Uncertain Climate Impact and Several Open Questions

An analysis of the proposed reform of the Energy Charter Treaty

IISD REPORT
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1.0 Introduction

In 2017, the contracting parties of the Energy Charter Treaty (ECT) decided to modernize the treaty and determine a list of topics for reform in 2018. After a lengthy process involving 15 negotiation rounds since 2020, they reached an agreement in principle for the reform of the treaty on June 24, 2022. The analysis below is based on the version of the agreement in principle that was leaked on 12 September 2022.

The now leaked agreement confirms and further supports IISD’s earlier conclusion that, while the suggested changes address some of the problems inherent in old-generation investment treaties, the reforms are too modest, too piecemeal, and too untested to transform the ECT into an instrument that is compatible with the global climate agenda and states’ energy transition goals. In addition, the agreement leaves many crucial questions unanswered, such as when its most impactful provisions would enter into force, whether they would do so simultaneously in all contracting parties, and how “flexibly” contracting parties and newly acceding countries could add fossil fuel carve-outs in the future.

This paper updates IISD’s previously published analysis (ADD LINK) of the public communication of the contracting parties released in June 2022. Expanding on the initial analysis, it examines the key changes that would be made to the existing text of the ECT if the agreement in principle is adopted. It also identifies relevant areas that will remain unchanged, with a view to examining how the revised ECT text will impact the critical objective of limiting global warming to 1.5°C.

For background on the ECT modernization project, please see IISD’s analyses on the implications of the ECT for climate policy (Schaugg & Muttitt, 2022), the phase-out of coal-fired power plants (Schaugg & Di Salvatore, 2022), investment in renewable energies (Di Salvatore et al., 2021), as well as Bernasconi-Osterwalder et al. (2021) on the legal conditions for a coordinated withdrawal from the treaty.
2.0 Scope of Analysis

This analysis focuses on the elements of the revised ECT text that are crucial for determining its scope of application. In a first step, it considers the available procedures to change the treaty, including voting rules, entry into force, and provisional application, that will impact the overall outcome of the reform. It then goes on to examine substantive elements, starting with the definitions of “Economic Activity in the Energy Sector,” “Investment,” and “Investor,” as well as the updated list of “Energy Materials and Products.” It then goes on to consider the revised substantive investment protections of fair and equitable treatment (FET), indirect expropriation—the most highly litigated clauses of the ECT—and most-favoured nation treatment (MFN), a clause with significant implications. Moreover, the analysis also assesses the effectiveness of the “right to regulate” and general exceptions clauses, as well as key aspects related to the investor–state dispute settlement (ISDS) clause, including the approach to valuation of damages, regulation of third-party funding, umbrella clause, and transparency of investment arbitration proceedings. Finally, it examines the newly introduced provision on Regional Economic Integration Organizations (REIOs), which addresses the much-discussed issue of the intra-European Union (EU) applicability of the ECT.

There are other changes to the ECT text that are not addressed in this analysis because they are less critical to the overall scope and impact of the revised ECT. Changes in respect of which the initial Communication offered too little detail to make a useful analysis possible have now been included. The relevant parts of the leaked legal text are cited in textboxes for ease of reference. The analysis also identifies some of the most problematic provisions of the ECT that have not been revised since the ECT contracting parties had not included them in their list of topics for discussion in 2018 (Energy Charter Secretariat, 2018). Most importantly, they include the ISDS mechanism itself and the treaty’s survival clause, which offers an additional 20 years of protection to investments made before the taking effect of a withdrawal by a contracting party or parties.
3.0 Key Issues

The contracting parties have addressed some of the problems that have arisen in relation to the ECT over the past two decades, when cases under the treaty drastically increased and the ECT evolved into the investment treaty that generated the highest number of ISDS cases. However, the contracting parties missed the opportunity to reform the ECT in a way that supports the energy transition and that addresses key investment governance challenges. While the contracting parties agreed to several useful changes and added some much-needed clarifications, the revised treaty has not, overall, succeeded in addressing major challenges for host states regulating in the public interest, including when taking climate action.

Continued protection for fossil fuel investors and extended treaty scope

- The legal text confirms: In the EU and United Kingdom, existing fossil fuel investments will continue to enjoy ECT protection for at least 10 more years and possibly up to 2040—a length of time at odds with current knowledge on the speed of fossil fuel phase-out required to limit global warming to 1.5°C (Bois von Kursk & Muttitt, 2022).

- Only the EU and United Kingdom will carve out some fossil fuels from investment protection. In addition, only Japan, Switzerland, and Turkey will deny benefits to fossil fuel investors from contracting parties having made carve-outs. This implies that in all other contracting parties besides the EU and the United Kingdom, existing and future fossil fuel investments, including those made by investors from the EU and the United Kingdom, would continue to be protected indefinitely.

- Despite earlier talk of a “flexibility mechanism” to exclude fossil fuel investment protection, the leaked agreement does not give contracting parties greater flexibility to make such carve-outs after the vote at the Energy Charter Conference on November 22, 2022, than the old ECT.

- In many contracting parties, the subject-matter coverage of the ECT is extended to new energy materials and carbon capture and storage technologies. Bringing a new class of investors under the coverage of the ECT implies greater ISDS risk, which can restrict the regulatory flexibility that states need when regulating new energy technologies.

- The revised definition of “investment” fails to require that covered investments be operated in accordance with host state law and contribute to host state development. It also fails to rein in shareholder claims for reflective loss due to the inclusion of portfolio investments.

Broad investment protection standards with weak, limited carve-outs to shield public policy

- The revised substantive provisions—especially the most highly litigated protections of FET and indirect expropriation—remain broad.

- New exceptions and carve-outs to protect states’ policy space are insufficient and weakened by major loopholes.
• The added value of MFN in the ECT is uncertain, and its retention may lead to unintended consequences such as the multilateralization within the ECT region of contractual or other obligations owed to investors from third states.

Uncertainty and inconsistency for European Union member states

• The new REIO provision is intended to exclude intra-EU ISDS in line with recent Court of Justice of the European Union rulings. However, it is unclear whether the provision will be fully effective in preventing intra-EU arbitration in practice.

• Key provisions other than ISDS—including the investment protection standards—will remain applicable in the intra-EU context and be enforceable in domestic courts. As a result, concerns remain in relation to the ECT’s status as an integral part of the EU legal order.

• Several key provisions are out of step with the EU’s recent treaty practice, such as the inclusion of legitimate expectations as a stand-alone ground for breach of FET and the umbrella clause.

No systemic reform of ISDS, compensation standards, or valuation techniques

• ISDS was not part of the agreed list of topics for modernization, and so the provision remains intact pending a possible introduction of a multilateral investment court (as currently discussed under the auspices of United Nations Commission on International Trade Law [UNCITRAL] Working Group III on ISDS reform.)

• Other reform areas related to the ISDS provision, including valuation, are limited and superficial. Failing to rein in the use of forward-looking valuation techniques such as the discounted cash flow method is a major missed opportunity. Read in conjunction with a wide definition of investment and broad substantive protections, this exposes states to extraordinary financial liabilities for their climate action.

20-year survival clause retained

• The survival clause was also not included in the agreed list of topics for modernization. This is a major omission, limiting states’ ability to exit the ISDS system by locking in existing investment protection for 20 years post-withdrawal.
4.0 Procedures to Change the Treaty

Any analysis of the likely practical implications of the provisions of the agreement in principle requires a preliminary consideration of the procedures of amendment and modification, the related voting rules, rules regarding entry into force, as well as the possibility of a provisional application. Indeed, both the current version of the ECT and the agreement in principle contain detailed rules regulating these issues that will inform and impact the assessment of the substantive provisions of the treaty conducted below. At the outset, it can be stated that, at the minimum, any decisions relating to the treaty must have the support of the simple majority of all contracting parties (Article 36(6)). Additional requirements, such as unanimity of all parties present and voting, are then required for certain categories of decisions, including changing the treaty (Article 36(1)).

Like the current version of the treaty, the new agreement in principle distinguishes three principal ways in which the content of the treaty can be changed: (1) amendments to the treaty (Article 34(3)(l)), as well as (2) modifications of and (3) technical changes to the annexes of the treaty (Article 34(3)(m)). Only (1) and (2) are relevant for the modernization and will be considered below.

4.1 Amendments of the Main Text of the Treaty

Amendments are changes to the main text of the treaty (excluding its annexes) that are negotiated among the contracting parties. They are proposed by at least one contracting party and must be notified by the Energy Charter Secretariat to the contracting parties at least three months before proposed adoption by the Energy Charter Conference (Article 42(1) and (2)). According to article 34(3)(l), it is the Energy Charter Conference that considers and adopts texts of amendments. As all those parts of the agreement in principle that suggest changes to the main text of the treaty are amendments, the text of the agreement must therefore have been notified to the contracting parties at the latest on August 22, 2022, that is, 3 months prior to the schedule conference meeting on November 22, 2022, for their proposed adoption.

Subject to minor exceptions that are irrelevant to the agreement in principle, the voting rules applicable to the adoption by the conference of amendments require “[u]nanimity of the Contracting Parties Present and Voting at the meeting of the Charter Conference where such matters fall to be decided” (Article 36(1)). Pursuant to Article 36(7), the EU has a number of votes equal to the number of its member states that are contracting parties to the treaty but may only exercise its right to vote if its member states do not.

It follows from the above that, in order to be adopted, all contracting parties present and voting at the conference meeting in November—possibly more than 50—would have to vote in favour of adoption. This is an exceptionally high threshold enabling a single contracting party to veto adoption and thereby prevent the reform as a whole.
4.2 Entry Into Force of Amendments

Moreover, the entry into force of amendments that have been adopted by the conference is regulated in a separate provision, Article 42(4), in a rather complex way:

(4) Instruments of ratification, acceptance or approval of amendments to this Treaty shall be deposited with the Depositary. Amendments shall enter into force between Contracting Parties having ratified, accepted or approved them on the ninetieth day after deposit with the Depositary of instruments of ratification, acceptance or approval by at least three fourths of the Contracting Parties. Thereafter the amendments shall enter into force for any other Contracting Party on the ninetieth day after that Contracting Party deposits its instrument of ratification, acceptance or approval of the amendments.

In essence, this means that even if adopted by the conference, in order to enter into force, amendments must first be ratified, accepted or approved by at least three fourths of all contracting parties (the “threshold”). And even when this threshold is met, amendments only enter into force among those contracting parties having ratified, accepted, or approved them. In other words, save for the uncertain option of provisional application (see below), the previous, unamended version of the treaty would remain in place in all contracting parties until the threshold is met and indefinitely in contracting parties that decide not to ratify, accept, or approve.

What does this imply for the modernization? In order to enter into force, the parts of the agreement in principle that are amendments will need to follow the abovementioned procedure defined in Article 42(4). Where ratification is required by domestic law, it is often tied to strict conditions of constitutional law, frequently requiring a parliamentary decision, and a vote to adopt the amendments in November is no guarantee of such ratification at a later stage. This generates a significant risk that two different versions of the treaty, the current and a “modernized” one, could coexist over extended periods of time, leading to legal uncertainty and a patchwork of coverage. At the time of the conference meeting on November 22, 2022, the contracting parties will not know which other contracting parties will eventually ratify the treaty. This creates additional strategic difficulties for the EU, the member states of which are expected to vote on their common position in the Council of the European Union most likely prior to the November conference and which might currently be contemplating a withdrawal.

4.3 Modifications of the Annexes of the Treaty

Besides amending the main text of the treaty, the agreement in principle, retaining the original treaty language, suggests altering the content of certain annexes using a process that the treaty defines as “modification.” According to Article 34(3)(m), the Energy Charter Conference considers and approves such modifications, but different voting rules apply depending on the annex in question.

The modification of certain annexes that are of particular importance, including those containing lists of Energy Materials and Products covered by or excluded from the investment
provisions (Annexes EM and NI), require the “[u]nanimity of the Contracting Parties Present and Voting at the meeting of the Charter Conference where such matters fall to be decided” (Article 36(1)(d)). The consequences of this high voting threshold for the fossil fuel carve-out negotiated by the United Kingdom and the EU will be discussed further below.

Modifications of all other annexes, including those that provide for a reciprocal denial of benefits to investors of contracting parties that have included fossil fuel carve-outs (Annexes NPT and IA–NI), require a three-fourths majority of the contracting parties present and voting (see, e.g., Article 36(4)). The modification of most annexes to the treaty is therefore subject to considerable procedural hurdles that act as an additional obstacle to modernization.

In order to assess the consequences of the proposed modifications to the treaty’s annexes, it is furthermore paramount to assess when they enter into force. Importantly, the current version of the ECT does not contain any rules in this regard and, consequently, the date of entry into force of the proposed modifications is unclear. The agreement in principle attempts to bring added clarity by suggesting the addition of an Article 48(2), stating that

Modifications to Annexes shall enter into force one year after the date of their approval by the Conference unless otherwise specified in the Annex. [...] Unless expressly mentioned otherwise in the modified Annex, modifications to Annexes shall only apply to Investments made after the date of the entry into force of such modification.

While this article clarifies the date of entry into force and introduces a default rule that modifications to annexes will not normally have retroactive effect on investments made before the date of entry into force, it is itself part of a proposed amendment to the treaty. This means that it would only apply to modifications made after the amendment has entered into force, which—save for provisional application—assumes that both the abovementioned unanimity and ratification threshold must be met first. Pending entry into force of the amendment, the entry into force of modifications therefore remains uncertain. The impact of this uncertainty on the fossil fuel carve-outs and the related possibility of a denial of benefits will be discussed further below.

4.4 Provisional Application of Parts of the Agreement in Principle

The possibility of provisional application may alter the entry into force of amendments and modifications. By provisionally applying some or all of the provisions of a treaty, a contracting party generally signals to other contracting parties that it considers itself bound by these provisions pending entry into force. It is a means to bridge the time gap created by domestic constitutional requirements related to signature, ratification and entry into force. Provisional application “is generally tailored for those subject matters characterized by urgency or deep political stakes, around which negotiating States are striving to build trust with their counterparts.”

1 Leal Arcas (2018).
While not without precedent (see, e.g., CETA), the provisional application of plurilateral agreements involving the EU among some or all contracting parties is a legally complex procedure that may raise issues pertaining to the domain of national law, EU law, and public international law. A full examination of the precise procedure and legal effects of a provisional application of the ECT exceeds the frame of the current analysis. However, some preliminary observations that directly influence the outcome of the modernization can nevertheless be made.

Besides Article 45, which appears to have exclusively covered the historical provisional application before the entry into force of the original treaty in the 1990s, the agreement in principle does not contain any provisions on the provisional application of the suggested amendments and modifications. This means that if all or parts of the treaty are to be provisionally applied by some or all of the contracting parties, they will have to agree to do so in a separate agreement such as a decision of the Energy Charter Conference. Besides the scope of provisional application, such an agreement could also clarify under what conditions a contracting party could stop provisional application. To date, however, no such agreement has been made public.

Moreover, it is uncertain at best whether the provisional application by some contracting parties of a treaty article will have any legal effect on other contracting parties that are not provisionally applying the same treaty article. It is therefore also uncertain whether provisional application will prevent ISDS claims on the basis of the old version of the ECT by investors from states that have decided not to provisionally apply all or parts of the agreement. If provisional application is not undertaken by all contracting parties simultaneously, it would allow investors to continue to commence arbitration on the basis of existing treaty language and therefore delay efforts to align the treaty with climate commitments and EU law.

Lastly, for the purpose of EU law and like the CETA, the ECT constitutes a so-called mixed agreement because it concerns both matters that fall into the exclusive competence of the EU (e.g., foreign direct investment) and matters in which the EU Member States are exclusively competent (portfolio investments; see provisional application of CETA). In contrast to CETA, the reformed ECT would bind numerous non-EU contracting parties, the EU and its member states (except Italy), further increasing the risk of piecemeal provisional application.
5.0 Scope of the Treaty: Substantive rights and obligations

5.1 Definition of “Economic Activity in the Energy Sector”

Communication text:

Under the topic “Definition of Economic Activity in the Energy Sector,” negotiations focused on the scope of the modernised ECT in terms of business activities and sources of energy covered. The definition is now extended to cover the capture, utilisation, and storage of carbon dioxide (CCUS) in order to decarbonise the energy systems. The revised provisions now envisage how investments in different sources of energy will be protected under the ECT against the backdrop of clean energy goals of Contracting Parties.

Text of the Agreement in Principle:

Article 1(5)

(5) “Economic Activity in the Energy Sector” means an economic activity concerning:

• the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products except those included in Annex NI,

• the capture, utilisation and storage of carbon dioxide in order to decarbonise the energy system except as included in Annex NI; or

• or concerning the distribution of heat to multiple premises.

More covered investments mean more potential claimants: Broadening the scope of “Economic Activity in the Energy Sector” increases ISDS risk.

The definition of “Economic Activity in the Energy Sector” has been a key issue throughout the negotiation process. The definition is crucial as it frames what types of activities will count as a protected investment pursuant to Article 1(6) of the current ECT. Article 1(6) of the agreement in principle provides in its relevant part that “‘Investment’ refers to an asset associated with an Economic Activity in the Energy Sector.” This, in turn, will determine an investor’s ability to bring a claim for compensation using ISDS. In the current ECT, economic activity in the energy sector is defined with reference to those energy materials and products that are listed in Annexes EMI and EMII, while those listed in Annex NI are excluded. The agreement in principle maintains this structure and further extends the scope of the definition of economic activity in the energy sector to additional business activities

2 See sections on “investment” and “investor–state dispute settlement” below.
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and sources of energy including carbon capture, utilization, and storage (CCUS). While the EU has carved out protection of CCUS in its area from the scope of the treaty by listing it in Annex N1, no other contracting party has made a similar carve-out. This will increase the risk of these states facing ISDS claims in the future because additional categories of investments will be protected.

Protecting capture, utilization, and storage of carbon dioxide under the ECT will not likely drive increased investment in this technology, which is untested and unproven at scale.

There is no conclusive empirical evidence that international investment agreements such as the ECT increase foreign investment (Bonnitcha, 2017). It is, therefore, uncertain whether the extension of the scope to additional activities will foster or attract such investments, including in decarbonization technology. Any policy rationale related to an alleged promotion of such investments is therefore at least questionable.

It is also uncertain whether CCUS can and will play a significant role in the energy transition, as the technology has yet to be proven to work at scale. To date, there are only about 26 large-scale commercial carbon capture and storage projects in operation worldwide. Most of them are dedicated for “enhanced oil recovery,” which uses the captured carbon dioxide (CO₂) to inject it back into oil wells in order to increase the reservoir pressure and extract more oil. Only eight of the 26 existing CCUS projects are dedicated for the long-term storage of CO₂. Overall, the current global capacity for CCUS is only about 56.7 million tCO₂ per year.³

Although many energy transition models assume that CCUS could eventually sequester several billion tCO₂ by 2050, the Intergovernmental Panel on Climate Change (IPCC) Sixth Assessment Report published a set of thresholds where serious concerns about the feasibility of the scaling up of these technologies begin to emerge. Based on this risk assessment and feasibility concerns over CCUS used in fossil fuel-combusting facilities, the IPCC suggests that a feasible deployment of fossil CCUS technologies should be limited to 3.6 billion tCO₂ sequestrations in 2050 (IPCC, 2022). Reliance on these technologies beyond this limit would impose a significant risk of irreversible levels of climate change if unsuccessfully implemented (see also Bois von Kursk & Muttitt, 2022).

New technologies require flexible and responsive regulation, which may be inhibited by the ECT’s investment protection standards enforced by ISDS.

The inclusion of CCUS within the scope of protected economic activity might in fact run counter to states’ efforts to implement the energy transition by restricting their freedom to regulate flexibly and responsively. This is particularly problematic for novel or emerging technologies, such as CCUS, in respect of which states still need to develop, test, and possibly readjust regulatory frameworks and incentive schemes. The revised ECT may, however, significantly limit their ability to do so in a flexible and timely manner. This is because, as detailed below in Part 2 of this analysis on investment protection, the revised ECT text will

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³ BloombergNEF (2022).
still contain broad investment protection standards that arbitral tribunals have construed in ways that severely restrict regulatory space. The use of more detailed treaty language or the inclusion of new exceptions and a right to regulate clause are unlikely to significantly mitigate this risk for the reasons outlined further below.

Indeed, the flexibility to adjust incentive schemes to renewable energy investments to reflect changing market dynamics and prevailing economic conditions has been the subject of more than 45 ECT-based investment arbitration claims. The majority of these proceedings were brought against the Kingdom of Spain, challenging the same set of legislative measures, i.e., the Spanish government’s decision to alter its feed-in tariffs for renewable energy producers in the wake of the financial crisis in 2008. These cases have attracted criticism for their divergent outcomes despite all challenging the same legislative measures and for inconsistency in arbitral conclusions around key questions. These key questions included the reasonableness of the regulatory changes, which one tribunal described as a “rational policy” that “had the aim of protecting the consumer.”

5.2 Updated List of Energy Materials and Products

Communication text:

Some Energy Materials and Products are introduced and covered by the investment protection provisions, such as:

- Hydrogen;
- Anhydrous Ammonia;
- Biomass;
- Biogas; and
- Synthetic fuels.

Additional Energy-Related Equipment is introduced and covered by the trade provisions, such as wool, rock-wool and similar mineral wools; and Multiple-walled insulating units of glass.

Text of the Agreement in Principle:

Annex EM – Energy Materials and Products (In accordance with article 1(4))

[...]

Other Energy

[...]

More covered energy materials entail increased ISDS risk, with unclear benefits in terms of these materials’ climate-neutral credentials.

Similar to the addition of CCUS mentioned above, the inclusion of additional energy materials and products within the scope of “Economic Activity in the Energy Sector” increases the risk of arbitration claims. It is important to note that the EU, the United Kingdom, and Switzerland have limited the extension of the ECT’s protection to these energy materials and products in their area by including certain carve-outs in Annex NI. Besides CCUS, the EU and Switzerland are carving out hydrogen except for renewable and low-carbon hydrogen and synthetic fuels except for low-carbon fuels. The United Kingdom is operating a similar carve-out of hydrogen but maintains the ECT’s protection of synthetic fuels. All other additional energy materials and products remain covered in the EU, the United Kingdom, and Switzerland and no other contracting party appears to have included a similar carve-out.

The inclusion of a broad range of new energy materials and products represents a significant expansion of the scope of the treaty. This constrains the regulatory space that states require when implementing the energy transition. As mentioned above, there is also insufficient evidence as to whether their inclusion will promote investment in these products, and the rationale for their inclusion is, therefore, unclear.

Moreover, depending on the way these products are produced and consumed, they might not be climate neutral. The general list of covered energy materials and products does not distinguish between renewable hydrogen that is produced using carbon-neutral energy sources and other types of hydrogen (so-called “blue” or “grey” hydrogen) that are not carbon neutral. In addition, low-carbon hydrogen, low-carbon synthetic fuels, and anhydrous ammonia will be covered in the EU, the United Kingdom, and Switzerland. Most of these energy products are produced using fossil fuels. This continuing importance of fossil fuels in the production chain of some of the added energy materials and products may therefore imply an extension of the protection of fossil fuels through the backdoor. Moreover, some of the listed products are not climate neutral at the consumption stage.
5.3 Investment Protection for Fossil Fuels: Introducing “flexibility”

Communication text:

A novel “flexibility mechanism” allows Contracting Parties, based on a Conference decision, to exclude investment protection for fossil fuels in their territories, considering their individual energy security and climate goals. For example, the EU and the UK have opted to carve-out fossil fuel-related investments from investment protection under the ECT, including for existing investments after 10 years from the entry into force of the relevant provisions and for new investments made after 15 August 2023 as of that date with limited exceptions.

The envisaged exclusions will not, as a matter of principle, affect investment protection in the territory of other Contracting Parties, unless they opt to apply them vis-à-vis investors from the aforementioned Contracting Parties reciprocally.

Text of the Agreement in Principle (in relevant part):

ANNEX NI:

[...]

Section B

[...] the Energy Materials and Products and activities listed below are excluded from the definition of Economic Activity in the Energy Sector only in relation to provisions contained in Part III of the ECT. [...]

1. In relation to investments made after 15 August 2023 in the European Union and its Member States which are Contracting Parties to this Treaty regarding:

[coal, oil, gas, or electricity produced from them, editor’s note: list summarized for brevity]

[...]

2804.10 Hydrogen, with the exception of low carbon hydrogen and renewable hydrogen, which remain within the scope of the definition of economic activity in the energy sector.

Low carbon hydrogen means hydrogen produced from non-renewable sources, with significantly reduced full life-cycle emissions resulting in less than 3tCO₂eq/tH₂.

Renewable hydrogen means hydrogen produced from renewable sources, with the exception of biomass, resulting in full life-cycle emissions of less than 3tCO₂eq/tH₂.

Synthetic fuels other than low-carbon fuels. Low-carbon fuels mean recycled carbon fuels, low-carbon hydrogen and synthetic gaseous and liquid fuels produced from low-carbon hydrogen, which meet a 70% reduction in full life-cycle emissions. Recycled carbon-fuels mean liquid and gaseous fuels that are produced from liquid or solid waste of non-renewable origin or from waste processing gas and exhaust gas of non-renewable origin.
The effectiveness of the newly introduced flexibility mechanism remains unclear owing to open questions on its governance and design.

The contracting parties have, furthermore, introduced a new idea of how investment protection of fossil fuels might be limited through what they call a “flexibility mechanism.” Considering the text of the agreement in principle, it is now clear that this mechanism simply amounts to a possibility for single contracting parties to exclude investment protection of investments related to the energy materials and products set out in Annex NI. This is combined with a corresponding possibility for other contracting parties to reciprocally deny benefits in Annexes NPT and IA-NI vis-à-vis energy materials and products of investors from contracting parties who have exercised the ‘flexibility’ under Annex NI.

Some of the questions that remained open in the previous analysis can now be answered at least in part: Who will use the mechanism? How and when would fossil fuel carve-outs and related denials of benefit enter into force? What distinguishes the treatment of existing from future fossil fuel investments considering these carve-outs? Will existing investments include early-stage investments that have been licensed but not started operating?

A Flexibility Mechanism With Limited Flexibility

As indicated above, a modification of the annexes containing the EU and United Kingdom fossil fuel carve-outs requires a unanimous vote by all contracting parties present and voting. Moreover, the annexes allowing for a reciprocal denial of benefits can only be modified by the vote of a three-fourths majority of all contracting parties present and voting. This means any unilateral exclusion of fossil fuels from investment protection requires a unanimous decision of all contracting parties present and voting. Obtaining such a favourable decision from possibly more than 50 states constitutes an exceptionally high threshold. The requirement to obtain three-fourths of the votes to be able to reciprocally deny benefits is similarly high. The agreement in principle, therefore, offers no greater flexibility for contracting parties to carve out fossil fuel investments than the old ECT, and the narrative of a “flexibility mechanism” in the public communication of the Energy Charter Secretariat is at best a misnomer, and at worst a deliberate greenwash.

Initial Use of the Mechanism Is Limited: Use at a later stage possibly unfeasible

At least initially, only the EU and United Kingdom will use Annex NI to carve out fossil fuel protection, with Switzerland merely limiting the inclusion of new energy materials and products. While the implications of the EU and United Kingdom fossil fuel carve-outs will be discussed further below, the fact that they have been included in the agreement in principle implies that these contracting parties have obtained at least affirmations by all other contracting parties that they would support such a step. None of the remaining 20+ contracting parties has opted to include a similar carve-out in the agreement in principle and, given the high voting threshold, it is uncertain at best whether they will be able to obtain the relevant support for such a step at a later stage. Importantly, these other members include major oil-producing states, such as Kazakhstan, as well as major capital-exporting states, such
as Japan. Furthermore, developing countries, particularly in Africa and Asia, are known to be among the targeted countries for ECT expansion (Bernasconi-Osterwalder, 2017), a process that is likely to recommence with renewed vigour if the modernized agreement is adopted.

The rigidity of the voting rules might eventually prevent such acceding states from negotiating similar carve-outs. If adopted, the new ECT would, therefore, effectively lock in investment protection for fossil fuel investments indefinitely across an entire region and possibly beyond—an additional blow to multilateral efforts to curb emissions.

Besides the carve-outs themselves, only three contracting parties plan to make use of mechanisms to reciprocally deny benefits to fossil fuel investors from those contracting parties that have negotiated carve-outs: Switzerland, Turkey, and Japan (See Annexes IA-NI and NPT).

This limited use of carve-outs and denial of benefits mechanisms in the agreement in principle would lead to a lopsided deal. If no further decisions to deny benefits are announced, fossil fuel investors from the EU, its member states, or the United Kingdom (i.e., the ECT contracting parties that are home to most major fossil fuel investors) would continue to be protected indefinitely in more than 20 other ECT contracting parties, effectively locking in investment protection for such investments indefinitely across an entire region. Moreover, these other contracting parties include developing countries such as Yemen, which has faced three known investment arbitration claims so far. As such, if adopted, the agreement would also undermine efforts to create a fairer and more balanced international investment regime.

EU Fossil Fuel Carve-out Follows Previous Proposals

The EU has included a fossil fuel carve-out in Annex NI that generally follows its 2021 additional negotiation proposal that was initially aimed at limiting fossil fuel investment protection in all contracting parties of the ECT but apparently failed to rally unanimous support. This proposal had already drawn widespread criticism for its lack of ambition and misalignment with both EU and multilateral climate objectives.

In essence, the carve-out distinguishes between existing and future investments in fossil fuels. According to the EU carve-out, future investments would be “investments made after 15 August 2023 in the European Union and its Member States which are Contracting Parties to this Treaty” regarding fossil fuel energy materials and products (Annex NI Section B(1) of the agreement in principle). Such investments would no longer be covered, albeit with considerable exceptions for gas-related investments extending the protection to 2030 for future investments in gas-fired power generation below a certain carbon threshold and to 2040 for “hydrogen-ready” gas infrastructure. The indicated carbon threshold for these investments of 380g of CO

Moreover, the EU carve-out defines existing investments as “[i]nvestments made before 15 August 2023 in the European Union and its member states which are Contracting Parties to this Treaty” regarding the same fossil fuel energy materials and products (Annex NI Section C(1) of the agreement in principle). These investments would continue to be protected for

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5 See https://investmentpolicy.unctad.org/investment-dispute-settlement/country/231/yemen/respondent
a period of “[ten] years after the date of entry into force of the changes in Section C of this annex approved on 22 November 2022 but no later than 31 December 2040.”

The unclear date of fossil fuel carve-outs’ entry into force blurs climate effect.

While the exemption of future investments appears relatively clear in most cases, the question of until when existing investments would be protected depends on the entry into force of the relevant part of Annex NI. There are reasons to believe that the EU and the United Kingdom will push for a single vote at the Energy Charter Conference in November for the adoption of all amendments and modifications as a package deal to avoid a deadlock, possibly even a silence procedure. The package of amendments and modifications now proposed will, therefore, most likely have to be adopted by a unanimous decision of all contracting parties present and voting at this conference—meaning that a single “veto” could prevent the reform.

It remains unclear, however, when the relevant part of Annex NI will enter into force. Article 36 on voting does not offer any guidance on that matter, and as mentioned above (see Section 4), the newly introduced article 48(2) is itself subject to prior entry into force. Annex NI is of crucial importance to the scope of the treaty as it severely limits the types of energy materials and products that are covered. Some contracting states, therefore, may well require that its entry into force be confirmed or even ratified by their parliament. Such requirements could significantly delay the starting date of the 10 years of additional protection granted to existing fossil fuel investments in the EU and United Kingdom carve-outs.

Pending such ratification, some or all contracting parties may therefore decide to provisionally apply Annex NI. It is unclear whether provisional application of Annex NI will amount to “entry into force of the changes in Section C” required by the EU and United Kingdom carve-outs to trigger the 10-year period of protection. And even if it does, it is uncertain what the consequences of a piecemeal provisional application of Annex NI would be. Would it lead to differing periods of protection in different ECT contracting parties? If only the EU were to provisionally apply the Annex, could fossil fuel investors from non-EU ECT contracting parties continue to bring claims against the EU and its Member States despite the carve-out? What about contracting parties terminating provisional application before ratification? These observations imply that it is unclear from what date the EU and United Kingdom carve-outs’ 10-year-period of additional protection would start to run and that, in practice, existing fossil fuel investments might continue to be protected for significantly more than 10 years.

Problematic Protection of Early-Stage Investments

Read in light of the broad asset-based definition of investment (discussed further below), “existing investments” will furthermore include investments in fossil fuels that are at a very early stage. This may, for instance, include fossil fuel investments in respect of which an exploration licence but no concession has been granted—indeed, licences are a class of asset that is expressly protected under the current definition of investment in the ECT. Arbitral jurisprudence, including the recent decision in the ECT-based case of Rockhopper v. Italy, demonstrates the willingness of tribunals to consider that such early-stage activities amount to an investment, and to award tremendous amounts of compensation for lost future income
Uncertain Climate Impact and Several Open Questions

streams even for an early-stage project with no proven record of profitability (see *Rockhopper Italia S.p.A.*, *Rockhopper Mediterranea Ltd*, and *Rockhopper Exploration Plc v. Italian Republic*, ICSID Case No. ARB/17/14; another example is *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, ICSID Case No. ARB/12/1). This concern is underscored by the failure of the revised ECT to properly address arbitral compensation approaches and valuation technique issues (discussed further below).

In principle, it is important to recall that in order for states to have the regulatory freedom to take the unprecedented steps required to still meet the goal of limiting warming to 1.5°C above pre-industrial levels, investment protection for fossil fuels must end years—if not decades—in advance. This includes cancelling current exploration licences and operational permits. The revised ECT carries a significant risk that fossil fuel projects at a very early stage would not only gain protection as an “investment” for the purposes of the ECT as a whole but gain continued protection as an “existing investment” as per the EU carve-out for more than a decade. Due to the uncertainty of the entry into force of the carve-out, a coordinated withdrawal of the EU and its member states in combination with an *inter se* agreement to neutralize the sunset clause could still be a valid option.

### 5.4 Review Mechanism

**Communication text:**

Five years after the entry into force of the modernised ECT and thereafter at intervals of five years, or on an earlier date as determined by the Charter Conference, the list of Energy Materials and Products covered under the ECT as well as the application of the Flexibility Mechanism will be reviewed. This will give Contracting Parties the possibility to react to technological as well as political developments.

**Text of the Agreement in Principle:**

Article 34(8)

(8) Five years after the entry into force of the amendment introducing this paragraph and thereafter at intervals of five years, or on such a date as may be determined by the Charter Conference, the Charter Conference shall periodically review the content of Annexes EM (I)14 and NI. In the course of that review, it may decide to modify any or both Annexes.

The text of the agreement in principle clarifies that the review mechanism will consist of periodic meetings of the Charter Conference at which the list of included and excluded “Energy Materials and Products” contained in annexes EM(I) and NI can be updated. Importantly, the provision does not alter the voting rules in Article 36(1)(d), pursuant to which any modification of these annexes requires unanimous approval by all contracting parties present and voting at the relevant meeting of the Charter Conference. The review mechanism therefore does not in fact lower the threshold for contracting parties “to react to technological as well as political developments.”
5.5 Definition of “Investment”

Communication text:

In order to be covered by the Treaty, an investment must, inter alia, explicitly be made or acquired in accordance with the applicable laws¹ of the host Contracting Party, and fulfil an indicative list of characteristics, such as the commitment of capital, the expectation of gain or profit, a certain duration or the assumption of risk.

The new definition excludes the coverage of judicial and administrative decisions and arbitral awards as well as limits the coverage of claims to money and credit arising solely from commercial transactions for the sale of goods and services. Specific public debt instruments are excluded from the coverage of the dispute settlement provisions.

¹ The modernized ECT clarifies that the domestic law of a Contracting Party shall not be part of the applicable law and may only be considered as a matter of fact.

Text of the Agreement in Principle:

Article 1

(6) “Investment” means every kind of asset, owned or controlled directly or indirectly by an Investor of a Contracting Party in the Area of another Contracting Party (“host Contracting Party”) that is made or acquired in accordance with the applicable laws in the latter and that have the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, a certain duration or the assumption of risk. Investment refers to assets associated with an Economic Activity in the Energy Sector and includes:

(a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;

(b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;

(c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;

(d) Intellectual Property;

(e) Returns;

(f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

For the avoidance of doubt in this Article:

(a) claims to money arising solely from commercial contracts for the sale of goods or services by a natural person, a company or other organisation in the territory of a Contracting Party to a natural person, a company or other organisation in the
It is unclear how the definition of “Investment” relates to the EU fossil fuel carve-out’s concepts of “existing investments” vs. “new investments”: This may lead to unintended outcomes.

The definition of “Investment” is crucial to determining the scope of any investment treaty. In the case of the ECT, it is particularly important for climate action and in relation to the proposed EU carve-out noted above. In its new version, the definition further blurs the lines between the concepts of existing investments (investments made before August 15, 2023) and future investments (investments made after August 15, 2023) as laid out in the EU carve-out. For example, the definition of investment in the agreement in principle provides that

Investment means every kind of asset, owned or controlled directly or indirectly by an Investor […] and includes […] any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

Economic activity is defined so as to include exploration. As such, a current exploration licence would meet the definition of an investment made before August 15, 2023, regardless of whether or not the licence holder has been granted an operational licence or started operations. This means that the ECT would continue to offer extensive investment protection to a number of early-stage fossil fuel investments exceeding the number of investments that are already producing by far.
The revised definition of investment misses three key reform opportunities to bring the ECT in line with modern treaty practice.

In addition to the above concern, four key opportunities have been missed to modernize the definition of investment. This definition is crucial because it determines the scope of protection offered by the ECT, the scope of access to the ISDS mechanism, and the extent to which investments are required to contribute to the sustainable development of the host state in order to earn the protection of the treaty.

**Missed reform opportunity #1: The revised ECT does not adopt an enterprise-based definition of investment.**

It is now clear that the agreement in principle maintains the asset-based definition of investment that is found in the current text instead of replacing it with an enterprise-based definition. Some recent bilateral investment treaty (BIT) models—for example the BIT models of India (2015) and Colombia (2017)—instead use an enterprise-based definition of investment. This is because it is understood that the benefits for host states most commonly associated with foreign direct investment, such as jobs, technology, and tax revenues, are most likely to be derived from an investment that takes the form of an enterprise. As such, the approach taken in these recent BIT models is that investments taking the form of an enterprise are entitled to the extraordinary protections afforded by an investment treaty, whereas other forms of investment are protected by the domestic law and any relevant investment contracts.

**Missed reform opportunity #2: The revised asset-based definition does not incorporate safeguards necessary to ensure that only investments that contribute to the host state’s development are covered.**

In modern treaties that nevertheless retain an asset-based definition instead of an enterprise-based one, it is common to include language that defines an investment by virtue of certain key characteristics. Pursuant to Article 1(6) of the agreement in principle, to qualify as an investment, an asset should have the “characteristics of an investment”, “such as the commitment of capital or other resources, the expectation of gain or profit, a certain duration or the assumption of risk.” These elements are derived from a test first set out by the tribunal in *Salini v. Morocco* (known as the Salini test). But there is an additional limb of the Salini test that is notably missing from this “indicative list,” which is the contribution to the host state’s economic development made by the investment.6

A number of modern BITs, including those concluded by and between ECT parties, incorporate this fourth limb of the Salini test into the definition of investment. This includes the definition of investment requiring a “significance for the development” of the host state (India–Kyrgyz Republic BIT, 2019; Turkey–Uzbekistan BIT, 2017); a “contribution to economic development” (Turkey–Burkina Faso BIT, 2019); a “contribution to the development” of the host state (India–Belarus BIT, 2018) or even a “contribution to sustainable development” (Egypt–Mauritius BIT, 2014).

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It is also noteworthy that the agreement in principle frames these Salini test elements as an indicative list. An alternative approach that would have a greater binding effect would have been to frame the Salini test elements as “minimum characteristics” that an investment must have in order to obtain protection under the treaty. This is the approach taken in the Colombia model BIT and various BITs based on that model (e.g., Colombia–India BIT, 2009, Colombia–UAE BIT, 2017; Colombia–Korea BIT, 2010; Colombia–United Kingdom BIT, 2010).

Article 1(6) of the agreement in principle excludes certain asset types from being considered an investment. Exclusions are made in relation to judicial and administrative decisions and arbitral awards, claims to money and credit from commercial sales contracts, and specific public debt instruments. But the article is silent as to a crucial category of asset: portfolio investments. A number of modern BITs that use asset-based definitions of investment seek to exclude forms of investment that are unlikely to make a direct or significant contribution to the development of the host state, and so exclude portfolio investment from the definition of investment for this reason.

For example, the definition of investment in the Turkey–Azerbaijan BIT, 2011 excludes investments that take the form of shares representing less than 10% of a company’s overall shareholdings, and the Turkey–Kyrgyz Republic BIT excludes portfolio investments.

Excluding portfolio investments from the definition of investment also has the effect of limiting a state’s exposure to multiple ISDS claims for reflective loss being brought by the shareholders of a company, in addition to claims brought by the company directly. Shareholder claims for reflective loss dramatically increase a state’s exposure to multiple claims, driving up arbitration costs and leading to inconsistency, fragmentation, and concerns of double recovery (UNCITRAL Working Group III Secretariat, 2019).

Missed reform opportunity #3: The revised ECT fails to link unlawful conduct in making the investment to the ISDS provision.

Pursuant to Article 1(6) of the agreement in principle, in order to enjoy treaty coverage, an investment must furthermore be made or acquired in accordance with the host state’s laws. This type of approach aims at removing investments made in breach of host state law, for example through corruption, from the scope of the definition of investment. The most important practical implication of this is that an investor whose investment was made unlawfully would not be able to use the ISDS mechanism of the treaty.

If the purpose of requiring that an investment be made in accordance with host state law is to have the jurisdictional effect of excluding the benefits of the treaty from investors who have breached host state law in making their investment, it would have been worth reiterating this point in the ISDS provision as well. For example, the EU–Canada Comprehensive Economic and Trade Agreement of 2016 (CETA) provision on ISDS states that “[A]n investor may not submit a claim under this Section if the investment has been made through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process.” Some recent BITs take the requirement that an investment be made lawfully a crucial step further, by requiring that the investment also be operated in accordance with the host state’s laws. For example, the India–Kyrgyz Republic BIT of 2019 provides that “investment means
an enterprise constituted, organised and **operated in good faith** by an investor in accordance with the law of the Party in whose territory the investment is made” [emphasis added].

### 5.6 Fair and Equitable Treatment

**Communication text:**

To increase legal certainty, the new article providing for fair and equitable treatment under the ECT will provide for a list that designates certain measures or series of measures that constitute a violation of this protection standard. Among such measures or series of measures, the new provision specifies the frustration of Investor’s legitimate expectations and it describes circumstances that give rise to Investor’s legitimate expectations and the conditions under which legitimate expectations may be considered.

**Text of the Agreement in Principle:**

**Article 10**

(1) Each Contracting Party shall accord to Investments of Investors of other Contracting Parties, and to such Investors with respect to their Investments, Fair and Equitable Treatment and Full Protection and Security in its Area.

(2) A Contracting Party breaches the obligation to accord Fair and Equitable Treatment set out in paragraph (1) through a measure or series of measures that constitute

(i) arbitrariness, such as blatant unreasonableness;

(ii) targeted discrimination on wrongful grounds, such as, gender, race or religious belief;

(iii) fundamental breach of due process, including a fundamental breach of transparency in judicial and administrative proceedings;

(iv) denial of justice in criminal, civil or administrative adjudicatory proceedings;

(v) abusive treatment such as harassment, duress or coercion; or

(vi) frustration of an Investor’s legitimate expectations\(^2\) where these were central to its Investment, and arose from a clear and specific representation or commitment\(^3\) by that Contracting Party upon which the Investor reasonably relied in deciding to make or maintain the Investment.

For greater certainty, a breach of another provision of this Treaty, or of any other international agreement, does not establish a breach of this paragraph.

(3) The obligation to accord “Full Protection and Security” refers to the physical security of Investors and Investments.

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\(^2\) For greater certainty, an Investor’s legitimate expectations do not include general expectations, such as an expectation (in the absence of clear and specific representations or commitments to
A state that frustrates an investor’s “legitimate expectations” would breach the revised FET clause: this runs counter to recent treaty reform practice and vastly widens the risk of ISDS challenges to regulatory action.

The reformulation of the FET article is crucial—FET is the most widely relied-on substantive protection in investment arbitration generally (United Nations Conference on Trade and Development [UNCTAD], 2020), and was claimed in 33 ECT-based arbitrations in which the investor succeeded, out of a total of 36 known cases (per the UNCTAD investment dispute settlement navigator).

According to the new article 10(2), the list of measures violating FET is a closed list, and the frustration of an investor’s legitimate expectations is expressly included in this list. The inclusion of legitimate expectations as a stand-alone measure that would constitute a violation of FET is a highly contentious and problematic approach that runs counter to the current reform trends in respect of FET. As highlighted in the UNCTAD Reform Accelerator, for modern treaties that aim to narrow the scope of FET by providing a closed list of state actions that would violate FET, “It is notable that recent treaties do not incorporate investors’ legitimate expectations in this closed list” (UNCTAD, 2020, p. 20, emphasis added).

The approach to legitimate expectations taken in the agreement in principle directly contradicts that taken in modern EU treaties, including the EU–Singapore Investment Protection Agreement, CETA, and the EU–Viet Nam Investment Protection Agreement, which provide that the frustration of legitimate expectations is but one factor that may be taken into account to determine whether there has been a breach of FET (as defined in accordance with a closed list). The text of the EU–Singapore Free Trade Agreement (FTA) goes so far as to provide in a footnote that

For greater certainty, the frustration of legitimate expectations as described in this paragraph does not, by itself, amount to a breach of paragraph 2, and such frustration of legitimate expectations must arise out of the same events or circumstances that give rise to the breach of paragraph 2.

While the agreement in principle bears similar language in footnote 2 to Article 10(2), it does not go as far as this exclusion of legitimate expectations as a standalone ground for breach of FET.

Moreover, while the footnote to Article 10(2) does provide that an Investor’s legitimate expectations “do not include general expectations such as an expectation (in the absence of clear and specific representations or commitments to that effect) that a Contracting Party’s
legal or regulatory framework will not change;” it does not confirm that this will remain the case even if the investor incurs damages as a result of the breach of these expectations.

Recent treaties, including the United States–Mexico–Canada Agreement, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, as well as the United Kingdom–New Zealand and United Kingdom–Australia FTAs, which expressly exclude legitimate expectations, go further in providing that if or greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.

Other modern treaties exclude FET altogether, including those between ECT parties such as the Mongolia–Tajikistan BIT (2009) and Cyprus–Moldova BIT (2007), as well as the Intra-MERCOSUR Cooperation and Facilitation Investment Protocol (2017) and Australia–China FTA (2015).

As demonstrated above, a treaty provision establishing legitimate expectations as a stand-alone breach of the FET provision cannot be described as “modernized,” being out of step with modern treaty practice, which seeks to minimize or entirely exclude the role of legitimate expectations in the determination of a breach of FET.

5.7 Indirect Expropriation

Communication text:

The new provision clarifies the notion of “Direct Expropriation” and further introduces a definition of “Indirect Expropriation” together with a list of factors that are required to be considered for the determination of the existence of an indirect expropriation in each case (such as economic impact and character of the measure). As a general rule, non-discriminatory measures that are adopted to protect legitimate policy objectives, such as public health, safety and the environment (including with respect to climate change mitigation and adaptation), do not constitute indirect expropriation.

Text of the Agreement in Principle:

Article 13

(3) Indirect expropriation occurs where a measure or series of measures of a Contracting Party has an effect equivalent to direct expropriation, without formal transfer of title or outright seizure, in that it substantially deprives the Investor of the value of its Investment or of the fundamental attributes of property in its Investment, including the right to use, enjoy and dispose of its Investment.

The determination of whether a measure or series of measures of a Contracting Party constitutes indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:
(a) the economic impact of the measures or series of measures, although the sole fact that a measure or series of measures of a Contracting Party has an adverse effect on the economic value of an Investment does not establish that an indirect expropriation has occurred.

(b) the character of the measure or series of measures, including its objective and context.

(4) Except in rare circumstances when the impact of a measure or series of measures is so severe in light of its purpose that it is manifestly excessive, non-discriminatory measures by a Contracting Party that are designed and applied to protect legitimate policy objectives, such as public health, safety and the environment (including with respect to climate change mitigation and adaptation), do not constitute indirect expropriations.

Requiring public policy measures to be “non-discriminatory” in order to be carved out of the definition of indirect expropriation is highly problematic for targeted policy measures for the clean energy transition.

Indirect expropriation is another substantive protection to reform carefully: it has been claimed in 18 ECT-based arbitrations in which the investor succeeded, out of a total of 36 known cases, making it the second most widely invoked substantive protection after FET in ECT arbitrations (which reflects the general trend in all investment arbitrations [UNCTAD, 2020]). Fossil fuel investors are likely to continue to rely on indirect expropriation.

Generally, the added value of the provision on indirect expropriation in the new ECT is uncertain, and some recent agreements have excluded the provision altogether (e.g., Brazil–Suriname BIT [2018], Brazil–UAE BIT [2019], Brazil–India BIT [2020]).

Where states do consider including indirect expropriation, the precise formulation of new carve-outs for regulatory measures relating to climate change and other public policy objectives is, therefore, particularly important.

Most modern treaty carve-outs from the definition of indirect expropriation for public policy measures require those measures to meet certain requirements, including that they be “non-discriminatory.” Article 13 of the agreement in principle introduces the same requirement. However, the inclusion of this requirement could be highly problematic to the value of this exception for countries’ energy transition policy measures. In the case of early shutdown of fossil fuel projects (which IISD research shows will be necessary to keep to the 1.5°C warming limit) measures will likely need to be targeted at specific fuels or even individual projects. Such targeted measures could be construed, in a strict legal sense, as “discriminatory” and so not entitled to the coverage of this carve-out. The unqualified requirement that a public policy measure be “non-discriminatory” can be contrasted with the GATT general exceptions language, which requires “arbitrary or unjustifiable discrimination.”
In addition to the requirement that measures be “non-discriminatory,” the new language of the article, following the approach taken in the former North American Free Trade Agreement (NAFTA), provides for an exception that does not allow a clear distinction between cases of indirect expropriation and measures “that are designed and applied to protect legitimate policy objectives, such as public health, safety and the environment.” Notably, Article 13(4) states that this latter category of measures does not constitute an indirect expropriation “[e]xcept in rare circumstances when the impact of a measure or series of measures is so severe in light of its purpose that it is manifestly excessive.” As a result, arbitral tribunals are given discretion to nevertheless find that measures amount to indirect expropriations.

Several recent texts and models have taken a more effective approach to limiting the scope of indirect expropriation in order to preserve the right to regulate in the public interest, simply by indicating that a category of legitimate general measures does not constitute indirect expropriation and cannot give rise to compensation. This is for instance the case in the new Canadian API model of 2021 (Article 9.3).

5.8 Most-Favoured Nation Treatment

Communication text:

For greater legal certainty, it is clarified that the most-favoured-nation treatment clause shall not extend to dispute settlement procedures in other international agreements and the substantive provisions in other international agreements in and of themselves do not constitute “treatment” to be accorded under this clause.

Text of the Agreement in Principle:

Article 10

(4) Each Contracting Party shall endeavour to accord, in like situations, to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (5).

(5) For the purposes of this Article, “Treatment” means treatment accorded by a Contracting Party which is the most favourable of that which it accords to its own Investors or to Investors of any other Contracting Party or any third state.

[...]

(8) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, the most favourable treatment no less favourable than that which it accords, in like situations, to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

(i) For greater certainty, the “treatment” referred to in this paragraph does not include dispute settlement procedures provided for in other international agreements;
An obsolete provision? MFN treatment may lead to unintended consequences for states, so it needs to be carefully limited. Once it is carefully limited, its added value as a form of investment protection becomes even less clear.

MFN treatment is a concept borrowed from international trade law. Tribunals have considered the purpose of MFN provisions to be to “provide a level playing field ... between foreign investors from different countries.” As such, it is a relative standard that implies a comparison of the treatment of protected investors with the treatment of other foreign investors. In practice, MFN has been used in investment arbitration to allow foreign investors to import more favourable substantive rules and more advantageous procedural clauses from other investment treaties concluded by their host state (Nikiêma, 2017). As a result of this unintended expansion of the concept of “treatment” by arbitral tribunals interpreting MFN, a number of modern BITs and model agreements do not include the standard, such as the Indian Model BIT of 2015 and several of India’s BITs based on that model, as well as the Singapore–Jordan BIT (2004).

In the context of the ECT—a sector-specific multilateral investment agreement with currently more than 50 contracting parties—it is questionable whether the inclusion of MFN is appropriate or relevant. Indeed, the ECT arguably already creates a level playing field among its contracting parties.

The MFN provision of the ECT has so far been invoked in only 6 out of the 145 known ECT-based arbitrations. The limited reliance by investors on the MFN provision in the ECT does not, however, imply that the provision will not create unwanted effects. Indeed, several tribunals have construed the standard broadly and some commentators take the view that MFN clauses amount to “multilateralization devices cast in bilateral form that prevent the states granting MFN treatment from shielding more favourable bilateral bargains contained in international treaties with third states from multilateralization” (Schill, 2017).

MFN reform efforts are weakened by broadly defined scope of “treatment.”

Given the inclusion of MFN treatment in Article 10 of the agreement in principle, a clear circumscription of the meaning of “treatment” is therefore paramount. To this end, one significant development is the express exclusion of ISDS provisions from the ambit of the MFN clause in Article 10(8)(i). Article 10(8)(ii) furthermore clarifies that “the substantive provisions in other international agreements concluded by a Contracting Party with a third

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7 Bayindir v. Pakistan (I) ICSID, Award, August 27, 2009, para. 387
state do not in themselves constitute ‘treatment’ referred to in this Paragraph.” While this exclusion addresses substantive provisions contained in other international agreements “themselves,” it is uncertain whether and when other measures adopted or (contractual or regulatory) commitments entered into by a host state would qualify as “treatment.” Indeed, the second sentence in article 10(8)(ii) clarifies that “[m]easures of a Contracting Party pursuant to those provisions may constitute such treatment and thus give rise to a breach of this Paragraph.” According to this language, as long as it is concluded “pursuant to the provisions” of another international agreement, any contract entered into by an ECT contracting party with an investor from a third state could be considered as comparable treatment and allow ECT investors to claim that they have been treated less favourably if that treatment is not extended to them.

Such contractual obligations could, for instance, include provisions in concession or production-sharing, gas purchase or supply, construction, or turnkey contracts, as well as charter agreements for liquified natural gas terminals. Contractual arrangements or inducements that may be part of a finely calibrated quid pro quo in an overall deal between an investor and a state could be “cherry-picked” by an investor from an ECT contracting party, claiming that provision constitutes more favourable treatment that should be extended to them. Such an application of MFN could greatly widen the scope and uncertainty of states’ obligations toward investors in their territory. Indeed, should it be allowed to function in this manner, the MFN clause of the ECT could expose contracting parties to significant additional liabilities arising from contractual or other obligations that they never intended to form part of their commitments under the ECT.

5.9 Right to Regulate

Communication text:

Additional wording in the preamble and throughout the Treaty are introduced to reiterate and strengthen the right of Contracting Parties to regulate within their territories. For legal certainty, a new stand-alone article on the right to regulate is introduced in Part III of the Treaty to reaffirm the Contracting Parties’ right to regulate vis-à-vis Investments and Investors in the interest of legitimate public policy objectives. Such objectives may include the protection of the environment, including climate change mitigation and adaptation, protection of public health, safety or public morals. A new structure is introduced in provisions on the exceptions from the Treaty to complement the existing general exceptions building on the provisions of GATT and GATS and clarify a possibility of taking measures for the maintenance of international peace and security.
Text of the Agreement in Principle:

NEW ARTICLE: RIGHT TO REGULATE

The Contracting Parties reaffirm the right to regulate within their territories to achieve legitimate policy objectives, such as the protection of the environment, including climate change mitigation and adaptation, protection of public health, safety or public morals.

Article 24

1) The provisions of this Treaty other than Articles 12, 13, and 29 shall not preclude any Contracting Party from adopting or enforcing any measure

(a) necessary to protect public morals or to maintain public order;

(b) necessary to protect human, animal or plant life or health;

(c) necessary to ensure the safety and integrity of critical energy facilities and infrastructure;

[...]

Asserting the right to regulate is not enough to protect states’ regulatory objectives where substantive protections remain too broad and public policy exceptions too weak.

The inclusion of a stand-alone provision on the right to regulate, while a welcome inclusion in the revised ECT text, does not obviate the need for more carefully circumscribed investor protections accompanied by robust carve-outs and exceptions for states’ regulatory conduct. The right to regulate is a sovereign prerogative that exists regardless of its express inclusion in a treaty text, but a general reassertion of that right will not safeguard against overly broad substantive protections.

Recent arbitral decisions have dramatically weakened the value of the GATT-style general exceptions, and the revised text fails to address this.

With respect to the “new structure” for “exceptions from the Treaty to complement the existing general exceptions building on the provisions of GATT and GATS,” the Communication text was notably silent as to whether the general exceptions will continue to not be applicable to the expropriation provision. It is now clear that the agreement in principle maintains this exclusion by specifying in Article 24(1) that the general exceptions apply to the “provisions of this Treaty other than articles 12, 13 and 29.” This is a major limitation of the current ECT general exceptions.

Moreover, it is now clear that the revised ECT language on general exceptions has not been adapted to respond to the *Eco Oro vs. Colombia* tribunal’s highly problematic interpretation of the GATT-style general exceptions. In that already infamous decision on liability from
2021, the tribunal interpreted the general exception language (“Nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures: (a) necessary to protect human, animal or plant life or health...”) as meaning that the state was not prevented from taking such a measure, but neither was it excused from having to pay compensation for that measure—effectively rendering the exception worthless. In order to overcome this highly problematic and widely criticized interpretation, the GATT-style general exception language would need to be carefully adapted to close off the Eco Oro interpretation loophole. Expanding the GATT-style general exceptions without doing so offers little to no comfort to states that they will be able to rely on this provision to avoid financial liability for their climate regulatory actions.

5.10 Umbrella Clause

Communication text:
Only a breach of specific written commitments through the exercise of governmental authority will be covered.

Text of the Agreement in Principle:

Article 10

(13) For the purpose of this Treaty, where a Contracting Party has entered into any specific written commitment with Investors of the other Contracting Parties or with their Investments in its Area, that Contracting Party shall not breach the said commitment through the exercise of governmental authority.

The ECT’s broad umbrella clause is retained and only slightly narrowed, remaining out of step with modern treaty practice and allowing non-treaty-based breaches to be litigated with the ISDS provision.

The current text of the ECT’s dispute settlement provisions includes a broad umbrella clause, allowing any dispute between a contracting party and an investor of another contracting party “relating to an investment” to be submitted to investment arbitration under the treaty’s ISDS provisions. This is known as an “umbrella clause” because it brings non-treaty-based disputes under the “umbrella” of the treaty’s protection. Many modern investment treaties include language that removes umbrella clauses by specifying that only claims of a breach of the treaty’s obligations may be submitted to the treaty’s ISDS clause. Treaties that do this include CETA (Art. 8.18(1)) and Turkey–Colombia 2014 (Art. 12(2)).

Instead of entirely removing it, the proposal for the revised ECT text would only slightly narrow the scope of the umbrella clause, still allowing non-treaty breaches to be submitted to the treaty’s ISDS mechanism. This remains a broad umbrella clause that inappropriately risks replacing the choice of forum clause in an investor–state agreement or contract (which
would fall within the scope of a “specific written commitment through the exercise of governmental authority”) instead of respecting them.

**5.11 Transparency**

**Communication text:**

The UNCITRAL Rules on Transparency in Treaty-based Investor–State arbitration of 1 April 2014 will apply to arbitral proceedings in disputes between Investors and Contracting Parties with further additions envisaged in the Treaty. A greater transparency is introduced in dispute settlement procedures for disputes between the Contracting Parties ensuring that procedural documents in such disputes are publicly available and that the hearings may be publicly accessible.

**Agreement in Principle:**

Article 26(6)

The tribunal shall apply the UNCITRAL Rules on Transparency in Treaty-based Investor–State arbitration of 1 April 2014 (UNCITRAL Transparency Rules) with the following additions:

Nothing in this paragraph requires a Contracting Party to make available to the public or otherwise disclose during or after the proceedings, including the hearing, confidential or protected information within the meaning of Article 7(2) of the UNCITRAL Transparency Rules, or information the disclosure of which is protected under its domestic law or which it considers to be contrary to its essential security interests.

Without prejudice to Article 3 of the UNCITRAL Transparency Rules, a disputing party may also make available to the public a request for amicable settlement, an agreement to mediate, a notice of challenge or a decision on challenge of a member of the tribunal, as well, as a request for consolidation, subject to Article 7 of the UNCITRAL Transparency Rules and after redaction of confidential or protected information done in consultation with the other disputing party.

The UNCITRAL Rules on Transparency give broad discretion to tribunals to exclude the public from arbitral hearings.

In light of the increased public awareness and campaigning activities associated with the ECT and its ISDS provisions, the incorporation of the UNCITRAL Rules on Transparency in Treaty-based Investor–State arbitration is especially relevant. The UNCITRAL Rules on Transparency require the prompt publication of the fact of a dispute and key documents related to it, the disclosure of evidence upon request, and the holding of hearings in public. The rules provide for a limited discretion on the part of the tribunal to prevent or delay publication of documents where it would “jeopardize the integrity of the arbitral process,” for example, by hampering the production of evidence, intimidating witnesses, or other “comparably exceptional circumstances.”
By contrast, a tribunal has a broad discretion to decide to hold hearings in private “where this becomes necessary for logistical reasons.” This wide discretion, unfettered by the requirement of “exceptional circumstances” gives broad licence to arbitral tribunals to conduct hearings of ECT arbitrations behind closed doors in order to prevent them from becoming a target of climate campaigners’ activities. Indeed, in light of the growing attention afforded to the ECT modernization talks by climate campaigners and deliberate efforts by some activists to prevent negotiations, the mere spectre of disruptions to arbitral hearings may prompt tribunals to hold them in private—and the language of the UNCITRAL Rules on Transparency would appear to allow them to do so.

5.12 Damages

**Communication text:**

The new provision clarifies that an arbitral award may provide for monetary damages or restitution in case of expropriation. Monetary damages are limited to the loss suffered by an Investor and may not include punitive damages. As a general rule, the costs of the proceedings and other reasonable costs shall be borne by the unsuccessful party to the dispute.

**Text of the Agreement in Principle:**

Article 26

(9) An arbitral tribunal may award:

(a) Monetary damages and any applicable interest; and

(b) restitution of property, in which case the award shall provide that the respondent may pay monetary damages determined in accordance with article 13(1) and any applicable interest in lieu of restitution.

(10) Monetary damages shall not be greater than the loss suffered by the Investor, as a result of the breach of the provisions referred to in Part III, reduced by any prior damages or compensation already provided by the Contracting Party concerned. The tribunal shall not award punitive damages.

(11) The tribunal shall order that the costs of the proceedings and other reasonable costs be borne by the unsuccessful party to the dispute, unless the tribunal determines that such apportionment is unreasonable in the circumstances of the case. Where only some parts of the claims have been successful, the costs shall be adjusted, proportionately, to the number or extent of the successful parts of the claims.

(12) A claim with respect to the restructuring of debt issued by a Contracting Party may only be submitted under Article 26(4) in accordance with Annex PD.

(13) A copy of the award shall be deposited with the Secretariat which shall publish it.
On the crucial issue of damages, the revised text addresses non-issues while failing to address the real issues.

The principles governing the award of damages and the valuation techniques used to implement those principles are of critical importance to the scope of financial liability of states for treaty breaches.

This is an area largely governed by customary international law and arbitral practice, with relatively little modern treaty language aimed at restraining arbitral discretion in applying the relevant legal principles and arbitral techniques. It is now clear that the agreement in principle goes no further in addressing this critical gap in treaty practice, merely restating current principles that can lead to awards in the hundreds of millions or even billions of dollars, even for early-stage investment projects with no history of profitable operations.

Non-issue #1: The clarification on the use of restitution is meaningless: Tribunals can already order it, and states don’t want it to become widely used.

The agreement in principle states in Article 26(9)(b) that arbitral tribunals may award “restitution of property, in which case the award shall provide that the respondent may pay monetary damages determined in accordance with article 13(1) and any applicable interest in lieu of restitution.” The ability of a tribunal to award restitution in lieu of monetary damages is well established at customary international law; however, states are typically reluctant to encourage its use in investment treaty arbitration. This is because, in this context, restitution could take the form of an order that a state issue a licence wrongfully refused to an investor or that it repeal legislation that wrongfully changed the regulatory regime governing an investment. Such an order would be a deep intrusion into that state’s internal system of government: hence states’ wariness toward this remedy (Bonnitcha & Brewin, 2019). The new provision addresses this issue by requiring a mandatory mention in the arbitral award that it is at the respondent’s discretion to pay monetary damages and interest in lieu of restitution. Given this discretion, it is uncertain what the added benefit of an order of restitution would be.

Non-issue #2: Limiting damages to “the loss suffered by an investor” is mere window dressing in light of modern arbitral practice in the expansive framing of “loss.”

Article 26(10) requires that “[m]onetary damages shall not be greater than the loss suffered by the investor, as a result of the breach of the provisions referred to in Part III, reduced by any prior damages or compensation already provided by the Contracting Party concerned.” On its face, this language (found in a number of European treaties, including CETA, the Dutch Model BIT, and the EU–Vietnam Investment Protection Agreement) appears to place some limitation on the amount of monetary damages a tribunal can award. However, the largest awards of compensation in investment arbitration have been made by tribunals that explicitly accept that damages are “limited to the loss suffered by the investor.” This issue is rather that tribunals interpret the concept of “loss” very broadly, to include loss of future income streams from a project even where that project had not yet begun profitable operations. For
example, the tribunal in *Tethyan Copper vs. Pakistan* awarded the investor USD 4 billion in compensation, even though the investor had spent only USD 200–300 million making its investment—a proposed mine that had no record of profitability and had never proceeded beyond the planning stage.

The prohibition of punitive damages in the second sentence of Article 26(10)—damages that do not serve to remedy loss but rather to punish and deter—does nothing to restrict these types of outsized awards, and, in any event, punitive damages are largely irrelevant in investment arbitration practice.

**Critical issue not addressed: Silence on valuation techniques.**

While the title of this section of the initial Communication was “valuation of damages,” the text of the agreement in principle nonetheless fails to address the critical issue of valuation techniques. This is a missed opportunity to regulate the growing and highly problematic use of the discounted cash flow (DCF) methodology to value early-stage investments. The DCF methodology is behind the growing size of arbitral awards and increasing numbers of awards in the billions of dollars. As explained in Brewin & Bonnitcha (2020), the International Law Commission Articles on State Responsibility, the World Bank Guidelines on the Treatment of Foreign Investment, and some arbitral tribunals consider the DCF methodology inappropriate for the valuation of early-stage projects without an established track record of profitability. However, this method is almost always argued in favour of by investors because it increases award sizes—including awards of compensation that vastly outweigh the amount invested—and is now the most widely used valuation technique in investment arbitration (UNCITRAL Secretariat 2021).

The unfettered use of DCF is highly relevant in the context of the ECT because, as noted above, the definition of investment in the agreement in principle includes “any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.” “Economic activity” is defined to include exploration. As such, any holder of a current exploration licence would meet the definition of an investor, regardless of whether the licence holder has been granted an operational licence or started operations.

The bottom line is that licence holders for fossil fuel exploration whose licence is cancelled (or whose expected operational licence is not issued) could seek damages for harm to their investment. Where their investment is valued using DCF methodology (as is almost certainly going to be the case), they could be awarded compensation based on a forecasted future income stream for the entire life of the project. For large fossil fuel projects and long-term licences, this forecasted future income stream could easily reach the multi-millions or billions of dollars— even after the tribunal has applied a highly variable and specious ‘discount rate’ to account for future uncertainties like political risk and fluctuating fuel prices. Failing to rein in the use of DCF and other forward-looking valuation techniques is a major missed opportunity, which, read in combination with a wide definition of investment and broad substantive protections, leaves states open to extraordinary financial liabilities.
5.13 Third-Party Funding

Text of the Agreement in Principle:

NEW ARTICLE: THIRD-PARTY FUNDING

(1) Each disputing party shall disclose in writing to the other disputing party and a tribunal established under Article 26(4) the name and address, the ultimate beneficial owner and corporate structure as applicable, of any natural or legal person who provides the Third-Party Funding.

(2) Such disclosure shall be made at the time of the submission of the dispute or without delay as soon as the funding agreement is concluded or the donation or grant is made after the submission of the dispute. Any changes in the information disclosed shall be immediately notified to the other disputing party and the arbitral tribunal.

(3) The information disclosed may be considered, in addition to any other relevant information, for assessing an arbitrator's impartiality and independence.

(4) The tribunal may order disclosure of further information regarding the funding agreement and the non-party providing funding, if it deems it necessary at any stage of the proceeding.

Reminiscent of current discussions on ISDS reform at UNCITRAL Working Group III, the agreement also introduces a new provision on third-party financing (TPF). The newly introduced language is a missed opportunity to efficiently tighten the regulation of TPF in investment disputes. Firstly, particularly problematic forms of third-party funding—where the third-party funder has a speculative financial interest in the outcome of the dispute—are not restricted or prohibited. Secondly, this provision, like several recent treaties that include a similar provision (CETA, Article 8.26; Canada’s 2021 MODEL APPI, Article 42), is limited to requiring the disclosure of the "name and address, the ultimate beneficial owner and corporate structure as applicable" of the third-party funder and neglects to require further details regarding the content of the funding contract. While the "tribunal may order disclosure of further information" regarding the funding agreement and the funder, this is left entirely to tribunals’ discretion. Thirdly, the absence of any sanctions for non-compliance renders the provision moot.
Communication text:

An article has been introduced that clarifies that Articles 7 (Transit), 26 (Investment dispute settlement), 27 (disputes between Contracting Parties), 29 (trade with non-WTO members) shall not apply among Contracting Parties that are members of the same Regional Economic Integration Organisation in their mutual relations. Currently, the European Union is the only REIO Contracting Party.

Text of the Agreement in Principle:

Article 24

(3) For greater certainty, Articles 7, 26, 27, and 29 shall not apply among Contracting Parties that are members of the same Regional Economic Integration Organisation in their mutual relations.

It is uncertain whether the newly introduced article will fully prevent intra-EU arbitration. Tribunals and arbitral institutions will retain the power to determine whether the provision actually functions as a bar to jurisdiction.

The newly introduced provision in Article 24(3) of the is framed as a clarification rather than a provision containing a new rule. This is consistent with the European Court of Justice’s observations in République de Moldavie vs. Komstroy LLC highlighting that

The Court has consistently held that an international agreement cannot affect the allocation of powers laid down by the Treaties and, hence, the autonomy of the EU legal system, observance of which is ensured by the Court. That principle is enshrined in particular in Article 344 TFEU, under which the Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for in the Treaties [emphasis added].

In any event, the Court also held “that Article 26(2)(c) ECT must be interpreted as not being applicable to disputes between a Member State and an investor of another Member State concerning an investment made by the latter in the first Member State.”

It is the position of the European Commission that this was already applicable law and that arbitral tribunals constituted on the basis of the ECT in relation to intra-EU disputes always lacked jurisdiction to hear intra-EU claims. Consequently, the Commission considers the content of the newly introduced article as a mere restatement of law that was already applicable and that it would be wrong to assume that this is a rule with retroactive effect.

The inclusion of a new provision on the application of the ECT to intra-EU disputes is a welcome clarification. In practice, it may, however, be uncertain whether this clarification will
be successful in preventing intra-EU arbitration in the future. Investors may still attempt to submit an intra-EU dispute to arbitration pursuant to Article 26 of the ECT, which remains unchanged as it is outside of the negotiation mandate. Subject to the fork-in-the-road provision in Article 26(3)(b)(I), they will have four options of different “modes” of arbitration contained in Article 26(4), including arbitration pursuant to the ICSID rules, the ICSID Additional Facility Rules, the rules of the SCC Arbitration Institute, or ad hoc arbitration pursuant to the UNCITRAL Arbitration rules. Depending on the mode chosen, the question of whether the newly introduced article functions as a bar to jurisdiction may be determined by arbitral institutions or arbitral tribunals themselves.

For instance, the relevant rules of ICSID and the SCC Arbitration Institute provide for a prima facie test of whether consent has been given to submit a dispute to arbitration. In case of a request for intra-EU arbitration, it will be for these institutions to decide whether the claim will move forward to the constitution of an arbitral tribunal. In the alternative of ad hoc arbitration pursuant to the UNCITRAL rules, the arbitral tribunal will decide on jurisdiction: Pursuant to Article 21 of the UNCITRAL Arbitration Rules on “Pleas as to the jurisdiction of the arbitral tribunal,” “The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction, including any objections with respect to the existence or validity of the arbitration clause or of the separate arbitration agreement.”

The activation of an arbitral institution at such an early stage, or the prior constitution of an arbitral tribunal in the case of ad hoc arbitration will generate procedural costs and raise issues of legal uncertainty as to whether institutions or tribunals will accept pleas of a lack of jurisdiction on the basis of the new article. Additionally, it may incentivize investors to submit intra-EU disputes to ad hoc rather than institutional arbitration.

In many cases, the procedural control exerted by the EU and its courts over ECT-based ISDS will be limited and may frustrate the intention behind the REIO clause. This applies to all stages of arbitral proceedings, from preliminary questions of jurisdiction to the enforcement stage.

Moreover, arbitral tribunals that would have to determine questions of jurisdiction in intra-EU disputes in light of the newly introduced article might have their seat outside of the EU. In such cases, EU courts would lack the supervisory role to issue injunctions and prevent cases from moving forward to a consideration of the merits. While respondent states could still petition EU courts to request an annulment of an award for lack of jurisdiction, it is uncertain whether such an annulment would prevent enforcement of the (annulled) award in other jurisdictions outside of the EU (Teo, 2019). This is especially the case where awards are enforced on the basis of the New York Convention. In the case of the ECT, this becomes

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8 See Article 36(3) of the ICSID Convention; See Article 9 of the Arbitration Rules of the SCC-AI; related to arbitral proceedings administered by the SCC-AI, the threshold to find prima facie jurisdiction has been described as low, see Magnusson and Larsson (2004) pp. 47–84, here p. 50.

9 As the tribunal in Perenco v. Ecuador emphasized, it is for the secretariat of the arbitral tribunal “to perform an initial check in order to dismiss immediately any requests manifestly outside the jurisdiction of the centres,” Perenco v. Ecuador, ICSID, Decision on Provisional Measures, 8 May 2009, para. 39.
relevant where proceedings are conducted pursuant to the UNCITRAL rules or administered by the SCC Arbitration Institute.

Concerns remain in relation to the ECT’s status as integral part of the EU legal order.

Moreover, the newly introduced article only excludes the application of a limited number of ECT provisions among member states of a REIO. Since the ECT forms part of the EU legal order, as is confirmed by case law of the European Court of Justice, the relevant remaining provisions of the ECT would continue to apply to intra-EU investments.

Despite the clarification that Article 26 is not applicable among EU member states, foreign investors could still bring a claim in the national courts or administrative tribunals of EU member states. This implies that the substantive investment protection standards in the new ECT, including FET and indirect expropriation will continue to apply to intra-EU disputes and remain enforceable in EU courts.

The modernized treaty therefore apparently fails to address the numerous conflicts of the ECT’s substantive investment protection standards with other areas of EU law, including the free transfer of capital or public policy requirements.

5.15 Non-derogation clause

The agreement in principle now clarifies that the contracting parties intend to delete the controversial non-derogation clause in Article 16 of the existing ECT. As observed by Atanasova (2022), non-derogation clauses generally "guarantee to investors the benefit of the more favourable among two potentially applicable provisions." Maintaining article 16 in the reformed ECT would have offered investors a choice between “reformed ECT provision and unreformed coexisting IIA provisions.” In other words, investors would have been able to import more favourable provisions in international investment agreements that coexist with the ECT into the ECT regime. The deletion prevents this risk and represents a welcome clarification.
6.0 Elements not Addressed by the “Modernization”

6.1 Dispute Settlement

Partly due to the constraints imposed by the initial mandate of the Energy Charter Modernization Group, the ECT contracting parties have taken an inconsistent approach to the reform of the problematic ISDS mechanism, introducing some new provisions on procedural aspects of dispute settlement while leaving the mechanism itself intact. The lack of a fundamental reform of the mechanism itself is one of the key weaknesses of the “modernization,” as many of the most pressing concerns relate to the way in which ISDS allows for the enforcement of other treaty provisions.

The lack of a reform of the mechanism also raises issues for the EU, particularly in relation to the potential EU-extraterritoriality of ISDS. The degree of procedural oversight of the EU and its courts over arbitral proceedings brought against it or its member states may thus be severely limited depending on the circumstances of an arbitration. For instance, arbitral proceedings may have their seat outside of the EU, and hearings may also be held elsewhere, giving domestic courts outside of the EU extensive and potentially unintended degrees of procedural oversight. In practice, this implies, for instance, that any court outside the EU might be asked to determine whether an arbitral tribunal lacks jurisdiction due to the newly introduced provision on REIOs and the exclusion of intra-EU arbitration.

Moreover, arbitral institutions administering ISDS proceedings may be located outside of the EU, and the decisions of these institutions, which may be vital for the cost and outcome of the proceedings, would not be subject to the oversight of EU courts. In addition, arbitral awards annulled by EU courts, for example on the basis of any of the newly introduced provisions and exceptions in the ECT, may still remain enforceable outside of the EU.

In addition to these broader concerns, the changes to the dispute settlement mechanism of the ECT do not extend to a number of important procedural issues that many modern investment treaties and ongoing reform processes aim to address, including:

- Consolidation or joinder of multiple proceedings, including those stemming from shareholders’ reflective loss claims (especially relevant in the context of the ECT’s asset-based definition of investment that does not exclude portfolio investments).
- Provisions for a predetermined roster of arbitrators from which tribunal appointments must be made (the approach taken in CETA).
- A code of conduct for arbitrators and disclosure rules to prevent “double-hatting” and other conflicts of interest.
- Requiring the exhaustion of local remedies before a claim can be submitted to ISDS.

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• Rules regulating the participation of non-parties in arbitral proceedings and the submission of *amicus curiae* briefs.
• Provisions affirming the right for the state to make counterclaims.

### 6.2 The Survival Clause

When determining the list of topics for ECT “modernization” in 2018, the contracting parties did not include the ECT’s survival clause. This is a major setback, limiting states’ ability to meaningfully exit the treaty by locking in existing investment protection for 20 years post-withdrawal.

The survival clause contained in Article 47(3) of the treaty provides that in the event of a withdrawal by a contracting party, the provisions of the ECT shall continue to apply to investments made (1) in the area of the withdrawing contracting party by investors from other ECT contracting parties, and (2) in the area of other ECT contracting parties by investors from the withdrawing contracting party, *for a period of 20 years after the withdrawal takes effect*.

In general, the 20-year survival period stands in stark contrast with the rapidly changing energy market and the need for states to take regulatory measures flexibly and to constantly adapt their energy policies to remain on track for their 1.5°C objectives. Moreover, the survival clause prevents states from limiting any damages linked to unintended consequences stemming from the revised ECT text by effectively locking in the status quo. This is particularly problematic in light of the number of new provisions that remain untested at the scale of an investment agreement with 52 contracting parties.

The failure of the contracting parties to revise the survival clause is also a missed opportunity when compared to recent treaty practice, where states have increasingly frequently reduced, removed, or omitted survival clauses altogether. For example, survival clauses were shortened as part of the incorporation of the Argentina–Chile FTA into the Chile–Mercosur Agreement in 2017, the termination of the Australia–Mexico BIT, and the termination of the Australia–Viet Nam BIT. In addition, some recent agreements replacing previous agreements, such as the 2019 Uruguay–Australia BIT, overrode pre-existing survival clauses. Another example of states extinguishing a survival clause by consent comes from the agreement for the termination of BITs between the member states of the European Union.
7.0 Conclusion

The agreement in principle for a “modernized” ECT, reveals an instrument that remains a serious obstacle to states’ ambitions to limit global warming to 1.5°C.

With regard to the protection of fossil fuel investments, only the EU and the United Kingdom will carve out certain fossil fuels from investment protection. Most fossil fuel investments made by more than 20 other contracting parties of the ECT would continue to be protected indefinitely. This is a major setback for multilateral efforts to curb emissions as it would lock in fossil fuel investment protection across an entire region. Moreover, the EU carve-out itself lacks ambition, is ill-aligned with other EU climate policies, and its implementation is uncertain. Broad exceptions for gas-related investments, the definitions of which contradict the EU taxonomy for sustainable activities, afford extensive protection for such investments in the future. Key questions also remain in relation to the entry into force of the carve-out, generating a risk of piecemeal implementation, further delays and legal uncertainty. The revised treaty is also wider in subject-matter scope introducing new and untested energy materials, products and technologies and thereby increasing the risk of new ISDS claims.

Besides the protection of fossil fuel investments, the approach taken in several substantive investment provisions—FET, definition of investment, and the umbrella clause—is out of step with modern treaty practice, including recent EU investment agreements. The reformed ECT will continue to grant arbitral tribunals considerable interpretive discretion to construe these standards broadly and expose states to liability.

Finally, the reform leaves the most problematic provision—the investor-state dispute settlement mechanism—intact. Despite the EU’s support for a multilateral investment court, no such institutional reforms are made. Moreover, it is uncertain whether arbitral tribunals will interpret the new provision on Regional Economic Integration Organization aimed at preventing intra-EU ISDS, as intended. New provisions aiming to rein in speculative valuation techniques used by arbitral tribunals and to regulate the problematic practice of third-party funding lack ambition and are too limited to make a difference in practice. Leaving the survival clause untouched locks in these shortcomings for an additional 20 years after a state withdraws from the “modernized” ECT.
References


Uncertain Climate Impact and Several Open Questions


