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Reforms to the Energy Charter Treaty: Rebalancing International Investment Law or a Step Too Far?

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The Energy Charter Treaty (ECT) is a multi-party investment treaty covering investment in the energy sector. Established in the 1990s, the ECT has over 50 signatories, including the UK. The ECT contains many of the traditional protections for foreign investment found in international investment agreements (IIAs), and much like international investment law generally, the treaty has been subjected to widespread criticism in recent years. The ECT has been particularly vilified for its alleged failure to deal with climate change by maintaining extensive protections for industries that supposedly contribute to this global problem.

As a consequence of the green energy movement as well as the more general backlash against investment law, especially investor-state dispute settlement (ISDS) proposals to ‘modernize’ the ECT gained traction and an updated text was put before ECT signatories last summer. Since then, ongoing dissatisfaction with the lack of sufficiently progressive elements in the original ECT led to a number of EU member states to withdraw from the instrument last fall including Poland, Spain, France and Germany. For many of these countries, abandoning the ECT may be primarily performative – it demonstrates the seriousness of their commitment to fight climate change, a policy which remains high on the agenda for many world governments and international organizations, even if it is of minimal interest to most voters.

Yet even as it appeared that the ECT had to reform or die, in November of 2022 at the ECT Conference, the signatories postponed the adoption of the modernized treaty, planning to revisit the matter at an ad hoc meeting in April. Since withdrawal from the ECT becomes effective only after a one-year notice period, the old ECT remains intact for the majority of its membership. Even following withdrawal, the treaty’s sunset provision provides that investments made prior to withdrawal are still protected for another 20 years. Still, it is worth considering some of the proposed amendments to the ECT. They respond to many of the central criticisms of international investment law and its enforcement process.

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With its main focus evidently on combatting human-induced climate change, the modernized treaty would introduce new provisions to reaffirm the respective rights and obligations of the contracting parties under other multilateral instruments such as the UN Framework Convention on Climate Change, and the Paris Agreement. Likewise, the new ECT would incorporate provisions emphasising the contracting states' "right to regulate" in the interest of legitimate public policy objectives. These would expressly include the protection of the environment, including climate change mitigation and adaptation. The addition of "right to regulate" clauses has become commonplace in the new generation IIAs such as the Canada-EU Comprehensive Economic and Trade Agreement (CETA), and the 11-nation Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). "Right to regulate" was arguably designed primarily to enlarge states' ability to enact laws relating to public health, an essential responsibility of any government. But the specific reference to climate change in the ECT breaks new ground. Given the inherent ambiguity of the concept of climate 'change' and difficulties in establishing causation, it is easy to see how this provision could end up creating a blanket right for states to intervene in the energy sector without fear of consequence.

The new ECT would also create a "flexibility mechanism", which would allow contracting states to exclude investment protection for fossil fuels in their territories. The EU and the UK reportedly intend 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 August 2023. This could have wide-reaching implications, paving the way for windfall taxes against energy companies, such as those which have already been implemented in the UK and the EU. Until renewable energy becomes more secure, this provision could end up endangering investment in the traditional energy sector at a time when the world's supply of fossil fuels is in jeopardy.

Turning to some of the more generic perceived flaws in the ECT, which encapsulate much of the modern derision towards international investment law generally, the updated ECT is designed to narrow the scope of protections to cover fewer investors and investments and in a more limited range of circumstances.

The revised ECT would tighten the concepts of both "investor" and "investment" by requiring that an "investor" satisfy a substantial business activities test based on factors such as physical presence, employment of staff, turnover generation or payment of taxes in the host state. It would also exclude from the definition those who are nationals or permanent residents of the host state at the time of making an investment. “Investment” would be defined investment by reference to an indicative list of characteristics similar to the *Salini* Test criteria: including commitment of capital, expectation of gain, duration and risk.

On substantive protections, the revised ECT would narrow the scope of the key protections available to investors. The notoriously vague and much maligned Fair and Equitable Treatment (FET) standard would be tightened with a view to increasing legal certainty. This would be done through a list that designates certain measures or series of measures that constitute a violation. This would include some of the familiar types of FET such as frustration of an investor’s legitimate expectations, but crucially the new article will describe circumstances that give rise to investor’s legitimate expectations and the conditions under which legitimate expectations may be considered. Since FET is the most commonly claimed standard in investment disputes, this provision could severely neuter the ECT’s protective effect. Meanwhile, FET’s sister provision, Full Protection and Security (FPS) would be defined so as not to include legal security, covering only physical harm to assets. This is probably a welcome change since the FPS standard’s extension to legal harms was arguably an unnecessary overlap with FET.

A revised expropriation provision in the ECT would include a list of factors to be considered to assess indirect expropriation claims – another one of the chief points of criticism against international investment law as a consequence of its alleged chilling effect on regulatory autonomy. This provision would state that, as a general rule non-discriminatory measures that are adopted to protect legitimate policy objectives, including with respect to climate change mitigation and adaptation, do not constitute indirect expropriation. Again, given the complex causality associated with climate change, this provision could be potentially incredibly far-reaching.

Resolving a long-standing point of dispute in international investment law, the ECT’s Most Favoured Nation (MFN) provision would expressly not cover dispute settlement, meaning that investors could not bring in more favourable kinds of dispute settlement from other treaties signed by the relevant host state.

On ISDS, perhaps the most controversial aspect of international investment law, the new ECT would ensure that ISDS provisions of Article 26 will not apply among contracting parties that are members of the same Regional Economic Integration Organisation, such as the

EU. This would set straight the EU's existing position that the ECT's ISDS provisions on dispute settlement do not apply between EU members states.

In order to resolve the problem of frivolous claims in ISDS, as often identified by critics and in keeping with changes to ICSID rules, the new ECT would include mechanisms for dismissal of claims that are manifestly without legal merit or submitted as a result of investment re-structuring for the sole purpose of bringing a claim under the treaty (known as Treaty Shopping). The new ECT's provision on security for costs will explicitly provide for the possibility of requesting security for costs from the claimant. Parties would also be required to disclose information on third-party funding. These could discourage speculative claims designed to pressure settlement.

The so-called modernization of the ECT is a good illustration of many of the reforms underway to ISDS undertaken by UNCITRAL and ICSID, as well as some of the progressive elements of the new generation international investment agreements. In that sense it could be described as an example of "best practice" or a "gold standard" of international investment law treaty-making. It would appear to achieve much in the way of re-balancing this regime in favour of host states, enabling them to safeguard their ability to regulate in matters of the public interest. On the other hand, severely undermining investors' protections, in particular in relation to far-reaching policy objectives such as climate change, could risk discouraging investment in the energy sector at a time when it is most needed. If the war in Ukraine continues into April, which seems likely, it will be interesting to see whether the revised ECT as proposed is adopted in its current form.