

Brussels, 23rd April 2020

Re: The modernisation of the Energy Charter Treaty - ensuring consistency and mutual supportiveness between climate, energy and investment policies

Dear Executive Vice-President Timmermans,

CC Commissioners: Kadri Simson (Energy), Virginijus Sinkevičius (Environment), Phil Hogan (Trade)

CC Directors General: Ditte Juul Jørgensen (DG Energy), Mauro Petriccione (DG Clima), Daniel Calleja Crespo (DG Env), Sabine Weyand (DG Trade)

We write to you to express our concerns regarding the modernisation process of the Energy Charter Treaty and the risk that this process jeopardises the EU's climate action undertaken by the European Commission. As the responsible authority to deliver on the Green Deal, we call on you to ensure that actions of the Commission in matters related to trade and investments are aligned with the commitments of the Commission in environment and climate matters.

The EU has a crucial and leading role to play in addressing the climate emergency. In order to achieve international climate goals and make the EU climate-neutral by 2050, the European Commission has recently delivered its plan for a European Green Deal and proposed a new Climate Law. The implementation of these initiatives will require ambitious targets and bold measures.

As you have already stated, the current COVID-19 crisis reveals the extent to which we cannot continue business as usual. We need to make a shift to sustainable practices in order to ensure we engage in a green transition. The EU will not succeed in delivering its Green Deal unless it changes the way it conducts trade and regulates investments.

We see the Energy Charter Treaty, to which the EU and most of its Member States are party (Italy left in 2016), as an important obstacle to climate action, including the above-mentioned plans. The Energy Charter (ECT) is a plurilateral trade and investment agreement applicable to the energy sector. The ECT was elaborated by the EU in the post-Cold War era in the 1990s and was signed in 1994 which makes it outdated and unfit to address the environmental and climate challenges we face today. The treaty requires states to compensate foreign investors in case of direct and indirect expropriation; to treat foreign investors 'fairly and equitably'; and not to discriminate between foreign and national investors or among foreign investors, among other provisions. Foreign investors can allege a breach of the treaty before arbitral tribunals and request compensation, using the investor-state dispute settlement (ISDS) mechanism in the treaty.

Many cases under the ECT have led to large damages awards, in the hundreds of millions or billions of EUR, the types of damages that would not be possible under national law. Because of the risk that investors may initiate legal action using ISDS, governments may be discouraged from introducing new levels of protection or may be encouraged to revoke or dilute existing environmental and social regulations.

To date, there have been 129 known claims from energy companies under the ECT, who have used it to challenge various government measures, including environment and energy measures. Companies have already started using the treaty as a lobbying tool to put pressure on governments to avoid enacting new stringent regulations, shift their stranded assets onto states following new climate or environmental regulations, or challenge and delay environmental and energy policies¹.

The danger is clear: if the EU and its Member States get serious about their ambitious climate targets, the measures they will have to put in place are going to be under significant threat of investor-state arbitration.

Acknowledging the widespread concerns over the ECT, the European Commission has recently submitted a draft proposal to its Member States for the ongoing modernisation process of the treaty, suggesting that some of the ECT's vague language be tightened with respect to definitions and substantive investment standards, and that the treaty reaffirm states' right to regulate in the public interest. While this gives some guidance to arbitral tribunals (or if it ever came to exist, the multilateral investment court, currently rejected by other ECT members, such as Japan), there is still the risk of being sued in international arbitration for implementing strong climate measures.² The Commission's proposal for a modernised ECT continues to allow foreign investors to go straight to investment arbitration, without first going through the national court systems. Nothing in the Commission's proposal addresses the fact that acts that would not be compensable under national law would still be compensable and subject to potentially high damages awards under the ECT.

Importantly, the ECT, even if revised according to the Commission's proposal, would still produce a dangerous chilling effect on environmental and social regulation. The fossil fuel industry does not need to win on the legal arguments. The threat or initiation of an ISDS claim can be enough to delay or undermine policy action, even across borders, regardless of the arbitration's outcome. In order to eliminate any risk of challenges to climate action measures under the ECT, the EU should, at a minimum, propose that these be carved out from the scope of ISDS. To avoid potential abuse, states could still rely on the ECT's State-to-State dispute settlement mechanism under Article 27, which is not as high-risk as ISDS.

But even if such a carve-out were to be adopted, the main focus of the ECT would still be on 'investment protection'. Cosmetic changes, as suggested by the EU, will not amount to 'modernisation' and will fall far short of making the ECT fit-for-purpose. Without more significant changes, it will not contribute to the achievement of the EU's and its Member States' climate action objectives. This process should instead be used as an important opportunity to transform the ECT into a positive force for the clean energy transition.

For example, the ECT should move away from its long-standing approach of not distinguishing between energy sources, which in any case is no longer reflective of the EU's own policy priorities. Instead, the ECT could be redesigned to differentiate clearly between those energy investments that are less carbon-intensive and those that are more so. States could designate, based on what is most appropriate for their respective situations, which sector or sub-sectors would eventually

¹ See for instance the threat of litigation by the German company Uniper against the Netherlands in relation to the decision to implement a coal phase-out; the case brought by British-based company Rockhopper against Italy over refusal to grant a concession for oil drilling in the Adriatic sea; or the cases brought by Vattenfall against Germany to challenge its nuclear phase-out and environmental restrictions on a coal-fired power plant. ISDS has also been used under similar treaties to challenge a range of environmental measures, including a coal phase-out and moratorium on fracking in Canada, and the rejection of an oil pipeline project in the United States.

² See further analysis on the Commission's current proposal for the modernisation of the ECT by ClientEarth, available at <https://www.documents.clientearth.org/wp-content/uploads/library/2020-04-23-legal-briefing-on-the-commission039s-draft-proposal-for-the-ect-modernisation-ce-en.pdf>.

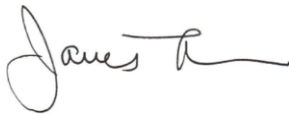
be phased out – drawing from the bottom-up nature of the Paris Agreement’s Nationally Determined Contributions.³

We therefore urge the Commission to reconsider its position on the ECT and to align it with the EU’s overarching objectives to combating climate change:

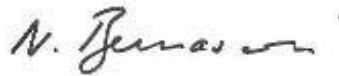
- Ensure mutual supportiveness between environmental and economic goals set at the international level by redesigning the ECT to help achieve states’ international climate commitments;
- Differentiate low-carbon from carbon intensive investments and commit to redirecting capital flows away from investments in fossil fuels and other carbon-intensive energy sources toward low-carbon investments in clean, renewable energy;
- Shield climate response measures from ISDS challenges via a specific ISDS carve-out to avoid any potential chilling effect of international disputes and large damages awards;
- If ISDS is retained for non-climate related measures, require investors to first seek redress for any harm allegedly caused within the host state’s domestic legal system;
- Clarify that investment protection may not come at the expense of human rights and environmental obligations; and
- Hold investors accountable through an ECT accountability mechanism.

The success of the modernisation process depends on the achievement of ambitious reforms that will ensure that the ECT facilitates, rather than frustrates, government actions under the European Green Deal and the proposed Climate Law.

Yours sincerely,



James Thornton
CEO
ClientEarth



Nathalie Bernasconi-Osterwalder
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³ Further details on how such an approach can work are elaborated in “Redesigning the Energy Charter Treaty to Advance the Low-Carbon Transition”, by N. Bernasconi-Osterwalder and M.D. Brauch in *Transnational Dispute Management*, available at <https://www.iisd.org/sites/default/files/publications/tv16-1-article08.pdf>.