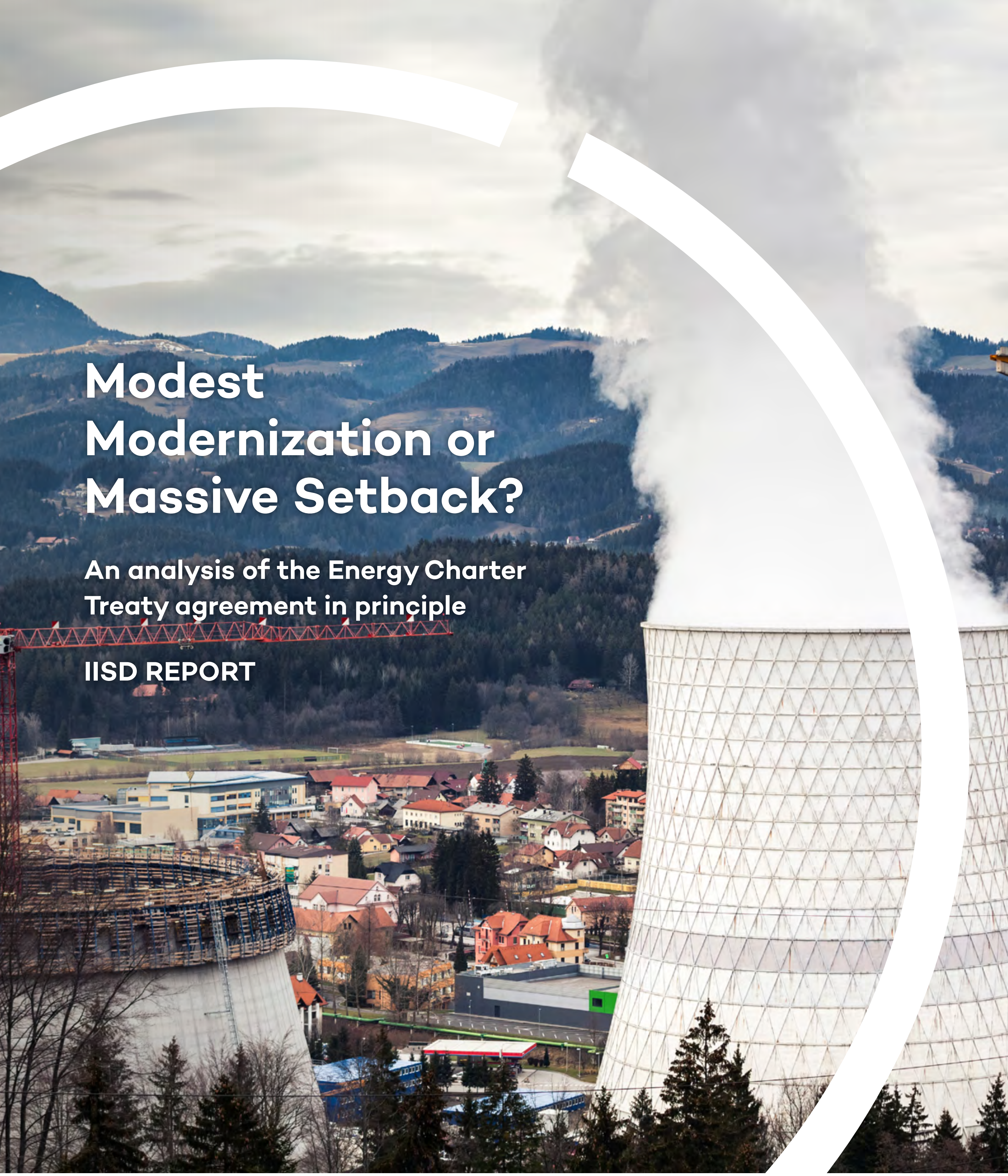

Modest Modernization or Massive Setback?

An analysis of the Energy Charter Treaty agreement in principle

IISD REPORT

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Written by Sarah Brewin and Lukas Schaugg with contributions from Olivier Bois von Kursk and Lucile Dufour

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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, the contracting parties reached an agreement in principle for the modernization of the treaty on June 24, 2022. While the text of the agreement in principle remains confidential, the public communication of the contracting parties provides certain key insights about what has been agreed.

This paper provides a detailed analysis of selected key aspects of the public communication explaining the main changes in the agreement in principle on the modernization of the ECT ("the Communication") released by the Energy Charter Secretariat on June 24, 2022.

The paper explains both the changes outlined in the Communication and identifies key areas where no change has been indicated, with a view to examining how the revised ECT text will impact the critical objective of limiting global warming to 1.5°C.

The analysis concludes that, while the 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.

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 (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, including the definitions of "economic activity in the energy sector," "investment" and "investor," as well as the updated list of energy materials and products. The analysis also considers 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 potential implications. Moreover, the analysis also considers 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, 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 mentioned in the Communication that are not addressed in this analysis, either because they are less critical to the overall scope and impact of the revised ECT, or because the Communication offers too little detail on the changes to make a useful analysis possible at this time. It will be nevertheless important to carefully analyze and understand these provisions once the final revised text is made public.

In addition, 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

- In the EU and United Kingdom, existing fossil fuel investments will continue to enjoy ECT protection for at least 10 more years—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).
- In almost all remaining contracting parties, existing and new fossil fuel investments could continue to be covered indefinitely.
- 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 provisions remain 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 provisions, including valuation, are limited and superficial. Failing to rein in the use of forward-looking valuation techniques such as discounted cash flow methodology is a major missed opportunity. Read in conjunction with a wide definition of investment and broad substantive protections, this leaves states open to extraordinary financial liabilities for their climate action.

Continued 20-year survival clause

- 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 Analysis of Elements Mentioned in the Communication

4.1 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.

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) provides in its relevant part that "'Investment' refers to any investment 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.[1] 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. Assuming that this structure will, in essence, be maintained in the revised ECT, extending the scope of the definition of economic activity in the energy sector to additional "business activities and sources of energy" will increase the risk of 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

[1] See sections on "investment" and "investor–state dispute settlement" below.

in decarbonization technology. Any policy rationale related to an alleged promotion of such investments is therefore at least questionable.

It is also uncertain whether "carbon capture, utilization, and storage" (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 (CO_2) 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 CO_2. Overall, the global current capacity for CCUS is only about 56.7 million tCO_2 per year.[2]

Although many energy transition models assume that CCUS could eventually sequester several billion tCO_2 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 scale 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 tCO_2 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 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

[2] BloombergNEF (2022).

the regulatory changes, which one tribunal described as a "rational policy" that "had the aim of protecting the consumer."[3]

4.2 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.

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 increases the risk of arbitration claims. 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. For instance, the list does not appear to 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. Grey hydrogen and most anhydrous ammonia 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. In addition, some of the listed products are not climate neutral at the consumption stage.

[3] *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153, Final Award, July 17, 2016. Para 823. https://www.italaw.com/sites/default/files/case-documents/italaw9219.pdf.

4.3 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.

The effectiveness of the newly introduced flexibility mechanism remains unclear owing to open questions on its governance and design.

Contracting parties have introduced a new idea of how investment protection of fossil fuels might be limited through a so-called "flexibility mechanism." The Communication does not specify, however, how this mechanism would be implemented in the new ECT apart from the fact that it would allow "contracting Parties, based on a Conference decision, to exclude investment protection for fossil fuels in their territories." Given that an exclusion would be based on a Conference decision, it is likely that the intended flexibility for ECT contracting parties to carve-out fossil fuel investments will be limited to some extent and require some form of consent by the other contracting parties.

Should the flexibility mechanism leave the existing system of annexes and the relevant voting rules in Article 36(1)(d) of the current ECT intact, any exclusion of fossil fuels from investment protection would require a unanimous decision of all contracting parties present and voting to modify the relevant annex. Obtaining such a decision from possibly more than 50 states would constitute an exceptionally high threshold and raise questions as to how "flexible" the intended mechanism really is.

The fact that the official communication mentions that "the EU and the UK have opted to carve-out" certain fossil fuel investments appears to imply that both the EU and UK have obtained at least affirmations by all other contracting parties that they would support such a step. This raises the issue of the temporal effect of the flexibility mechanism: Will the individual fossil fuel carve-outs be decided at the same time as the adoption of the other amendments by the Charter Conference, i.e., on November 22, 2022? And how flexible will the mechanism be for other contracting parties wishing to carve out fossil fuels at a later date?

The EU and UK's apparent desire to carve out fossil fuels from investment protection in certain circumstances leaves many questions open. The answers to these questions will be crucial for determining the risks and benefits of staying in the ECT or proceeding with coordinated withdrawal for EU member states.

The EU and the UK appear to have expressed their desire to carve out certain fossil fuel activities from investment protection through the flexibility mechanism, but how, and importantly when, this carve-out would be put into practice remains unclear. The EU carve-out appears to follow the EU's (2021) additional negotiation proposal that initially intended to limit 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. Existing investments will be protected for a period of "10 years from the entry into force of the relevant provisions." Therefore, in order to fully gauge the effect of this carve-out, it is critical to understand; a) when it would come into force and b) which investments would be protected as "existing" investments at the time it came into force. There remain major open questions as to both of these elements.

Open question 1: When will the carve-out enter into force?

The provisions of the current ECT require significant procedural steps before the revised ECT can enter into force (in the absence of provisional application, which may be difficult to achieve in the EU and elsewhere).[4] Firstly, the package of amendments and changes now proposed will have to be adopted by a unanimous decision of all contracting parties present and voting at the Charter Conference in November pursuant to Article 36(1) of the current ECT. Secondly, any amendments would still need to be ratified, accepted, or approved by at least three fourths of all contracting parties before the new ECT could enter into force (Article 42(4) ECT). Importantly, this would mean that at least 39 contracting parties would have to do so, 12 more than the EU and its member states.

In light of this high threshold, a rapid entry into force of the treaty is far from certain, making it unclear from what date the 10-year-period of additional protection would start to run. This means that in practice, *existing* fossil fuel investments might continue to be protected for significantly more than 10 years.

Open question 2: How many more investments will start to "exist" before the carve-out comes into force?

The category of "existing investments" raises key concerns both on its own and when read in conjunction with other provisions of the revised ECT. On its own, the temporal category of "existing" is highly unclear and problematic when coupled with the highly unclear question of when the carve-out will enter into force. This is because, until the carve-out does enter into

[4] See section on provisional application.

force, any number of additional investments may start to quality as "existing" investments. The longer the delay in the carve-out entering into force, which is entirely outside the control of the parties intending to use the carve-out, for the reasons outlined above, the more "existing" investments there will be. This is especially concerning in light of the fact that the 10-year timeframe, even if it started tomorrow, is itself not aligned with the recent International Energy Agency and IPCC scenarios that require states to phase out existing fossil fuels.

Open question 3: What does "existing investments" mean? Will it include early-stage investments that have been licensed but not started operating?

Read in light of the broad asset-based definition of investment (discussed further below), it is likely that "existing investments" will 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 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 streams even for an early-stage project with no proven record of profitability (see for example *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 protection as an "existing investment" for the purposes of the flexibility mechanism.

Open question 4: Who will use the mechanism?

Only the EU and the United Kingdom have been expressly mentioned in the Communication. This may be an indication that at least 23 of the remaining contracting parties have opted not to make any fossil fuel carve-out, in which case the new ECT would continue to protect fossil fuel investments made in the area of these contracting parties indefinitely. Importantly, these other members include major oil-producing states, such as Kazakhstan, as well as major capital-exporting states such as Japan and Switzerland. If this were the case, the new ECT would effectively lock in investment protection for fossil fuel investments indefinitely across an entire region—an additional blow to multilateral efforts to curb emissions.

These open questions significantly detract from the attractiveness of the flexibility mechanism—coordinated withdrawal may still be preferable.

The scope of these unanswered questions outlined above—and indeed their likely answers—makes it very difficult to conclusively evaluate the preferability of remaining in the revised

ECT and making use of the flexibility mechanism with the 10-year phase-out, as against a coordinated withdrawal subject to the 20-year survival clause. Subject to how the above questions are answered, coordinated withdrawal may still make the most sense for states concerned about the ECT's compatibility with their climate agenda, including the EU parties to the ECT.

4.4 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.

The Communication does not specify how this review mechanism will be implemented. In the current version of the ECT, the "list of Energy Materials covered under the ECT" is contained in Annex EMI. Pursuant to Article 36(1)(d), any modification of this annex requires unanimous approval by all contracting parties present and voting at the relevant meeting of the Charter Conference. If these voting rules will remain in place, it is uncertain whether and how the review mechanism would, in fact, lower the threshold for contracting parties "to react to technological as well as political developments."

4.5 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 laws[5] 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.

[5] 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.

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 use of the flexibility mechanism noted above. In particular, the definition of investment does not currently cohere with the concepts of "existing investments" and "new investments" in the manner likely to be understood in the context of the flexibility mechanism. For example, the definition of investment in the current text of the ECT 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, **any holder of a current exploration licence would meet the definition of an investor**, regardless of whether or not the licence holder has been granted an operational licence or started operations. This means that the new ECT would continue to offer extensive investment protection to a number of fossil fuel investments exceeding the number of investments that are already producing by far.

For the purposes of the EU carve-out, for instance, the EU negotiators may have intended to classify an exploration licence for a fossil fuel project that has not started production as a "new investment." As such, the EU carve-out may require its own definition of "new investment" and "existing investment" rather than relying on those found in the text of the treaty, if the mechanism is to operate as intended by the EU.

The revised definition of investment misses four 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 assumed that the final text of the "modernized" ECT will maintain the asset-based definition of investment that is found in the current text instead of replacing it with an enterprise-based definition. Several recent bilateral investment treaty (BIT) models—for example the BIT models of India (2015), Colombia (2017), and Canada (2021)—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. The Communication explains that per the new definition, an investment will be required to "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." These three elements are derived from a test first set out by the tribunal in *Salini v. Morocco* (known as the Salini test). But there is a fourth 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).

It is also noteworthy that the Communication describes these Salini test elements as an "indicative list." An alternative approach that would have a greater binding effect would be 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–UK BIT, 2010).

The Communication explains that the revised definition excludes or limits certain asset types from being considered an investment or having access to the ISDS mechanism. The Communication mentions judicial and administrative decisions and arbitral awards, claims to money and credit from commercial sales contracts, and specific public debt instruments, but 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.

[6] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, Decision on Jurisdiction, July 31, 2001, Paragraph 52.

For example, the definition of investment in the Turkey–Azerbaijan BIT 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 and fails to require that an investment be conducted in accordance with host state laws.

The Communication notes that in order to enjoy treaty coverage under the revised ECT text, an investment must 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, this should be explicitly linked to in the ISDS provision. 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].

4.6 FET

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.

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 challenge 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).

It is assumed for the purposes of this analysis that the list of measures violating FET is a closed list, and that 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 described in the Communication 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 provides 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.

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, expressly exclude legitimate expectations, providing

> For 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. It is difficult to conceive of a treaty text that will be able to clearly define, ex ante, the "circumstances that give rise to Investor's legitimate expectations and the conditions under which legitimate expectations may be considered" in such a way that does not lend itself to the types of expansive and unexpected arbitral interpretations that prompted the wholesale rethink of FET provisions in the first place.

4.7 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.

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 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]). When construing indirect expropriation, arbitral tribunals often follow the "sole effect doctrine" focusing on the impact of the measure in question on the economic value of the investment (Bonnitcha, 2014). On the contrary, tribunals have held conflicting views as to whether the intent of the host state in adopting the measure should be taken into account—raising doubts as to whether tribunals would indeed take into account public policy rationales or climate-related considerations.[7]

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." However, the inclusion of the "non-discriminatory" 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."

4.8 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.

An obsolete provision? Most-favoured nation (MFN) treatment may lead to unintended consequences for states, so needs to be carefully limited. Once it is carefully limited, its added value as a form of investment protection becomes even less clear.

[7] Cases in which tribunals took the view that host state intent should not be taken into account when considering whether a measure has amounted to indirect expropriation include: *Inmaris Perestroika v. Ukraine*, ICSID, Award, March 1, 2012, para. 304; *Chemtura v. Canada* PCA, Award, August 2, 2010, para. 242; *National Grid v. Argentina*, Ad hoc Arbitration, Award, November 3, 2008, para. 147; *Telenor v. Hungary* ICSID, Award, September 13, 2006, para. 70.

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."[8] 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 (Nikièma, 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 53 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).

Inclusion of MFN requires significant precautions to circumscribe the scope of "treatment."

Given the inclusion of MFN treatment in the new ECT, a clear circumscription of the meaning of "treatment" is therefore paramount. The Communication states inter alia that the new MFN provision clarifies that "the substantive provisions in other international agreements in and of themselves do not constitute 'treatment' to be accorded under this clause."

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." Unless carefully circumscribed, any agreement entered by an ECT contracting party with an investor from a third state could be considered as comparative 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

[8] *Bayindir v. Pakistan* (I) ICSID, Award, August 27, 2009, para. 387

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.

4.9 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.

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 is notably silent as to whether the general exceptions, currently contained in Article 24, will continue to not be applicable to the expropriation provision. This is a major limitation of the current ECT general exceptions.

It is also unclear whether the revised ECT language on general exceptions will be 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.

4.10 Umbrella Clause

Communication text:

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

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)), Japan–Ukraine BIT 2015 (Art. 18(1)), 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.

4.11 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.

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.

4.12 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.

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. The Communication indicates that the revised ECT text 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 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).

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."'

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—damages that do not serve to remedy loss but rather to punish and deter—does nothing to restrict these types of outsize 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 Communication is "valuation of damages," it 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 current text of the ECT 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 a licence holder 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.

4.13 REIO

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.

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.

This provision appears to be 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[9] 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.[10] 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 will generate procedural costs and raises issues of legal uncertainty as to whether a tribunal 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 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, according to the Communication, the newly introduced article only excludes the application of a limited number of ECT provisions among member states of a REIO. Since

[9] 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.

[10] 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.

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 therefore 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 requirement.

5.0 Elements not Addressed by the "Modernization"

5.1 Dispute Settlement

Partly due to the constraints imposed by the initial mandate of the Energy Charter Modernization Group,[11] 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 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 described in the Communication 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.

[11] See Energy Charter Secretariat (2018).

- 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.

5.2 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 53 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.

6.0 Conclusion

The agreement in principle for a "modernized" ECT, as summarized in the Communication, reveals an instrument that remains a serious obstacle to states' ambitions to limit global warming to 1.5°C. The revised ECT will continue to protect fossil fuel investments for at least 10 years in some states, and indefinitely in others. The revised treaty is wider in subject-matter scope, retaining broad and generous investor protections with weak carve-outs to shield state regulatory action from ISDS claims. The approach in several key provisions—FET, definition of investment, and the umbrella clause—are out of step with modern treaty practice, including recent EU investment agreements. New provisions aiming to allow EU member states to exclude fossil fuel investments and prevent intra-EU ISDS raise as many questions as they answer. It appears unlikely that they will work as intended. Leaving the survival clause untouched locks in these shortcomings for an additional 20 years after a state withdraws from the "modernized" ECT. The ISDS mechanism remains intact; no institutional reforms are made, despite the EU's support for a multilateral investment court, and new ISDS provisions are largely superficial, continuing to leave states exposed to extraordinary financial liabilities for their climate action.

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