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## Energy Charter Treaty and the Paris Agreement – Friends or Foes? – 7th EFILA Lecture (28 October 2021)

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(\*)

### Abstract

In this lecture the question was answered whether the ECT and the Paris Agreement are friends or foes? The conclusion is that so far they appear never to have even talked to one another. At least in the ECT jurisprudence, it seems as if energy investment law and climate law exist in parallel and at times very different worlds. In light of the urgent climate crisis, this needs to change.

### 1 Introduction

If the world is to meet the climate goals, and by now most countries have committed to Net Zero carbon emissions by 2050 or earlier, all lawyers must play a proactive and engaged role in accelerating the transition.

Perhaps this was best said by US Special Presidential Envoy for Climate John Kerry, speaking earlier this summer to the members of the American Bar Association. In his speech, John Kerry said:

You are all climate lawyers now, whether you want to be or not”, and “We need your skills, your expertise, and hard work to lay the legal pathways and to expedite our progress. (1)

At Climate Change Counsel we couldn't agree more.

In August 2021, the Intergovernmental Panel on Climate Change (ipcc) reported that “human-induced climate change is already affecting many weather and climate extremes in every region across the globe”. (2) The ipcc also reported evidence of observed changes in weather extremes such as heatwaves, heavy precipitation, droughts, and tropical cyclones, and, in particular, that their attribution to human influence, had strengthened since the previous Assessment Report in 2014. (3)

Climate change is happening now. But we do not need to consult the ipcc report to get a sense of what is going on. It is enough to follow the news where noticeable effects of temperature increases and weather events have brought climate change into the mainstream view.

Today we are only a few days away from the opening of cop26, and this is dominating a large portion of the daily media reporting. An important element of the expectations that have been building up is that the outcome of the meeting will support the development of strong policies. (4) The necessity of energy-related infrastructure investments is very much a part of the discussions leading up the meeting in Glasgow, and it is also a vital component of the issue whether governments will be able to deliver on their climate change commitments and meet the 1.5°C target. (5)

The calls for long-term and stable policies to foster investments in support of climate change mitigation and adaption measures is not something new. We have heard these calls for many years. (6)

In May 2021, the International Energy Agency (iea) released the report *Net Zero by 2050: A Roadmap for the Global Energy Sector*. (7) The pathway for global Net Zero by 2050 as outlined by iea includes efforts across many areas, including vast amounts of investment, innovation, skilful policy design and implementation, technology deployment, infrastructure building, and international co-operation. (8) Additionally, the iea report emphasizes that investments to reach the Net Zero target includes: (1) a historic surge in clean-energy investment, (2) no investments in new fossil fuel supply projects, and (3) no further final investment decisions for new unabated coal plants. (9)

To summarize, the climate change crisis and the Paris Agreement targets clearly send us

P 177  
P 178

P 178  
P 179

in the direction of very large investments in energy, with a clear focus to de-carbonize the energy sector. Which brings us to the Energy Charter Treaty (ect).

## 2 ect Arbitration and Climate Change

This audience of course is no stranger to the ect. The ect is held by some as the most important of the bilateral and multilateral trade agreements that govern trade and cross-border investments in energy and energy-related transactions. Signed in 1994, the ect resulted from an international effort to facilitate cross-border energy transactions following the end of the Cold War. (10) Today, the ect has more than 50 state signatories from Europe, Central Asia, and other regions. (11)

The ect establishes a framework for cooperation in the energy industry, provides for free trade in energy products and freedom of energy transit, includes certain investor protections, and aims to stimulate foreign direct investments (12) The ect is also currently undergoing a thorough review, commonly referred to as the ect modernization process, and the Member States have undertaken several rounds of negotiations, including three rounds in 2020 and a total of six rounds in 2021. (13) Meanwhile, ● the ect modernization negotiations have been concluded in June 2022. (14)

P 179  
P 180

One of the most debated issues in the modernization negotiations is whether and how the ect should be revised to align with the global climate goals and support the clean energy transition. The fact that the ect provides equal protection to all investments in the energy sector, regardless of whether the energy source is fossil-based or renewable, is one of the elements in this debate. (15) And one observation in this context is that the iea investment recommendations in the report mentioned above could be said to contrast with the ect's fuel- and technology-neutral protection of all investments in the energy sector.

The 2015 Paris Agreement has been ratified by 191 states and the European Union, representing over 98 percent of the world's emissions. This represents near-universal global consensus on the need to act to reduce greenhouse gas (ghg) emissions to limit global average temperature rise to well below 2°C, preferably 1.5°C, above pre-industrial levels. (16)

Most parties to the Paris Agreement have set Nationally Determined Contributions (ndcs), as required by the Agreement. (17) These typically aim to cut emissions significantly by 2030, and to attain climate-neutrality or "Net Zero" carbon emissions by 2050. (18)

It is widely recognized that reaching these targets requires an unprecedented overhaul of energy systems around the world, including most importantly a transition away from coal, oil and gas to renewable energy sources. (19) In a report published in October 2021 on the State of Climate Action, (20) a number ● of bright spots in climate change mitigation are pointed out, for example an exponential growth in wind and solar power over the past two decades. But the report also states that the public and private sectors, as well as philanthropy and civil society, must continue to step up and accelerate the investments needed to maintain a climate-safe world for all.

P 180  
P 181

There is a broad spectrum of views on how the ect fits into the context of the Paris Agreement and the clean energy transition.

On one end of the spectrum, it is held that the current version of the ect supports the energy transition by encouraging and protecting investments, including those in renewable energy, and holding states accountable for regulatory changes, including those affecting the energy transition. Others say that an investment treaty is not the right place to implement global climate targets, and that the ect therefore should remain technology-neutral and leave it up to governments to implement the necessary policies to achieve their desired energy mix.

On the other end of the spectrum, it is said that the ect hinders the energy transition by protecting fossil fuel investments and using tax money to compensate fossil investors. Investor claims under the treaty, or even threats of such claims, are deemed to cause a "regulatory chill" that restricts states' ability or willingness to change laws and policies in the energy sector. Some argue that the only solution is to abandon the ect, while others advocate for thorough reform of the treaty's language. (21) This brings us to the main question of whether the ect and the Paris Agreement are friends or foes?

## 3 The Study

To explore this question, Climate Change Counsel performed a study of the available ect awards to assess the ect’s interaction with the clean energy transition. The study is intended to provide an objective review of ect arbitral awards, and designed to assess the interaction between investor protection, energy transition policy, and climate change agreements. It is a project in collaboration with the Net Zero Lawyers Alliance (nzla) (22) funded by a philanthropic foundation.

Through stakeholder interviews, desk studies and a thorough review of the jurisprudence, the study looks at if and how arbitral tribunals in the past have weighed the treaty’s investor protections against the host state’s energy policies and commitments under international climate law.

Examples of questions examined in the course of the study include (i) what type of energy sources the investments consist of or align with, (ii) the role played by energy policy in the party’s submissions or in the reasoning of the Tribunal, (iii) how, if at all, climate change related policy appears in the award, and (iv) if tribunals in the past have considered state action motivated by international commitments.

The purpose of the study has been to view the awards through an energy transition lens and describe the facts as found from an objective perspective. Many additional and interesting questions presented themselves in the stakeholder interviews and in the review of the awards, many of which unfortunately fell outside the scope of the study. This applied for example to the issues of whether awards had affected the general energy mix of states, if and how any compensation received by investors had been reinvested, and whether the mere threat of recourse to investment arbitration prevents states from taking measures that would accelerate the clean energy transition (so called “regulatory chill”).

### 3.1 Findings

The final report, titled *The Energy Charter Treaty, Climate Change and Clean Energy Transition* has been published in early 2022 after the lecture was delivered. (23) In the following sections some preliminary findings are presented before the final report was published.

### 3.2 Numbers

A first look at the numbers reveals the following. (24) First, of the 64 awards reviewed, 42% relate to investments in solar energy, 16% to oil and 12% to gas. ●

In the 21 awards relating to investments in fossil fuels, 36% represents investments in infrastructure, 29% exploitation and 19% exploration. Second, all awards relating to oil and gas did not touch upon policy issues such as energy transition, climate change, or obligations under climate law. Rather, the disputes concern isolated issues stemming from denials of licenses, contractual breach, or discriminatory conduct. (25) In other words, they are not systemic in character. In contrast, the renewable energy cases are more about changing the entire energy mix of the state.

### 3.3 Climate Change Law

International climate change law is not a central element in the jurisprudence. For example, the United Nations Framework Convention on Climate Change (unfccc) from 1992 is mentioned in 19% of the awards, but only by way of background to the facts and never in the reasoning of tribunals. Equally, 78% of the awards have no mention of the 1997 Kyoto Protocol, and only one award includes a reference to the 1997 Kyoto Protocol in the tribunal analysis. In short, climate change is not discussed in depth any of the 64 awards examined.

### 3.4 Environmental Aspects of the ect Itself

The ect contains provisions on sustainability, renewable energy, and coordination of energy policy. The treaty’s preamble refers to energy efficiency, environmental concerns, and mentions the unfccc. However, none of these provisions have played any significant role in investor-state disputes to date. Article 19 of the ect contains interesting language on Environmental Aspects. It requires that signatory states “minimise, in an economically efficient manner, harmful environmental impacts arising from energy use” and that they “take account of environmental considerations throughout the formulation and implementation of their energy policies”.

Article 19 is found in part iv of the ect, and the dispute resolution provision in Article 26 of the ect covers only obligations stated in Part iii of the ect. However, in three awards Article 19 appears in the tribunal's reasoning, and the language surrounding Article 19 in the awards is an area which we will analyse in more detail ahead. (26) ●

### 3.5 Applicable Law

One question which surfaced in the stakeholder interviews was the issue of applicable law. What sources of law do tribunals use and is climate change law part of the picture?

Each case under the ect operates under a set of procedural arbitration rules containing a provision on applicable law. The procedural rules of the International Centre for Settlement of Investment Disputes (icsid), the uncitral Arbitration Rules, or the Arbitration Rules of the Stockholm Chamber of Commerce (scc) contain similar applicable law provisions, in essence stating that the arbitrators should decide the merits of the dispute on the basis of the law agreed upon by the parties, and that, in the absence of such agreement, the arbitrators shall apply the law or rules of law that it considers most appropriate. (27)

The parties making the choice are the state parties to the treaty, as opposed to the investor initiating the arbitration.

In ect investor claims, the law agreed upon by the parties is specified in ect Article 26(6), which provides that an arbitral tribunal established under the treaty "shall decide the issues in dispute in accordance with the ect and the rules and principles of international law".

When discussing ect Article 26(6) in stakeholder interviews, some stakeholders saw this provision to have some potential from a climate perspective. Firstly, because Article 26(6) considers the treaty as a whole document, including the language on sustainability and energy efficiency in Article, and second, because it opens up for an application of "the rules and principles of international law" to be applied in ect investor state disputes – including state obligations under international climate law, such as the Paris Agreement. Many of the stakeholders interviewed were also of the opinion that Article 26(6) has not been fully utilized, and that exploring the boundaries of governing law would be a specific interest going forward.

At the outset of the study, one hypothesis was that there would be interesting findings relating to how tribunals have interpreted the ect in accordance with international environmental or climate agreements. It turns out none of the 64 awards examined contains such reasoning. The fact that so few ect ● awards even mention other international obligations regarding sustainable development and clean energy transition is an interesting finding in itself.

In the absence of any precise examples of climate change law being applied in the reasoning of the tribunals, could the principles for applicable law, including as referred to by tribunals, be of interest to understand the relationship between the ect and international climate change law? Could other sources of international law influence the definition of legitimate expectations? There is tribunal language that points in that direction, and this will be examined further in the final report. The study will also look at how tribunals have interpreted ect investor protections in the context of conflicting EU obligations, which may indicate how future tribunals could rule on conflicting obligations under the ect and climate law. (28)

### 3.6 Energy Transition

Very few of the 64 awards discuss or even mention energy transition, and none of them discuss whether a state action motivated by energy transition constituted a breach of ect investor protections. The reasoning surrounding the challenged state action focus on fiscal policy and related issues. In other words, even where the original state policy was motivated by energy transition, this perspective does not seem to have influenced how parties have later argued and tribunals decided cases.

Where tribunals have had reason to balance the state's right to regulate against an investor's legitimate expectations, the state policies addressed and analysed have related to budgetary concern on state level, or the cost of energy for end consumers, and not energy transition policy objectives.

Many of the awards with investments in renewable energy turn on the fair and equitable

treatment (fet) standard, and the boundaries of investor's legitimate expectations. For example, what does an "assurance" or a "commitment" from the government look like and how should a change in the regulatory framework be assessed in this context? Tribunals have answered this question differently. (29)

P 185

P 186

Perhaps this is the part of the current jurisprudence that will be of most interest for stakeholders looking to understand how future tribunals will respond to investor claims challenging state actions seeking to phase out fossil fuels in the ambition to meet climate targets under the Paris Agreement. The first of such "phaseout cases" were filed under the ect this year. (30) German coal power producer rwe filed an icsid-claim against the government of the Netherlands, following the Netherlands' plans to end coal-fired power production by 2030. (31) A few months later, German energy company Uniper also filed a dispute against the Netherlands alleging that the government's plan to phase out coal by 2030 violates the Energy Charter Treaty. (32) However, recently, Uniper had to withdraw its claim against the Netherlands as part of the German government's bail out package because Uniper was at the brink of bankruptcy and has now be nationalized. (33)

There might be more phase-out cases to come as countries pass legislation aimed at reducing emissions by 50% until 2030 and to reach Net Zero carbon emissions by 2050. These cases will certainly test the Energy Charter Treaty and the people involved.

#### 4 Friends or Foes?

To conclude, I would like to end with a personal reflection.

I have worked with international disputes for more than 20 years. At the scc I have seen probably well over 2,000 disputes, and if there is one common denominator for all of them, it is that disputes always represent a failure.

P 186

P 187

Disputes almost always represent a break-down of relations and expectations, notwithstanding who is right or wrong from a legal perspective. A dispute means that time and money need to be spent figuring out what happened, who was responsible and, if possible, how to repair the damage. For any organisation, public or private, disputes are at the very bottom of the list of things managements want to spend time and money on. Investment disputes are no different.

The energy transition is urgent. Time and money should be spent not on dispute but on designing climate and investment policy and carrying out energy investments. An important question which therefore needs to be asked in relation to the ect jurisprudence is the following: what can we learn from previous failures?

It is pointed out by iea in its 2021 report mentioned earlier that almost half the reductions needed for the 2050 target are expected to come from technologies that are currently at the demonstration or prototype phase. (34) Investments need to keep coming.

We have less than ten years to the necessary 2030 milestone and investment cycles for 2050 are happening now. There is no time to solely focus on negotiating new agreements and treaties, but time also needs to be spent on figuring out on how to best work with what we have. To this end we need to listen to science and use the full spectrum of international law to the best of its potential.

P 187

Returning to the question *ect and Paris Agreement – friends or foes?* I would claim that they are neither, because they appear never to have even talked to one another. At least in the ect jurisprudence, it seems as if energy investment law and climate law exist in parallel and at times very different worlds. This needs to change. ●

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- 24) The cut-off date for the study is 3 August 2021.



- 25) The study is limited to awards rendered but recognize that there have been additional claims challenging regulations relating to fossil energy sources, e.g., *Vattenfall v Germany* in 2009 (coal, settled), *Rockhopper v Italy* (offshore drilling, pending), and two current coal-phaseout cases against the Netherlands.
- 26) For additional reading, see Chapter 5 of the final report *The Energy Charter Treaty, Climate Change and Clean Energy Transition*.
- 27) See uncitral Arbitration Rules Article 35, scc Rules Article 27. The language of the icsid Convention is slightly different, see Article 42: “The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable [...]”.
- 28) A full account of the findings in this regard is available in Chapter 6 of the final report *The Energy Charter Treaty, Climate Change and Clean Energy Transition* (2022) [https://www.climatechangecounsel.com/\\_files/ugd/f1e6f3\\_d184e02bff3d49ee8144328e6c45215f.pdf](https://www.climatechangecounsel.com/_files/ugd/f1e6f3_d184e02bff3d49ee8144328e6c45215f.pdf) accessed on 12 July 2022.
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