

The Commission's draft proposal for the modernisation of the Energy Charter Treaty

Legal briefing

The Energy Charter Treaty (ECT) is a plurilateral trade and investment agreement applicable to the energy sector. The ECT was elaborated by the EU to secure a market economy approach for the reconstruction and restructuring of the energy sector in the former communist countries after the end of the cold war. In the absence of the protection afforded by the European Treaties in these countries, the ECT was designed to ensure the protection of foreign investments in the energy supply. It was signed in 1994, and both the EU and its Member States are parties to it.¹

The ECT covers aspects of commercial energy activities including trade, transit, investments and energy efficiency. Its Article 26 provides for investor-state dispute settlement (ISDS) which allows foreign corporations to sue states before private investment arbitration tribunals where it is alleged that government policy changes have damaged the profitability or viability of their investment.

Many cases under the ECT have led to large damages awards, in the hundreds of millions or billions of EUR, the types of damages that would not be possible under national law. Because of the risk that investors may initiate legal action using ISDS, governments may be discouraged from introducing new levels of protection or may be encouraged to revoke or dilute existing regulations.

To date, there have been 129 claims from energy companies under the ECT, who have used it to challenge government measures. Companies have already started using the treaty as a lobbying tool to put pressure on governments to avoid enacting new stringent regulations, shift their stranded assets onto states following new climate or environmental regulations, or challenge and delay environmental and energy policies².

In response to growing legal and political concern about the ECT, the Energy Charter Secretariat proposed the modernisation of the ECT. On 14 May 2019, the Commission submitted to the Council a recommendation for a Council decision authorising it to enter into negotiations on the modernisation of the ECT. On 15 July 2019, the Council gave a mandate to the European

¹ Italy left the ECT in 2016

² See for instance the threat of litigation by the German company Uniper against the Netherlands in relation to the decision to implement a coal phase-out; the case brought by British-based company Rockhopper against Italy over refusal to grant a concession for oil drilling in the Adriatic sea; or the cases brought by Vattenfall against Germany to challenge its nuclear phase-out and environmental restrictions on a coal-fired power plant. ISDS has also been used under similar treaties to challenge a range of environmental measures, including a coal phase-out and moratorium on fracking in Canada, and the rejection of an oil pipeline project in the United States

Commission to begin negotiations on the modernisation of the ECT, along with negotiating directives.³

This legal analysis looks at the draft Commission's proposal in the light of the two main objectives set by the Commission⁴: to ensure compatibility with EU law by bringing the ECT in line with new investment standards (section 1), and to ensure the ECT does not stand in the way of fighting climate change (section 2).

1. Compatibility with the autonomy of EU law

Following two recent judgments, the legality of the ECT has become very uncertain. This makes the Treaty very problematic for the EU. It has to deal with its intra-EU validity and applicability as well as to ensure its compatibility with EU law in its external application with non-EU Contracting Parties.

First, in 2018, in the landmark ruling *Achmea*, the Court of Justice of the European Union (CJEU) confirmed ISDS provisions in bilateral investment treaties between EU countries (intra-EU BITs) are incompatible with EU law because they sideline and undermine the power of EU courts.⁵ In order to comply with the *Achmea* ruling, the EU and its Member States have a positive obligation to remove the incompatibility by carving-out the application of the ECT among EU countries. If this is not dealt with through the ongoing modernisation process, there will be an urgent need to address this issue in parallel, through an inter-se agreement between the EU and its Member States.⁶ This would address the Commission's concerns about the flood of investment cases brought by EU investors against EU countries.

Then, in 2019, the CJEU decided differently in *Opinion 1/17* on EU treaties with third countries that include an ISDS mechanism. It clarified the constitutional principles and framework that guide the EU in its external action, and the conditions under which the EU can enter international agreements providing for dispute settlement. It follows from *Opinion 1/17* that the EU and its Member States must revise the ECT by incorporating safeguards equivalent to those in CETA's investment chapter to preserve the judicial and regulatory autonomy of the EU unique legal order.

Acknowledging the ECT provisions on investment protection have not been revised since the 1990s and are "no longer sustainable or adequate for the current challenges"⁷, the Commission sought to address this issue through the ongoing modernisation process of the ECT. However, the key elements of the EU's modern investment standards are absent from the Commission's draft proposal for a modernised ECT. First, the Commission's draft proposal does not provide for an investment court system (ICS) or equivalent guarantees of independence and impartiality. The ICS, the Commission's preferred ISDS model, is composed of a first instance Tribunal and an Appeal Tribunal and provides a more objective selection and appointment of Tribunal members. According to the CJEU, these elements are necessary to address one of the core criticisms of ISDS - the lack of independence and bias towards investors of ISDS arbitrators.

The Commission clarified that the modernisation of the relevant provisions of the ECT should only be conducted once tangible results have come out of the international ISDS reforms at the

³ Council of the European Union, Negotiating Directives for the Modernisation of the Energy Charter Treaty, 2 July 2019, <https://data.consilium.europa.eu/doc/document/ST-10745-2019-ADD-1/en/pdf>

⁴ Ibid

⁵ Laurens Ankersmit of ClientEarth and Layla Hughes of CIEL, "Implications of Achmea: How the Achmea Judgment Impacts Investment Agreements with Non-EU Countries", April 2018, <https://www.documents.clientearth.org/wp-content/uploads/library/2018-04-19-implications-of-achmea-judgment-coll-en.pdf>

⁶ Pursuant to Article 41 of the Vienna Convention for the Law of Treaties, the EU and its Member State are allowed to modify the ECT among themselves

⁷ European Commission, Recommendation for a Council Decision authorising the entering into negotiations on the modernisation of the Energy Charter Treaty, 14 May 2019, http://trade.ec.europa.eu/doclib/docs/2019/may/tradoc_157884.pdf

UNCITRAL Working Group III, where the EU is proposing a permanent multilateral investment court (MIC).⁸ The proposal therefore includes a reference to the future application of a Multilateral Investment Court to the ECT. However, the outcome of the UNCITRAL reforms remain highly uncertain, since several countries, including ECT members such as Japan, openly oppose this project. There is no assurance the EU will get sufficient support to lead to the adoption of its proposal. Furthermore, the (hypothetical) establishment of the MIC would take many years before being effective. Such timeframe is not suitable for addressing the immediate risks the ECT poses to the implementation of climate policies.

Second, the Commission's draft proposal clarifies that arbitral tribunals do not have jurisdiction to apply domestic law. Further textual safeguards equivalent to CETA Article 8.31 on applicable law were inserted in a footnote, which seeks to preserve the powers of the CJEU and the autonomy of the EU legal system by limiting the powers of the arbitration tribunals in relation to domestic law.⁹

In the absence of an intra-EU disputes carve-out, and if the ECT parties cannot agree on the introduction of sufficient guarantees for the independence and impartiality of arbitrators and appropriate safeguards for the interpretation and application of EU law, the modernised ECT is unlikely to be legal under EU law.

2. Consistency with sustainability and climate goals

The Commission intends to pursue a trade policy 'based on values'.¹⁰ The EU Treaties make clear that this is not only a policy preference but also a legal obligation. The Treaties state that in its relations with the wider world, the EU 'shall uphold and promote its values', 'contribute to the sustainable development of the earth' and the 'eradication of poverty and the protection of human rights, in particular the rights of the child'.¹¹ Moreover, the 'Union's action on the international scene shall be guided by [...] democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms'.¹² In light of these policy objectives and legal guidance, the EU should not promote International Investment Agreements (IIAs) that would allow investors to bring claims that violate these values.

Despite minor improvements, the Commission's draft proposal for the modernisation of the ECT does not fundamentally depart from the out-dated spirit of 'investment protection', nor does it effectively promote responsible and sustainable investments (section 2.1.), respect domestic courts (section 2.2.), preserve regulatory space (section 2.3.) and redress the imbalance (section 2.4.).

2.1 Promoting responsible and sustainable investments

The Commission's draft proposal does not embrace substantive changes to re-orientate priorities towards broader sustainable development objectives. If the ISDS mechanism remains, the Commission should make sure the agreement can only be used by responsible investors for

⁸ On 27 November 2017, the United Nations Commission on International Trade Law (UNCITRAL) Working Group III started discussing potential reform of the ISDS system, which provided the perfect forum for the EU to launch its initiative. After the European Commission obtained a mandate to negotiate the MIC in March 2018, the EU and its Member States officially submitted on 18 January 2019 its proposal to establish this MIC in the context of UNCITRAL. See the Commission's website on the MIC project, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1608>

⁹ In any case, it remains to be seen in practice whether future CETA Tribunals will not interpret and apply EU rules, other than the provisions of the CETA. In our views, the interpretation of EU law will thus occur de facto, even with the new ICS model of the EU

¹⁰ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Trade for All Towards a more responsible trade and investment policy, COM/2015/0497 final

¹¹ Article 3 (5) TEU

¹² Article 21 (1) TEU

investments that support the implementation of the Paris Agreement, as well as the European Green Deal and proposed Climate law.

(a) Differentiating low-carbon and carbon-intensive investments

First and foremost, in order to be coherent with its recent climate law, the EU should not allow preferential treatment to investors and their investments, without taking their impacts and contributions to achieving carbon neutrality and SDGs into account. This first requires a **distinction** to be drawn between low-carbon and carbon-intensive investments. As suggested by Nathalie Bernasconi and Martin Dietrich Brauch, the ECT could mirror the voluntary and bottom-up approach by Nationally Determined Contributions (NDCs) under the Paris Agreement.¹³ The ECT would require States to provide annexes and schedules listing low-carbon investments to be covered by the ECT. The approach in the recent initiative for an EU taxonomy of sustainable activities could serve as a basis for the determination of what constitutes a 'low-carbon investment'.¹⁴ The ECT should then expressly allow Contracting Parties to discriminate between low-carbon and carbon-intensive investments. This can be achieved by using the Contracting Parties' lists of low-carbon investments as the basis for defining covered investments, limiting the scope of investment protection and / or by restricting access to ISDS.

(b) Protecting only responsible investors

The Commission's draft proposal clarified in ECT Article 1(6) on 'investment' that investments must be made "in accordance with the applicable law and the domestic law of the host Contracting Party". In the footnote of ECT Article 26(4), the proposal also contains a list of reasons for excluding investors from ISDS as is provided under CETA Article 8.18(3). However, the list should be expanded to cover situations in which investors have committed fraud, human rights abuses, or otherwise violated national or international environmental, social, consumer, or labour laws. The aim of including such a '**clean-hands clause**' would be to exclude any claim regarding an investment that violates host state law.¹⁵

(c) Monitoring and enforcing effective sustainability provisions

The Commission's draft proposal includes new articles related to sustainability. While a reference to the Paris Agreement and the clean energy transition, along with provisions on Multilateral Environmental Agreements (MEAs) and Corporate Social Responsibility are all welcome, their language is not binding and enforceable.

The new requirement for impact assessment to be carried out prior to granting authorisation to a project is also a step in the right direction. The article should further provide for a procedure or at least criteria to identify the projects that "may have a significant impact".¹⁶ However, even a perfectly drafted provision would be useless if not properly implemented and enforced.

¹³ See further details on this Nathalie Bernasconi and Martin Dietrich Brauch, "Redesigning the Energy Charter Treaty to Advance the Low-Carbon Transition", Briefing Note, September 2019, Transnational Dispute Management, <https://www.iisd.org/library/redesigning-energy-charter-treaty-advance-low-carbon-transition>.

¹⁴ See the Commission initiative on a taxonomy for sustainable activities, https://ec.europa.eu/info/publications/sustainable-finance-teg-taxonomy_en.

¹⁵ Example of a clean hands clause based on Articles 8.1 and 8.18 (3) CETA: "An investor may not submit a claim if the investment has been made through fraudulent misrepresentation, concealment, corruption, conduct amounting to an abuse of process, fraud, human rights abuses, or not in accordance with the applicable environmental, social, and consumer law, including international law." The Dutch model BIT provides further that tribunals should decline their jurisdiction (Article 16(2)) in such cases, but also when the investors changed its corporate structure to gain protection under the agreement or to submit a claim against its original home state (Article 16(3))

¹⁶ For example the EIA Directive and the Aarhus Convention work with an Annex of activities for which a significant effect on the environment will always be assumed

These so-called “TSD” provisions are subject to a dispute settlement mechanism in line with its approach in recently concluded agreements. However, the EU’s approach to the enforcement of environmental provisions is rather cooperative and relies on dialogues, consultations and consideration by expert panels, which have so far not proven to be effective. To have a meaningful impact and actually influence the Contracting Parties’ behaviour, the sustainability provisions of the ECT must be bolstered by mechanisms that enable **comprehensive monitoring** of compliance **and robust enforcement** which discourage non-compliance. This mechanism should be transparent and inclusive (complaint procedures for CSOs), independent (not under the Charter Conference) and dissuasive (sanction-based).

(d) Holding investors accountable

The above-mentioned sustainability provisions cannot “force” investors to contribute to the Paris Agreement targets. If investors fail to take the protection of the environment, labour standards and CSR obligations into account when making investments, there is no binding obligation and mechanism to hold them accountable. Therefore, these provisions merely “green” the ECT objectives, but do not constitute a “fundamental shift”. The Commission should go beyond general and vague sustainability commitments by imposing best-efforts **obligations** on investors and setting up an **accountability process**.¹⁷

2.2 Respecting domestic courts

As mentioned above (section 1), the Commission did not seek to preserve the powers of the CJEU and the autonomy of the EU legal system by limiting the powers of the arbitration tribunals in relation to domestic law (as under CETA Article 8.31). Moreover, the Commission’s proposal would continue to allow foreign investors to bypass normal domestic legislative and judicial frameworks where applicable procedural rules have been developed and refined over time, reflecting important policy choices about the scope of public and private rights.

The ECT should thus **oblige parties to the proceedings to exhaust local remedies** (ELR) before bringing a claim at the international level. The principle of ELR is an important rule of international law that gives the State where the violations occurred an opportunity to redress the issue by its own means, within the legal framework of its domestic legal system. Investment agreements therefore go against a standing practice in international law and perpetuate the privileged status of foreign investors under international investment law.¹⁸ An ELR requirement would make ISDS a ‘subsidiary’ remedy, merely complementary to, and a limited corrective of, domestic legal processes and national policy choices, rather than being a substitute for domestic procedures.¹⁹

Moreover, the ECT **does not require ISDS to involve domestic courts or authorities** of the host State for matters of domestic law.²⁰ Investment arbitrators are generally specialists in international trade and investment law, and are not necessarily familiar with the intricacies of a domestic legal system. Instead, investment tribunal should be required to defer to local authorities

¹⁷ The inclusion of investors’ obligations in IIAs is not a novel idea: India’s Model BIT, for example, includes a number of obligations that investors must respect when they make an investment in a host country. See articles 9-12 of the India Model Bilateral Investment Treaty.

¹⁸ There are a few IIAs that do explicitly require ELR, including those of several Member States. See for instance the recent Albania-Lithuania Bilateral Investment Treaty and the Romania-Sri Lanka Bilateral Investment Treaty. An ELR clause could also be formulated as follows: “A state party, an investor, or an affected third party must exhaust local administrative and judicial remedies before it may submit a claim before the arbitration tribunal seeking damages for an alleged breach of an International Investment Agreement.”

¹⁹ Nico Krisch, Institutionalizing Subsidiarity in the Reform of Investment Adjudication, TheGlobal, January 27, 2020 <https://theglobal.blog/2020/01/27/institutionalizing-subsidiarity-in-the-reform-of-investment-adjudication/>

²⁰ Inspiration for this requirement to refer can be taken from the draft agreement providing for the accession of the European Union to the Convention for the Protection of Human Rights and Fundamental Freedoms

in order to ensure that they do not incorrectly read or apply domestic rules, or subordinate unfamiliar social and environmental interests to familiar investment ones.

2.3 Preserving regulatory space

The Commission's draft proposal tightens the language of the substantive provisions and reaffirms states' right to regulate. However, as long as the ECT contains an ISDS mechanism, cosmetic changes are not sufficient to shield effective and necessary climate response measures from ISDS challenges.

(a) Preserving State's right to regulate

How public and private interests are balanced by investment tribunals is highly problematic in the absence of transparency and guarantees of judicial independence and impartiality. The inclusion of a new article on regulatory measures is intended to strengthen States' rights to regulate. This is welcome. However, the first paragraph of the proposed article merely 'reaffirms' that the Contracting Parties, by definition as sovereign entities, possess the right to regulate. The following paragraph offers some improvement, as it seeks to clarify that investors' treaty-based privileges do not constitute a commitment from the Contracting Parties not to change their regulatory or legal framework. However, the formulation is merely a guideline for investors and arbitrators and does not constitute a proper **carve-out** for decision-making in the public interest that would ensure that investors cannot challenge public interest regulations in the first place.²¹ States could still rely on the ECT's State-to-State dispute settlement mechanism under Article 27, which is not as high-risk as ISDS.

Considering that there is currently no mention of the climate emergency in the ECT, the new article referring to the UNFCCC and the Paris Agreement is also welcome. However, this new article, even when read in conjunction with the new article on the right to regulate, is not sufficient to ensure the ECT cannot be used to challenge climate response measures. Consequently, in the absence of a general public interest carve-out, a **specific climate carve-out** could be introduced. In case an investor initiated a challenge against a climate response measure, access to ISDS would be subject to a mandatory preliminary reference procedure before a **panel of climate experts**. They would determine whether a measure's impact on investment is justified by its climate objectives. This determination should be guided first and foremost by a scientific evaluation of the measures' impact on emissions reduction. Such a process would ensure that climate expertise be applied to the range of complex questions that such measures necessarily arise. If it is determined that the measure challenged is a legitimate climate response measure, the dispute cannot be subject to arbitration under the ECT and must instead automatically be referred to national courts or eventually challenged before the State-to-State dispute settlement mechanism.

Furthermore, the Commission's draft proposal does not propose the inclusion of a **supremacy clause** clarifying to investment arbitrators that investment protections do not outweigh the EU's obligations arising out of international environmental, social and human rights agreements.²² The new article referring to and recognising Contracting Parties' obligations under MEAs as well as specifically under UNFCCC and the Paris Agreement is not sufficient to ensure arbitrators will interpret investors' privileges accordingly – i.e. as secondary to commitments in other international

²¹ A carve-out to protect public policy measures could be formulated as follows: "Any measure or action undertaken by a Party that aims or has the effect of contributing to a public interest, such as environmental protection including measures or actions combating climate change, social protection, consumer protection, and public health protection, does not constitute a breach of the provisions of this Chapter." Another example can be found under the Nigeria-Morocco Reciprocal Investment Promotion and Protection Agreement, 3 December 2006, Article 23.3, <https://investmentpolicyhub.unctad.org/Download/TreatyFile/5409>

²² A supremacy clause could be formulated as follows: "In the event of any inconsistency between an international investment agreement and any international environmental, social, or human rights agreement binding on one party to a dispute, the obligations under the international environmental, social, or human rights agreement shall prevail."

agreements. Arbitrators in many cases have demonstrated a lack of understanding of the complexities of environmental governance.²³ In the event of a conflict between these rules, there is a serious risk that investor protections will prevail over public social and environmental obligations. A supremacy clause would address this issue in a number of ISDS cases, where investment arbitrators have found that obligations under international environmental or human rights agreements cannot justify infringing on investors' rights.

Finally, the Commission has introduced a specific **non-regression clause**, according to which Parties shall 'strive to ensure' a high level of environmental and labour protection, and not to weaken or reduce the level of protection in order to encourage trade or investment. While this constitutes a step in the right direction, the provision contains significant shortcomings. The provision suggests that it prevents Parties from lowering levels of environmental protection or failing to enforce domestic laws, but makes clear that a Party is only prohibited from doing so (1) 'through a sustained or recurring course of action or inaction' (2) in order 'to encourage trade or investment'. This sets a very high burden of proof on the other Party to demonstrate that the Party in question failed to effectively enforce their environmental laws and has done so with the intention of encouraging trader or investment. This qualifying language should be amended or removed. Alternatively, the burden of proof should be reversed. When a Party is found to lower its level of protection or is found to have failed to effectively enforce its domestic laws, that Party should be required to plausibly demonstrate that this was not done in order to attract trade and investment.

(b) Restricting investment protection standards

Despite the European Commission's attempt to narrow down the most controversial provisions, as it did in CETA, nothing in these provisions effectively protects domestic policy space from erosion:

- The Commission's proposal for the fair and equitable treatment (ECT Article 10) falls short of real improvement. The article codifies that 'frustration' of an investor's '**legitimate expectations**' will breach the FET standard. This is one of the most far-reaching interpretations of FET. Codifying this interpretation is not a limitation of the standard, but an expansion of it. It allows tribunal to rely on the legitimate expectations of an investor to assess whether or not the government violated the FET standard. Moreover, the provision does not require a written promise or commitment in order for a legitimate expectation to be established: any form of 'representation' seems sufficient. This leaves room for wide interpretation and will most likely lead to a chilling effect on necessary and important domestic regulation.
- The Commission's proposal for indirect expropriation (ECT Article 13 and its Annex) is unsatisfactory. It only applies to 'non-discriminatory measures' that protect 'legitimate' public welfare objectives and to measures that do not 'appear manifestly excessive'. This merely invites additional scrutiny of domestic policies by private investment lawyers. It also creates a significant legal loophole, as it would be very easy for investors and arbitrators to present disruptive – albeit entirely necessary – emission reduction measures taken to achieve climate objectives as '**manifestly excessive**'..
- The Commission's addition "**in like situations**" to the national treatment and most favoured nation clause (ECT Article 10(7)) is not sufficient to allow differentiation and different treatments to low-carbon and carbon-intensive investments.

²³ As noted by Bonnitcha and Williams, "Investors regularly characterize state conduct as 'political' in order to discredit the conduct in question" and "many tribunals regard influence of broad interest groups over executive decision making processes as inherently illegitimate." See J. Bonnitcha, and Z. Williams, "Politically motivated conduct in Investment Treaty Arbitration", Investment Treaty News, Issue 1, Volume 10, April 2019, <https://www.iisd.org/sites/default/files/publications/iisd-itn-april-2019-english.pdf>

(c) Clarifying valuation methods

The prospect of the obligation to pay high compensation as a result of regulatory change may make it more difficult for host States to regulate in important areas such as human rights and environmental protection - including complying with their evolving international obligations. The Commission proposes to clarify that “valuation criteria shall be based on **internationally recognised principles** and norms to determine **fair market value**”. However, in certain situations, compensation equal to the fair market value of the investment may be inappropriate or unjust.²⁴ One such situation is when the investment is expropriated (or otherwise impacted) by a government in order to address climate change. This is particularly relevant in cases where the owner of the investment has made concerted efforts (e.g. lobbying, funding climate change denial, etc.) to delay action on climate change. The ECT should thus rather clarify that, when calculating a fair and adequate compensation, arbitrators should take into account all relevant circumstances and compensation amounts must be based on a fair balance between the public interest and the interests of the injured parties.²⁵ In addition, excluding **expectation of gain** or profit from recoverable damages would help to put foreign and domestic investors on a more equal footing. It would improve investment decision-making (i.e. by increasing the risk associated with investing in new carbon-intensive projects), and limit the ability of investors to use the threat of liability to prevent a country from implementing climate change measures.

2.4 Redressing the imbalance

The ECT does not include scope for States’ counterclaims, nor does it ensure participation rights for affected third parties. This is of particular importance given potential environmental impacts of investors, including their contribution to climate change.

Some tribunals have already recognized the right of states to bring **counterclaims** against the investor.²⁶ Unfortunately, rulings such as these are not the norm: counterclaims are generally unsuccessful in the absence of explicit language in the applicable investment treaty. The Commission’s proposal should include clarification that states are allowed to bring counterclaims and provide, in addition, for investors obligations (or refer to domestic law).

The Commission’s proposal does not ensure **full participation rights for affected third parties** in disputes beyond *amicus curiae*. Although important and valuable, the submission of *amicus* briefs alone does not provide sufficient participation for affected parties to ensure that their rights and interests are properly accounted for in proceedings.

Ensuring third parties’ participation rights would contribute to making investment arbitration more transparent, fairer and more inclusive. Opening up the jurisdiction of tribunals in this way would also ensure that dispute settlement could cover breaches of investor obligations that also need to be provided for in the agreement (e.g. related to environmental protection, human rights, and free prior and informed consent).

²⁴ Suzy Nikièma, “Compensation for Expropriation, The International Institute for Sustainable Development”, IISD Best Practices Series, March 2013, https://www.iisd.org/pdf/2013/best_practice_compensation_expropriation_en.pdf

²⁵ Southern African Development Community (SADC) Model BIT, Article 6.2; See also Schneiderman’s discussion of appropriate or flexible compensation in “Reviving the ‘Lost Art’ of Exit: Thinking About Substitutes for International Investment Law”, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3382060; Jonathan Bonnitcha and Sarah Brewin, “Compensation Under Investment Treaties (Advance Draft)”, IISD Best Practices Series, October 2019, <https://www.iisd.org/library/iisd-best-practices-series-compensation-under-investment-treaties>; Toni Marzal, “Rethinking the quantification of damages in international investment arbitration”, 5 March 2020, <https://verfassungsblog.de/we-need-to-talk-about-valuation-in-isds/>.

²⁶ Edward Guntrip, “Urbaser v Argentina: The Origins of a Host State Human Rights Counterclaim in ICSID Arbitration?”, EJIL:Talk!, <http://www.ejiltalk.org/urbaser-v-argentina-the-origins-of-a-host-state-human-rights-counterclaim-in-icsid-arbitration/>

Conclusion

The EU has a crucial and leading role to play in addressing the climate emergency. In order to achieve international climate goals and make the EU climate-neutral by 2050, the European Commission has recently delivered its plan for a European Green Deal and proposed a new Climate Law. The implementation of these initiatives will require ambitious targets and bold measures.

However, we see the Energy Charter Treaty as a significant obstacle to EU and Member States climate action.

As demonstrated in this briefing, the European Commission's draft proposal for the ongoing modernisation process of the ECT is insufficient to shield states' climate efforts from ISDS challenges if that mechanism stands intact. The proposal tightens some of the ECT's vague language with respect to definitions and substantive investment standards, and reaffirms states' right to regulate. However, while this gives some guidance to arbitral tribunals (or if it ever came to exist, the MIC), there is still a risk of being sued in international arbitration for implementing strong and progressive climate measures.

Importantly, the ECT, even if revised according to the Commission's proposal, would still lead to a dangerous chilling effect on environmental and social regulation. The fossil fuel industry does not need to win on the legal arguments. The threat or initiation of an ISDS claim can be enough to delay or undermine policy action, even across borders, regardless of the arbitration's outcome.

Cosmetic changes, as suggested by the EU, will not amount to 'modernisation' and will fall far short of making the ECT fit-for-purpose. Without more significant changes, it will not contribute to the achievement of the EU's and its Member States' climate action objectives. This process should be used as an important opportunity to transform the ECT into a positive force for the clean energy transition.

In order to effectively reduce the risk of regulatory chill for climate action, and align the ECT with the EU's overarching objectives to combating climate change, the EU should at minimum:

- Ensure mutual supportiveness between environmental and economic goals set at the international level by redesigning the ECT to help achieve states' international climate commitments;
- Differentiate low-carbon from carbon intensive investments and encourage capital flows to shift swiftly away from investments in fossil fuels and other carbon-intensive energy sources toward low-carbon investments in clean, renewable energy;
- Shield climate response measures from ISDS challenges via a specific ISDS carve-out;
- Clarify that investment protection may not come at the expense of the human rights and environmental obligations;
- Ensure respect of domestic courts and institutions through a requirement to exhaust local remedies; and
- Hold investors accountable.

Amandine Van Den Berghe

Lawyer/Juriste, Trade & Environment

60 Avenue du trône

1050 Brussels

+32 (0) 2808 0484 AVanDenBerghe@clientearth.orgwww.clientearth.org

ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

ClientEarth is funded by the generous support of philanthropic foundations, institutional donors and engaged individuals.

Brussels

Rue du Trône 60

5ème étage

1050 Bruxelles

Belgique

London

274 Richmond Road

London

E8 3QW

UK

Warsaw

ul. Żurawia 45

00-680 Warszawa

Polska

ClientEarth is a company limited by guarantee, registered in England and Wales, company number 02863827, registered charity number 1053988, registered office 10 Queen Street Place, London EC4R 1BE, with a registered branch in Belgium, N° d'entreprise 0894.251.512, and with a registered foundation in Poland, Fundacja ClientEarth Prawnicy dla Ziemi, KRS 0000364218.