be sustained in the modern era.

The ECT was concluded in recognition of the fact that significant, cross-border investment in energy would be needed, and that investment protection was a critical component to realizing that investment.

Today, the situation is arguably more exigent, with global powers largely agreeing that a true energy transition will require trillions of dollars in foreign direct investment. Yet, many of those same powers are ready to quit the very treaty that could help realize that collective goal.

The sunset clause ensures treaty compliance.

Perhaps all is not lost. The 20-year-long sunset clause in Article 47.3 of the ECT, which is reduced to 10 years in the modernized, but not yet adopted, version of the ECT, will continue to apply in its current form to investments made in a contracting party for 20 years from the date when that party's withdrawal from the ECT took effect.

Given the global objective to reach net-zero emissions by 2050, withdrawing from the treaty now still ensures protection of the energy sector for well into the time frame to reach that milestone.

But investors should be wary, as certain parties have the ECT's sunset provision in their sights.

Consistent with its prior position as to the relationship between the ECT and EU law, the EU has called into question the applicability of the sunset clause, at least as between EU member states. Specifically, in its decision on the withdrawal of the union from the ECT on July 7, the European Commission[2]:

- Stated that the sunset clause never applied — and thus will not apply in the future — to intra-EU disputes;

- Acknowledged that there is nevertheless "a risk of legal conflict that must be eliminated," reflecting the fact that the vast majority of arbitration tribunals have rejected the intra-EU jurisdictional objection, while enforcing courts located outside the EU have reached diverging positions; and

- Proposed that the appropriate response would be to adopt between the EU member states, the EU and European Atomic Energy Community a "'subsequent agreement … regarding the interpretation of the treaty or its application of its provision' within the meaning of Article 31(3)(a) of the [Vienna Convention on the Law of Treaties]."

However, there are three problems with the EU's position.

First, as confirmed on Sep. 14, 2020, in an award by an International Centre for Settlement of Investment Disputes tribunal in ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH and InfraClass Energie 5 GmbH & Co. KG v. Italian Republic, under international law, Article 31(3)(a) of the Vienna Convention on the Law of Treaties applies only to interpretations adopted by all parties to the ECT.

The article requires the taking into account of "any subsequent agreement between the parties regarding the interpretation of the treaty."

Thus, a common EU position would not be sufficient to modify the ECT in this way or derogate from its sunset clause.

Second, and as the vast majority of international tribunals have found, Article 16 of the ECT, which provides, inter alia, that no subsequent international agreement can derogate from "any right to dispute resolution" under the ECT, precludes any inter se modification removing access to investment arbitration in an intra-EU dispute.

It may be for that reason that the commission has not proposed an inter se modification of the ECT under Article 41 of the Vienna Convention on the Law of Treaties.

Third, even if the EU did succeed in either of the routes set out above, it would still leave the unreformed ECT in force, including against EU member states insofar as non-EU states are concerned.

The EU and its member states would therefore still be amenable to ECT claims brought by investors from non-EU countries. Investors can restructure their investments through, e.g., the U.K. or Switzerland

to preserve their access to the ECT in the event of a future dispute.

Furthermore, the EU's stance seems unnecessary in circumstances where the revised ECT, in a specific concession to the EU, provides that the investor-state dispute settlement provisions in Article 26 will not apply among contracting parties that are members of the same regional economic integration organization, such as the EU.

And, in any event, an ECT contracting party considering withdrawal, like the U.K., stands to lose on multiple fronts.

The sunset provision ensures its compliance for 20 more years; it risks losing a seat at the negotiating table for an amended version of the treaty; and withdrawal signals to the international investment community that it may be a risky or unreliable investment partner.

The political climate surrounding the ECT heats up.

Given the prevailing public narrative regarding the ECT in recent times, the news that more and more states are considering a withdrawal from the treaty should come as no surprise — maybe the only surprise is that it took so long.

That narrative focuses heavily on the idea that the treaty is a vehicle for claims in protection of fossil fuel investments to the detriment of the need for energy transition and of international climate change goals.

What it ignores, however, is the number of renewable investments to which the treaty afforded protection in the past — not to mention the even greater number it would protect in the future.

More fundamentally, it also ignores the significant strides taken to modernize the ECT, which promote the ongoing, explicit integration of climate law into the international legal system.

It also fails to take into account that even the current version of the ECT requires its parties to "strive to minimize … harmful Environmental Impacts" of their energy sectors and to "take account of environmental considerations throughout the formulation and implementation of their energy policies."

These elements show how the international investment regime can and arguably already does provide a framework for advancing climate goals and promoting clean energy investment in a way that is consistent with the legitimate exercise of nondiscriminatory public interest regulation.

While maybe well-meaning, what those buying into the somewhat misconceived concerns of the ECT do not seem to appreciate is that in the face of cancellation by a state of an incentive to invest in a major clean energy project, the absolute last place an investor wants to find itself is in the courts of a state trying to recover its losses.

One reason why is that energy security has become a major concern and something that we are all too familiar with given the events in Europe of the past year and a half.

It is also hard not to think that at least some of the activity by states around these issues may be motivated less by genuine climate concerns and more by a desire to shed the perceived burden of international obligations to stand by promises made to the energy industry, whether conventional or

renewable.

Whether the ECT will weather these storms remains to be seen. In the meantime, investors can take comfort that the sunset clause in the ECT will continue to ensure its application for some time to come.

Amy Frey is a partner and Simon Maynard is counsel at King & Spalding LLP.

[1] https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/.

[2] European Commission Proposal for a Council Decision on the Withdrawal of the Union from the Energy Charter Treaty, 7 July 2023 (https://energy.ec.europa.eu/system/files/2023-07/COM_2023_447_1_EN_ACT_part1_v1.pdf).