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Beyond repair? The Energy Charter Treaty

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Beyond repair? The Energy Charter Treaty

An obscure investment agreement threatens to undermine bold action on the climate crisis. But is the modernisation of the Energy Charter Treaty doomed to fail?

Summary

An obscure investment agreement, the Energy Charter Treaty (ECT), threatens to undermine bold climate action to transform Europe's energy system. But as negotiations begin for the reform of the treaty, this paper asks, is it beyond repair? When it comes to ending its protection for fossil fuels, and scrapping investor rights for climate-damaging industries, is the modernisation doomed to fail?

On the 10th of December, representatives of 53 countries plus the European Union and Euratom gather to kick off the “modernisation” of the Energy Charter Treaty (ECT), one of the most harmful investment agreements currently in force. The EU and its member states present these negotiations as a way to bring the 25-year-old pact in line with new standards in investment and sustainable development they adopted in recent years. They argue this will “facilitate investment in the energy sector in a sustainable way” and “reflect climate change and clean energy transition goals”.¹

Those claims, however, do not stand up to scrutiny of the treaty and its disastrous consequences for people and planet. So long as it provides excessive protection for energy investors, the ECT will allow them to obstruct public policies aiming to carry out the energy transition, mitigate climate change, protect the environment, bring energy under public or citizen control, and fight energy poverty. The ECT is in its very nature in contradiction with the commitments of the EU and EU Member States to the Paris Agreement on climate change and further necessary measures to reach carbon neutrality by 2050. Unfortunately, neither the agenda initially proposed by the ECT for the negotiations nor the recent proposals made by its members (including the EU mandate) are up to this challenge.

A revised ECT may never see the light of day: members have clashing interests and any change requires unanimity. Years of negotiations may deliver no achievement.

Meanwhile, the secretariat of the Energy Charter Treaty is engaged in strong efforts to expand its membership, especially to African countries. This poses an additional threat to the capacity of these countries' governments to keep control over their resources and meet the climate challenge.

For the modernisation to be successful, the EU and EU Member States should ensure an end to all protection of fossil fuels and removal of any investor state dispute -settlement provisions. Should this reform fail, they must agree to jointly terminate the treaty or withdraw from it. They should immediately halt the expansion of the agreement to Global South countries.

The Energy Charter Treaty: an obscure treaty granting sweeping rights to investors

The Energy Charter Treaty (ECT) is an international investment agreement signed in 1994 to establish a framework for investment, transit and trade in the energy sector. Members include the EU, all EU Member States but Italy, plus most countries from Eastern Europe and Central Asia, and Japan. The cornerstone of the ECT is the investor-state dispute settlement system (ISDS) through which investors can sue states when they consider that a legislation or a court ruling affects their profits or expected (future) profits. These lawsuits take place before an international tribunal of business-friendly arbitrators which can order states to pay up to hundreds of millions or even billions of euros of public money to the plaintiff.²

As of October 2019, investors used the ECT at least 128³ times as a legal basis to trigger lawsuits against states, which makes it the most litigated investment agreement in the world. As not all cases are made public, the number is likely to be even higher. Companies are expected to bring more and more disputes under the ECT in the future as states increasingly implement measures against climate change that challenge the production and use of fossil fuels. But this figure is actually only the tip of the (melting) iceberg: In many cases, investors do not officially file a case but threaten to do so at an early stage of policy-making, thus creating a chilling effect at the expense of the public interest (see annex 1).

A reform to fix the ECT?

In October 2017, the Strategy Group of the Energy Charter Treaty initiated the work on the modernisation. It agreed to set up an ad-hoc working group to conduct the discussions on the modernisation. The mandate specifies that the (energy) industry should be closely associated to the discussions.⁴ One year later, the Bucharest Energy Charter Declaration specified the purpose of the review is to catch up with the rapid evolutions in the fields of energy and international investment since the Treaty was signed in 1994. An accompanying list of 25 topics was proposed as terms of reference for the negotiations.⁵ Members of the Energy Charter Treaty were then invited to comment until September 2019 on each of the suggested issues and to communicate the “policy options” they will back during the negotiations.⁶

As for the EU, Member States gave a mandate to the European commission in July 2019 to negotiate on their behalf. However, as EU countries are also members of the ECT themselves, (with the exception of Italy, which stepped out of the treaty in 2006), they can also make their own proposals beyond the EU position and participate in negotiations. In practice, Luxembourg was the only EU member state to suggest any policy options separate from the EU, on just 3 out of the 25 topics proposed for discussion, so the voices of EU Member States are largely represented by the EU mandate.

Protecting fossil fuels not the climate

Fossil fuel investors can continue to feel protected by the ECT. The ECT's modernisation proposals are far from questioning the protection given to benefit dirty energy projects.

Though scientists agree that the reserves in currently operating oil and gas fields alone, let alone coal, would take the world beyond 1.5°C⁷ the ECT will continue to facilitate the exploration, extraction and distribution of oil, coal and gas. There are no proposals in the mandates or country contributions to end investor protection for fossil fuels.

The objective set out by the EU to “facilitate investment in the energy sector in a sustainable way” is an oxymoron: nothing in the EU proposals could ensure that the sweeping rights granted to the fossil fuel industry are cancelled and replaced by the development of cleaner sources of energy. Actually, the ECT can even be an obstacle to the promotion of renewable energy as it “does not allow regulators to discriminate between different sources of energy. This makes it difficult and financially risky for governments to take highly needed measures to favour renewable at the expense of carbon-intensive investments. In addition, the ECT neither protects investments in energy efficiency nor other measures to reduce energy demand.”⁸

No binding targets to address the climate emergency

In its contribution, the EU suggests that its “approach towards sustainable development should be reflected in the modernised ECT”, which should “contribute to the achievement of the objectives of the Paris Agreement”.

Beyond this vague wording, no mention is made of any binding target or objective to reduce greenhouse gas emissions or otherwise end climate change. This is despite the severe impact of the ECT on climate: experts from OpenEx estimate carbon emissions protected by the ECT, since its entry into force in 1998, at almost double the remaining EU carbon budget for the period 2018-2050.⁹

The lack of ambition from the EU to push for stronger reform of the ECT is striking. Firstly, because EU member states plus the EU make up more than half of the ECT's membership. They together contribute around 65% to the €4m annual budget of the Energy Charter Secretariat in Brussels.¹⁰ They would therefore have the leverage to place climate goals higher on the agenda of the reform if they wanted. Secondly, because it deeply contrasts with all the commitments taken by the EU institutions and EU members: the European Commission proposes carbon neutrality should be reached by 2050 and the new President of the European Commission Ursula von der Leyen took office on the 1st of December 2019 with the flagship promise to unfold a Green Deal for the EU, of which one of the pillars is the supply of “clean, affordable and secure energy”.¹¹ On the 14th of November 2019, the European Investment Bank announced it will divest from fossil fuels by 2021 and just two weeks later, Members of the European Parliament declared climate emergency.

Going slightly beyond the EU, Luxembourg suggests to introduce a stand-alone article with reference to Climate change and Sustainable Development Instruments, including the Paris

Agreement, while Switzerland proposes to include these references in a preamble to the treaty.

Suing governments' climate actions

The ECT has an Investor State Dispute Settlement (ISDS) mechanism that allows foreign investors in the energy sector to directly sue governments outside of existing courts, in secretive international tribunals, claiming up to billions in compensation if their (future) profits are affected. But is this up for discussion?

The investor-state dispute settlement system was a notable absentee on the list of 25 topics put forward by the Secretariat of the ECT. The EU however added it to the agenda of the negotiations, because it wishes to align the arbitration system of the ECT with the new standards recently developed – Investment Court System (ICS) - or still in the making – Multilateral Investment Court (MIC). Indeed, after the mobilisation of civil society against the US-EU Transatlantic Trade and Investment Partnership (TTIP) and the EU-Canada Comprehensive Economic and Trade Agreement (CETA), in large part caused by the outrage against the ISDS, the Commission under pressure devised a new proposal, the Investment Court System (ICS), to be implemented on an ad hoc basis in investment treaties and a proposal for a Multilateral Investment System (MIC) under the aegis of the United Nations Commission on International Trade Law (UNCITRAL). Despite few procedural improvements,¹² the ISDS rebranded as ICS or MIC perpetuates the core problems of investment disputes: it only gives rights to investors, no obligations; it creates parallel legal systems which can only be used by foreign investors, and not by governments and affected citizens.

In short, the EU pushes for continued strong protection of investors in the modernised ECT by proposing an evolution of the old style ISDS into an ICS and that the MIC applies to the ECT when it is operational. Thus a modernised ECT would continue to undermine the “right to regulate” of ECT member states. The sheer fact that investors can claim millions or even billions in compensation will lower the willingness and ambition of countries that want to take measures to end climate change. Even a threat of a dispute can have a powerful deterrence effect on climate regulations.

A long and bumpy ride

After the first round of negotiation starting December 12, members of the ECT will hold a new round every 3 months for at least 2 or 3 years.¹³

Any amendment to the treaty requires a unanimous decision of all the members.

This is far from being a detail, considering the polar positions of the members and the different interests at stake. Japan, for example, made very clear that it didn't want any reform, let alone the transformation of ISDS into an ICS or MIC. Resource-rich countries from Eastern Europe and central Asia draw a majority of their revenues from the transit and export of fossil fuels: they have little interest in terminating the protection of fossil fuel

industry. The same goes for home states of big oil and gas companies such as BP, Shell, Total.

On the other side of the spectrum, some countries might prefer to abandon the treaty altogether rather than giving approval to a half-hearted reform. Luxembourg's Minister of Energy Claude Turmes overtly criticized the EU mandate as regard to climate objectives and declared that withdrawal was “an option worth considering seriously”.¹⁴

Doubts are also raised from within the ECT: in an internal report, Energy Charter's assistant secretary general Masami Nakata wrote that **“it is unlikely that Contracting Parties would reach an agreement to align the Treaty with the Paris Climate Agreement”**.¹⁵ In a similar vein, former employee at the ECT secretariat Yamina Saheb believes “It is time to scrap the Energy Charter Treaty” and gives little credit to the upcoming reform.¹⁶

This all makes it very unlikely that any agreement can be reached that will bring the ECT in line with what is needed to implement the Paris Agreement and further measures to end climate change.

But even if an agreement is reached during the negotiations the new text will then have to be ratified by all the signatories at national level and at the European Parliament. Some of these might decide not to ratify.

Conclusion : a long road to stop the ECT protecting fossil fuels

It is clear that the reform will be a long and difficult road. One cannot imagine how a revision could fix a treaty tailored for the era of fossil fuels. Yet, phasing out fossil fuels is overdue now. The impacts of climate change and environmental devastation are already being felt by communities around the world. This is no time to be lenient with a treaty that does nothing to encourage the energy transition, but rather hinders it and reduces the capacity of states to implement ambitious measures in the public interest.

Therefore, Friends of the Earth Europe and 265 other civil society organisations¹⁷ call on members of the ECT, and especially the EU and EU states, to:

- Include as a condition for entering negotiations to modernise the ECT the **removal of provisions that protect fossil fuels**;
- Request the **removal of investor-state dispute settlement** provisions from the agreement;
- **Withdraw from or jointly terminate the ECT** if the modernisation process fails to promptly make the agreement climate- and environment-proof by removing investor-state dispute settlement and protections for fossil fuels and nuclear energy;
- Immediately **put a brake on the process to expand the ECT** geographically to ever new states and to not allow any treaty accessions as long as the ECT is in its current state.

Annex 1: Sued via the ECT for action on climate change and the environment

Disputes :

Vattenfall I & II vs. Germany¹⁸

In 2009, Swedish energy multinational Vattenfall sued Germany, seeking €1.4 billion in compensation for environmental standards imposed on a coal-fired power plant near Hamburg. The case was settled after the City Government agreed to relax the environmental requirements.

In 2012, Vattenfall did it again. The company claimed more than €6.1 billion for lost profits related to two of its nuclear power plants. Vattenfall claims its projects were frustrated by the democratic decision of the German Parliament to accelerate the phase-out of nuclear energy after the 2011 Fukushima disaster.

Rockhopper vs. Italy¹⁹

In 2015, the Italian Parliament approved a ban on oil and gas projects near the Italian coast. As a result of this new piece of legislation, a number of fossil fuels projects were outlawed, including the Ombrina Mare oil platform, for which energy company Rockhopper acquired the license in 2014. In 2017, Rockhopper challenged under the ECT Italy's refusal to grant the concession in an arbitration tribunal. Their claim is admissible even though Italy withdrew from the ECT treaty on the 1st of January 2016 because the ECT features a "survival" clause which allows the corporate privileges to live on for another 20 years after a country has withdrawn from the agreement.

Aura vs. Sweden :

In November 2019, Australian mining company Aura lodged a compensation demand against Sweden after the country decided to ban the mining of Uranium in its territory. The new legislation also forbid the issuance of permits to prospect for, explore or exploit uranium deposits. This law, mainly stemming from the concerns of the environmental impact of Uranium exploitation, thwarts Aura's perspectives of profits: a 2012 scoping study ranked the project in "the top 5 undeveloped uranium resources in the world"²⁰ and the future net revenues of the project were estimated at US\$1.85 billion.²¹ Although the sum claimed by Aura is unknown, it is likely that it will be at least as much as US\$1.85 billion.

Threats :

Vermilion - France²²

In 2017, French Environment Minister Nicolas Hulot drafted a law to put an end to fossil fuel extraction on all French territory by 2040. This first draft of the law would have allowed a progressive phase-out of fossil fuels as it banned the renewal of exploitation permits. This plan didn't please Canadian energy company Vermilion: they sent several lobby letters to the French Council of State, the institution in charge of checking the legal compatibility of the draft bill and of giving an opinion to the government. They argued that the proposed ban on

renewing oil exploitation permits violated the rights of investors under the Energy Charter Treaty. The law was then modified, and the new version allowed for the renewal of oils exploitation permits until 2040, meaning that all current exploration and exploitation projects would continue being developed without constraints for more than 20 years. Even though it is impossible to know the exact level of influence this ISDS threat from Vermilion had in watering down the Hulot law, it certainly played a big role alongside lobbying from other fossil fuel companies.

Uniper and RWE - Netherlands

German energy companies Uniper and RWE are threatening to sue the Netherlands under the ECT rules if it passes its proposed law to phase out the burning of coal for electricity power plants by 2030. The companies built coal-power plants while knowing the considerable impacts of burning coal: coal-fired electricity generation accounted for 30% of global CO₂ emissions in 2018.²³ They now claim compensation for their investments and the profits they expected from more years of operation. This threat is a sword of Damocles over the head of the Dutch Senate which will have to vote on the law on December 10. If the law passes, The Netherlands could be forced by an arbitration tribunal to pay hundreds of millions of euros for taking firm steps to fight climate change.

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