Modernisation of the Energy Charter Treaty

The European Commission is currently negotiating a revision of the 1994 Energy Charter Treaty (ECT). This revision would, inter alia, reform the ECT's investor–state dispute resolution mechanisms and explicitly allow countries to take regulatory actions affecting existing investments, for reasons such as environmental protection or climate action. The overarching objective is to ensure that the ECT is modernised in a way that would avoid the EU and its Member States deciding to withdraw from the ECT on either a coordinated or a unilateral basis.

Background

The Energy Charter Treaty (ECT) is a multilateral agreement that provides a binding framework for energy cooperation between its 53 signatories and contracting parties, consisting of 51 member countries plus the EU and Euratom in their own capacity. The ECT was signed in December 1994 and entered into legal force from April 1998. It is complemented by the European Energy Charter (1991) and the International Energy Charter (2015), which are non-binding political declarations setting out the goals of the Energy Charter process. Some countries have signed one or both of these political declarations but not ratified the ECT.

The ECT covers the full process of energy investment, production, supply and consumption. It was crafted in a particular geopolitical context after the fall of the Soviet Union (USSR), when many Western countries and their companies were keen to invest in modernising the energy sectors of eastern Europe, but were concerned about the legal protection of their investments. ECT provisions therefore focus on the protection of foreign investments; non-discriminatory treatment in energy trade; resolution of disputes between member countries; resolution of disputes between member countries and foreign investors, involving the use of international arbitration mechanisms; and the promotion of energy efficiency and environmental protection. The Energy Charter process is managed by a small secretariat based in Woluwe (Brussels). A 2017 EPRS in-depth analysis provides a comprehensive overview of the ECT's organisation and objectives, and analyses the main challenges it has faced, including Russia's withdrawal and dispute resolution.

Europe and the ECT

The EU and its Member States are original contracting parties to the ECT, and still account for over half of its member countries. The ECT has also been ratified by several non-EU countries in Europe (Western Balkans, EFTA/EEA countries, United Kingdom). Other contracting parties are energy-producing and/or transit countries in the former USSR, which developed strong energy supply chains to western Europe during the Cold War. Russia was an original contracting party, but never ratified the ECT and ultimately withdrew in 2009 for several reasons (see EPRS in-depth analysis for details). Ukraine and Belarus are among the original contracting parties that continue to apply the ECT. Japan remains an important and active contracting party, yet few other countries in Asia, Africa, America or the Middle East have ratified the ECT, although several have signed one or both of the above-mentioned political declarations.

EU concerns about the ECT

EU concerns over the ECT have been growing, especially the provisions relating to investment protection, which allow companies headquartered in any member country to sue the government of another member country if it harms their existing energy investments. The rulings of international arbitration tribunals are rarely in the public domain, and there is little awareness about the real costs involved (e.g. legal fees, damages awarded). Moreover, there are few opportunities for legal redress and oversight of arbitration decisions via national courts and the European Court of Justice (ECJ). The ECT secretariat is not informed automatically about arbitration cases that draw on the ECT, and instead monitors the process independently. It has compiled a database of 145 known arbitration cases. Although many are not successful, the majority of these cases have been launched against EU Member States, often by investors.
Withdrawal or renegotiation?
Disagreement over the investor–state dispute settlement mechanisms could explain the decision of the Italian government to withdraw from the ECT in 2016, after fulfilling the required notification period of one calendar year. However, unilateral withdrawal does not exempt the contracting party from ECT provisions on investor–state dispute settlement, except where this concerns new energy investments. This is because the ECT contains a powerful sunset clause (see 2022 European Parliament study) that means existing energy investments (i.e. those made prior to withdrawal) can be subject to arbitration proceedings up to 20 years after ECT withdrawal. This has prompted calls for a more collective EU solution to this problem, involving modernisation of the ECT, ideally in the form of a treaty revision. Governments in some EU countries (France, Spain and Luxembourg) have at times called for the EU and its Member States to collectively withdraw from the ECT, unless it can be radically reformed. A similar view has been expressed, in a personal capacity, by the chairs of the European Parliament's ENVI and IMCO committees.

In some ways, the EU’s climate ambition sits uneasily with its ECT membership. The European Green Deal involves a huge transformation in EU energy markets, including a vast scale-up in the promotion of renewable energy sources and energy efficiency measures, and an almost total phase-out of fossil fuel use by 2050. The ECT framework was devised for energy systems driven largely by fossil fuels. By strongly protecting existing energy investments, the ECT could make it harder and riskier for Member States to embark on a green transition. An important caveat is that the ECT does cover renewable investments (i.e. it is not specific to particular energy sources), and its provisions have been invoked by renewable energy companies opposed to adverse and retroactive regulatory changes by governments such as Italy and Spain. Yet whereas ECT arbitration decisions over investment protection are binding, the energy efficiency and environmental protection measures in the ECT (listed in a separate Protocol) are mostly voluntary and non-binding, and do not reflect the more recent global climate goals set out in the Paris Agreement.

Treaty renegotiation
In July 2019, the Council of the EU gave a negotiating mandate to the Commission so that it could spearhead a modernisation of the ECT framework, involving a full treaty revision to provide legal certainty and align the ECT with the EU’s environment and energy goals. Treaty revision is the most thorough but also the most difficult path to tread, because it ultimately requires unanimity from all contracting parties.

The EU text proposal (May 2020) does not try to radically change the ECT framework and its dispute settlement procedures, but rather aims for the following improvements: i) ensure that contracting parties can more clearly take regulatory measures that are in the public interest (including environment and climate action); ii) raise the minimum threshold for legal challenges over investment protection, and avoid both punitive damages and frivolous cases; iii) introduce detailed provisions on sustainable development; iv) provide for the involvement of a multilateral investment court in the arbitration process. An additional submission (February 2021) from the Commission proposes to introduce 'sunset clauses', lasting up until 2030 or even 2040, for future ECT-related disputes concerning fossil fuel investments.

Some commentators have suggested that developed countries outside the EU (Japan, Switzerland, United Kingdom, Norway) do not fully share the EU’s negotiating position and would be satisfied with less radical changes to the ECT. There have been 11 rounds of negotiation so far, most recently in March 2022 when the Russian invasion of Ukraine greatly affected the proceedings. There are signs of incremental progress in over two years of negotiations and some hopes for an agreement on treaty revision by summer 2022. Even if such an agreement were reached among the contracting parties, it might not be considered satisfactory after scrutiny by their national parliaments and stakeholders. Prominent environmental organisations continue to support a coordinated EU withdrawal from the ECT.

The European Parliament will be asked to give its consent to any ECT revision, since the EU itself is one of the contracting parties.