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BULLETIN

The Significance of the Energy Charter Treaty and Perspective for Reform

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The Energy Charter Treaty (ECT) allows energy companies to protect their foreign investments in fossil fuels, among others. It is controversial, though, because the treaty makes it difficult for its parties to implement ambitious climate policy and decarbonise their economies. The current debate on reforming the ECT creates an opportunity to amend the treaty to better fit the EU's—and Poland's—needs. However, if the negotiations are delayed further, it would be advisable to abandon the treaty.

Origins of the ECT and Main Provisions. The genesis of the ECT dates back to 1991 when 50 parties (mainly the countries of the former Western and Eastern blocs) signed a political declaration, the "European Energy Charter". This political process aimed mainly to ensure the protection of investments in former Soviet countries and transparent rules of trade in energy resources and their transit. It was supposed to facilitate promising energy cooperation: in 1991, former Soviet countries had around 11% of the world's oil and 30% of its natural gas reserves. Meanwhile, OECD countries—those with financial resources and modern technologies—accounted for around 60% of the world's oil and 50% of its gas demand. From a political perspective, the initiative was also part of closer cooperation between the Western countries and Russia after the disintegration of the Soviet Union.

In 1994, negotiations of the binding Energy Charter Treaty were completed and it was signed, entering into force in 1998. It currently has 56 parties, including the EU as party, almost all European and Central Asian countries, Australia, Japan, and others. The ECT focuses on facilitating non-discriminatory rules for the trade of energy resources, energy-related equipment and others, as well as the transit of energy resources, protection of foreign investments, and a process for settling disputes between investors and host states.

ECT in Practice. The treaty gives companies access to an investor-state dispute settlement (ISDS) system. The ISDS allows a foreign investor to sue a state that has introduced regulations it believes violate its rights under the ECT. The case is brought before an arbitration tribunal and, if the claimant is successful, the country must pay compensation. This is particularly important when there is no bilateral investment agreement (BIT) between the state where a foreign investor is headquartered and the investment host state. For example, the ECT allowed foreign shareholders of the oil and gas company Yukos, which was nationalised by Russia in 2003, to be awarded record compensation of more than $50 billion in 2014. In that award, the tribunal's findings included that the Russian authorities had demanded the repayment of alleged tax arrears to bankrupt the company. The real purpose was to remove the head of Yukos and Vladimir Putin's political opponent, Mikhail Khodorkovsky, and also send a warning to other oligarchs. Another example of the ECT in practice is the case against Kazakhstan initiated by the shareholders of Tristan Oil, a company involved in oil and gas projects in that country. The tribunal awarded more than $500 million in compensation for the nationalisation of the company in 2010 based on false accusations by Kazakh state institutions.

However, the ECT has also become a tool for challenging environmental regulations in EU countries by companies

involved in the extraction and processing of fossil fuels. For example, in 2021, lawsuits against the Netherlands were brought by the companies RWE (for €1.4 billion) and Uniper (€1 billion) against the ban on electricity production from coal from 2030, which will affect coal-fired power plants they launched in recent years. Although the ECT provides for cooperation on environmental protection, its general provisions do not provide grounds for rejecting such lawsuits.

There are also problems with compliance with EU law in arbitration between EU investors and EU Member States—currently the vast majority of cases under the treaty. In Achmea from 2018, the Court of Justice of the EU (CJEU) stated that intra-EU arbitration violates the principle of the primacy of EU law, and such disputes should be resolved by the national courts of EU countries. However, it was unclear whether this also applied to proceedings initiated under the ECT. The arbitral tribunals said no, the European Commission (EC) said yes. An opinion in line with the opinion of the EC was presented this year by one of the Tribunal's Advocates General. The CJEU will have to address this issue in response to a request by Belgium in 2020 for the court's opinion.

Discussion about ECT Reform. Given the controversies, a process to reform the ECT started in 2017. It will be difficult, though, since all parties to the treaty must reach consensus. The EU is the biggest supporter of the changes. It aims to include provisions in a revised ECT that guarantee it cannot undermine any new legislation protecting the environment, climate, and public health and also include the EU's third-party access rule on transit.

The EU also proposes shortening the protection period for existing investments in fossil fuels to 10 years and excluding such future investments from protection. Moreover, the EU calls for replacing the treaty's ISDS system with a multilateral investment court and blocking the possibility to sue countries by companies that have no real economic activities in the EU. Some of these postulates (e.g., on restraining claims) are supported by Albania, Georgia, Turkey, and others. Some energy exporting-countries such as Azerbaijan, Kazakhstan want the ECT provisions on transit and access to infrastructure to be more favourable for them. Russia does not recognise itself as an ECT party, but state-owned Gazprom and Switzerland-based NS2AG have tried to use the treaty to legally challenge EU regulations that ensure transparency in the operation of the Nord Stream 2 gas pipeline (Russia also shares the above-mentioned concerns regarding the transit). Japan is against changes to the ECT, while the UK and Norway are sceptical of changes.

There's a consensus in the EU on the need to modify the ECT and the Member States' negotiating mandate in 2019 concerning the reforms. Some Member States, such as France and Spain, support radical changes, calling on withdrawal from the treaty unless progress in the negotiations is made—Italy withdrew from the ECT in 2015, the only EU country so far to do so. The problem is that the ECT's "sunset clause"—even in case of withdrawing from the treaty—allows investors to sue countries for up to 20 years after the effective withdrawal date. That period could be shortened if all parties agree to it, but it is unlikely that the signatories outside the EU would do so.

Prospects. The year 2021 is likely to be a decisive one for the future of the ECT. Maintaining the treaty as it stands may hinder the EU's energy transformation and the achievement of the goal of climate neutrality by 2050. The Union thus faces two options. The first one is to still count on reform that increases the freedom to introduce new regulations protecting the climate or phasing out the protection of investments in fossil fuels. The second one is the termination of the treaty which would start the 20-year period after which the EU and its countries would no longer be at risk under the ECT.

Since some parties to the treaty do not want to change a situation that is favourable to them, the negotiations are likely to drag on. Therefore, the EU should set and announce a deadline by which it expects the changes to happen. If they do not, together with the Member States, the EU should terminate the ECT. A temporary partial solution would be the conclusion by the Member States of a separate treaty between them in which they waive the possibility of using arbitration by national entities under the ECT. As a result, the number of cases against EU countries would be significantly reduced, limited to those brought by investors from outside the EU. An alternative to a treaty between EU members might be a clear opinion by the CJEU critical of the continued use of the ECT in intra-EU disputes. In the event of the termination of the treaty, the protection of investments of EU countries in ECT countries and vice versa will still be possible based on BITs, which due to the small number of parties to each may be adapted much easier to climate protection and other needs. It also will be possible to enforce claims pursuant to agreements concluded by the EU, in which case it will be up to the EC to ensure regulatory freedom or compliance of arbitration solutions with Union law.

Due to Poland's slower decarbonisation plan than, for example, that of the Netherlands, ECT lawsuits against Poland related to phasing out coal from the energy mix are unlikely. The country supports the EC's efforts to change the ECT, but because of the role gas is to play in the Polish energy mix, it seems reasonable to strive to ensure that a reformed ECT does not affect gas investments. In this context, it will also be important whether the Commission recognises natural gas as a sustainable energy source contributing to the energy transformation—a decision on that is expected this year.