

## The Agreement in Principle on ECT “Modernization”: A Botched Reform Attempt that Undermines Climate Action



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Seeing the Agreement in Principle<sup>1</sup> on Energy Charter Treaty (ECT) “modernization” and its leaked<sup>2</sup> full text,<sup>3</sup> the “modernization” misnomer can safely be abandoned. The renegotiated ECT does not rise to the mounting global challenges regarding energy investment, climate action, and sustainable development. The ECT reform process missed the mark in nature, scope, ambition, and speed to address the ECT’s risks for and negative impacts on<sup>4</sup> the Sustainable Development Goals (SDGs)<sup>5</sup>, particularly SDG 13 (Climate Action), and Paris Agreement goals and commitments.<sup>6</sup> The proposed ECT amendment would continue to

make it difficult and costly for governments to adopt urgently needed climate policy. Withdrawing from the ECT—Poland and Spain<sup>7</sup> are taking steps to do so—and neutralizing the survival clause to the extent possible continues to be the best strategy.

## 1. Not on Point: Investment Protection and Arbitration Are Unfit for Accelerating Investment

The Intergovernmental Panel on Climate Change (IPCC) has expressed the scientific consensus that global emissions of carbon dioxide (CO<sub>2</sub>) from human activities must “decline by about 45% from 2010 levels by 2030 [...] reaching net zero around 2050<sup>8</sup>” to limit global warming to 1.5°C in line with the Paris Agreement.<sup>9</sup> About three-quarters of greenhouse gas emissions come from the energy sector.<sup>10</sup>

Pathways to reduce emissions from the energy sector—such as the landmark Net Zero by 2050<sup>11</sup> report by the International Energy Agency (IEA)—all point to the same direction: the world needs to invest substantially more in solutions including energy efficiency; renewable energy generation (solar, wind, hydropower, and geothermal); energy storage including in the form of batteries; green hydrogen; and electrification of transport, heating, cooling, and industry. At the same time, the world needs to phase out investment in fossil energy (coal, oil, and gas). In the IEA’s pathway, “there is no need for investment in new fossil fuel supply [...] beyond projects already committed as of 2021.”<sup>12</sup>

However, in 2022, the average annual growth rate in low-carbon energy investment is “well short of what is required to hit international climate goals,” and annual investments in fossil energy are projected to reach USD 952 billion, accounting for a whopping 39.8% of global energy investment.<sup>13</sup>

Shifting energy investment flows away from fossils and into renewables requires greater international cooperation, without which “global CO<sub>2</sub> emissions will not fall to net zero by 2050.”<sup>14</sup> The ECT’s purpose is to establish “a legal framework in order to promote long-term cooperation in the energy field” (Art. 2), but nothing in the proposed amendment contributes to greater or more effective international cooperation in the areas of the IEA’s “priority actions,”<sup>15</sup> as exemplified below:

- “Policies should be strengthened to speed the deployment of clean and efficient energy technologies,” including through mandates and standards to drive investment, fossil fuel subsidy phase-outs, and carbon pricing. There is no mention of any of these approaches in the renegotiated ECT. The proposed new ECT Article 17 *bis* (Subsidies) attempts to limit the arbitrability of subsidies, but shies away from committing ECT members to phase out their fossil fuels subsidies,<sup>16</sup> or even providing guidelines for that phase-out.<sup>17</sup>
- Nothing was agreed between all ECT parties to “limit or provide disincentives for the use of certain fuels and technologies, such as unabated coal-fired power stations, gas boilers and conventional internal combustion engine vehicles.”
- The amendment does not address the need for increased international flows of long-term capital, as well as technical and financial support and technology transfers, to support the net-zero transition in

developing countries—despite the ECT’s campaign to expand<sup>18</sup> into Africa, Asia, and Latin America and the Caribbean. ECT Article 8 (Transfer of Technology) remains unchanged, committing members to remove existing barriers to technology transfer and not to create new ones, but failing to create cooperation mechanisms to actively foster and increase transfers of energy technologies.

- ECT Article 9 (Access to Capital) requires each member to open its capital markets and programs for public loans, grants, guarantees or insurance to foreign investors from other members. However, it was not renegotiated to foster “closer cooperation between developers, investors, public financial institutions, and governments,” as required for “mobilizing the capital for large-scale infrastructure,” In the IEA’s words.
- The renegotiated ECT does not acknowledge the need for a just transition;<sup>19</sup> neither does it create international cooperation mechanisms addressing the needs of the disproportionately affected, including regarding worker retraining, renewable energy siting, aid programs, or social safety nets.

ECT members missed the chance to tackle the above priority actions head-on and to convert the treaty into an effective international legal instrument to govern energy investment<sup>20</sup> for a just transition to zero-carbon energy systems and economies.<sup>21</sup> Instead, they launched a renegotiation purporting to circumscribe, but actually strengthening and expanding the privileges of the ECT’s investment protection provisions for foreign investors. ECT proponents continue to claim that investment treaties mobilize new investment, despite decades of evidence that the “effect of international investment agreements is so small as to be considered zero,”<sup>22</sup> and ample evidence<sup>23</sup> of their outsized costs.<sup>24</sup>

## 2. Tweaks at the Margin: Modest Changes of Questionable Effectiveness

ECT members set themselves up for failure when they approved<sup>25</sup> in 2018 the list of topics for renegotiation, covering “a narrow set of investment protection issues.”<sup>26</sup> They did not set out to reconsider the problematic investor–state dispute settlement (ISDS) mechanism, which is at the root of staunch civil society rejection of the ECT in Europe<sup>27</sup> and the ECT’s incompatibility with European Union (EU) law.<sup>28</sup> The renegotiation was launched three years after the adoption of the Paris Agreement, but ECT members did not set out to align the ECT with climate goals.

Under the proposed new article titled “Climate Change and Clean Energy Transition,” each ECT member merely “reaffirms its [existing] commitments” to the international climate change regime and to other avenues for cooperation on climate, energy, trade, and investment. ECT members do not take on new or more ambitious commitments, create new cooperation mechanisms, or improve existing ones.

The very modest proposed changes to the ECT’s investment protection provisions in Part III (including fair and equitable treatment, expropriation, and transfers related to investments) and arbitration provisions in Part V (including new language on transparency and new articles on frivolous claims, security for costs, and third-party funding) merely reflect some of the recent trends in investment treaty-making,<sup>29</sup> which have limited and dubious effectiveness.<sup>30</sup> The renegotiated ECT would still give investment tribunals excessive

leeway in second-guessing the appropriateness of countries' climate-related measures, and the extent to which private interests prevail over the public good.

### 3. Not Bold Enough: The ECT Will Continue to Make Climate Action Difficult and Costly

The proposed “flexibility mechanism” allowing each ECT member to unilaterally exclude investment protections for fossil fuels in its territory (through exclusions in Annex NI<sup>31</sup>) fails to offer an ambitious response to the climate emergency. The announced intentions of the EU and the United Kingdom<sup>32</sup> would likely entail their continued protection of fossil fuel investments<sup>33</sup> well into the 2030s. The ambitions of other ECT members are likely to be even slower and lower.

The amended ECT would—for a long period, or even indefinitely in countries that do not use the flexibility mechanism—continue to make climate action costly and chill climate regulation.<sup>34</sup> It would continue to undermine climate action by allowing many fossil companies,<sup>35</sup> already the most frequent users<sup>36</sup> of treaty-based ISDS mechanisms, to launch international arbitration claims<sup>37</sup> seeking compensation from governments for legitimate policy measures that may negatively affect the companies' interests.<sup>38</sup>

The proposed extension of investment protections to potentially sustainable fuels (including hydrogen, anhydrous ammonia, biomass, biogas, and synthetic fuels) does not represent an improvement. Rather, it further constrains governments' regulatory space<sup>39</sup> to adopt energy transition policies and increases their costs and liability<sup>40</sup> as they take steps to do so.

### 4. Not Fast Enough: A Lengthy Modernization Process, and Even Lengthier Survival Clause

ECT members officially started the treaty reform process in November 2017, and it took them 15 negotiation rounds (July 2020–June 2022) to reach the Agreement in Principle. After five years,<sup>41</sup> the process is far from concluded. If adopted by the Energy Charter Conference by November 22, 2022, the amendment will be submitted to ratification. It will enter into force only if three-fourths of the members ratify it, 90 days after that happens, and only for those that ratify it.

Ratification procedures vary significantly between members and may extend over a few years. For example, the original ECT entered into force 3.5 years after signing.<sup>42</sup> The amended ECT—with its narrow changes of dubious effectiveness—is likely to enter into force only in the second half of the 2020s.

In addition, Article 47 (Withdrawal) remains unchanged, maintaining the sunset or survival clause<sup>43</sup> on the treaty's continued application for 20 years after withdrawal.

Whether under the existing ECT or the eventually amended one, and even when withdrawing from either, ECT members will continue to be locked into investment protection and arbitration for a long period that is incompatible with the urgency of the just net-zero energy transition.

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