POLICY BRIEF

01 / 2022 — Trade

The Energy Charter Treaty: No significant advantages for Contracting Parties

Key Points

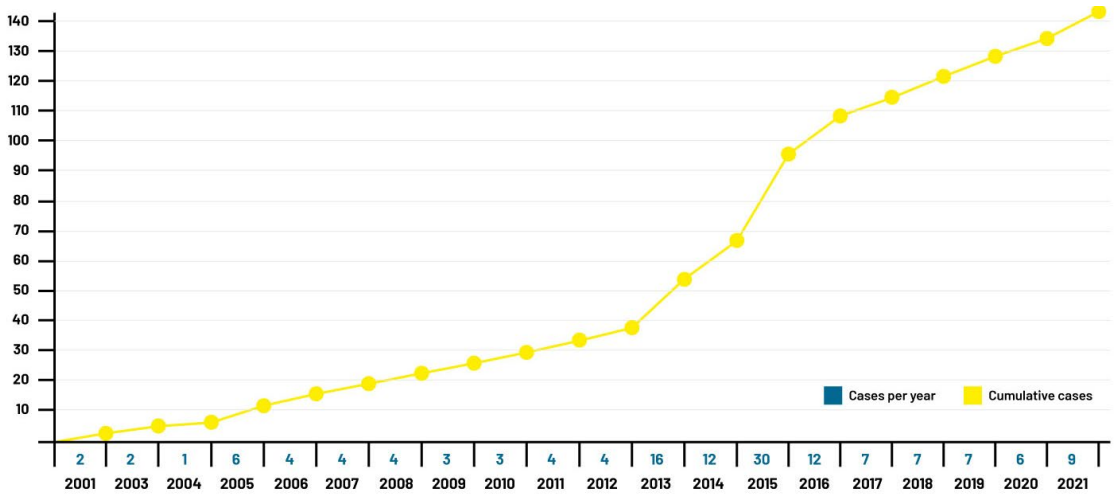
- The Energy Charter Treaty (ECT) was the first energy agreement that brought together republics of the former Soviet Union with OECD countries in the 1990s. Since then, the political framework conditions as well as the environmental and climate-related objectives have undergone enormous changes. Today the ECT **diametrically contradicts** the achieve-ment of the EU's **climate targets** and the **Paris Climate Agreement** by 2050.
- The ECT allows investors to sue states before a **parallel judiciary** in the form of private arbitration courts, **bypassing the ordinary courts**. It is the investment agreement with the highest number of disputes in the world. Special litigation rights for investors (investor-state-dispute settlements „ISDS") influence democratically legitimised national decision-making processes and weaken democratic institutions. Moreover, in two-thirds of cases, European investors sue EU Member states. In 2021, the European Court of Justice (ECJ) has held that **intra-EU arbitration violates Union law** (C-741/19).
- Since 2019, negotiations have been underway to **modernise the ECT**. These negotiations **will not solve the existing problems**: The central question of ending protection for investments in fossil energy sources for reasons of climate protection is subject of controversy and in some instances openly rejected. Compromises that have been put forward deviate blatantly from necessary reforms. The controversial ISDS mechanism is not part of the negotiations at all.
- With regard to the question of what legal benefits the Energy Charter Treaty actually offers to Contracting Parties, a legal brief published by AK concludes that the Energy Charter Treaty offers **no significant legal advantages for Contracting Parties such as Austria.**

Background

The ECT is a multilateral agreement on trade and investment in the energy sector which protects investments in fossil energy sources in particular. Currently, 53 countries from Western Europe to Central Asia and Japan as well as the EU and EURATOM are Parties to the agreement, which entered into force in 1998. All EU Member States belong to the ECT - with the exception of Italy, which withdrew in 2016. Russia has never ratified the treaty.

The agreement was intended to give western energy companies access to oil and gas deposits in the countries of the former Eastern Bloc, to facilitate investments in the resource-rich countries of the East and to enhance security of supply in the West. To this end, the agreement contains provisions regarding trade and investment and establishes dispute settlement mechanisms, in particular investor-state arbitration (ISDS), to enforce them. A sunset clause makes it more difficult to terminate the agreement: It stipulates that Contracting Parties can still be sued for twenty years after they withdraw.

Even though the agreement was adopted more than 20 years ago, its content has hardly been changed. Due to increasing political and legal concerns, a process to modernise the ECT was initiated in 2017. This process is still ongoing, and important issues, in particular the phasing out of protection for investments in fossil energy sources such as oil, gas and coal are extremely controversial. The European Commission presented a text proposal in February 2021, but other Contracting Parties vehemently oppose the phasing out of fossil investment protection.



Number of ECT-Cases from 2001 to 31.10.2021

Source: Energy Charter Treaty's Dirty Secrets

Main Findings

With over 140 cases, the ECT is the investment treaty with the most disputes worldwide. So far, countries have been ordered to pay more than 57.2 billion US dollars from public funds. An increasing number of cases are brought against countries that take important measures to protect the climate: For example, the Netherlands was sued for more than 2 billion euros by the large corporations RWE and Uniper in 2021 because it announced a coal phase-out by 2030. RWE and Uniper have to shut down power plants in the Netherlands ahead of schedule because of the measures being taken.

Due to the investment protection provisions, the ECT provides corporations with far-reaching rights to enforce their interests - rights that no other party is entitled to. Countries, on the other hand, are restricted in their political room for manoeuvre and run the risk of being ordered to pay billions in damages. Empirical evidence for societal benefits of investment protection agreements is largely lacking.

Synopsis "Assessment of possible consequences of an Austrian withdrawal from the Energy Charter Treaty"

The question arises which benefit the ECT has for individual Contracting Parties. Are there concrete legal advantages for a country to be a party to the treaty? Or is this treaty obsolete anyway 25 years after it was signed? In view of the immense democratic and climate policy threat posed by the ECT, a suitable evaluation is necessary. The Austrian Chamber of Labour (AK) commissioned the lawyer Florian Stangl, specialized in energy and European law, to shed light on the possible consequences of Austria's withdrawal from the ECT with regard to the aspects of trade, competition and transit (Chapter II ECT) in a legal brief.

Trade

In the areas of trade and transit (Art. 4 and 5 ECT in conjunction with Art. 29 ECT) the ECT is essentially based on the provisions of the General Agreement on Tariffs and Trade (GATT). Most of the countries of the former Eastern Bloc were not Contracting Parties to the GATT at the time of signing the ECT in 1994. The ECT thus also closed potential gaps in the local scope of application of GATT/WTO law in the energy sector for countries that were not yet WTO members but were to become so in the future. In the meantime, however, a number of countries have joined the WTO and thus the GATT: Only the Contracting Parties Azerbaijan, Belarus, Uzbekistan, Turkmenistan and Bosnia and Herzegovina are not yet WTO members. However, they have WTO observer status and are seeking WTO membership.

The Energy Charter Treaty is based on WTO law and regulates the non-derogation from the provisions of the WTO Agreement between individual ECT Contracting Parties that are also Parties to the GATT (Art. 4 ECT). Art. 5 ECT prohibits trade-related investment measures that are inconsistent with Art. III or XI of the GATT. Dispute settlement is governed by the interim provisions of Art. 29 ECT and concerns the period during which an ECT Contracting Party is not (yet) a GATT Contracting Party.

Trade with other WTO countries

In the area of trade, the provisions of the ECT essentially refer back to the existing provisions of the GATT. This extends to the fact that the list of prohibited trade-related investment measures in WTO law has been taken over verbatim in Art. 5(2) ECT. In practice, energy-related disputes have so far only been dealt with through the WTO dispute settlement mechanism, such as proceedings on subsidies for biodiesel (DS459, Argentina vs. EU) and subsidies for renewable energies (DS510, India vs. USA).

Trade with non-WTO countries

With regard to trade with non-WTO countries, the ECT offers the benefit of making the trade law provisions contained in the GATT applicable to non-WTO countries. This would involve the Art 29 procedure, which is a purely intergovernmental mechanism based on consultations, recommendations, and negotiations. However, as the study shows, there is no evidence that the dispute settlement procedure under Art. 29 ECT has ever been applied. Energy trade-related disputes between WTO and non-WTO countries have apparently not been resolved via the ECT.

Furthermore, there are other bilateral and multilateral agreements that cover trade-related WTO guarantees in whole or in part: The EU and its Member States have concluded Partnership and Cooperation Agreements with various non-WTO countries, including Azerbaijan, Turkmenistan and Belarus. In addition, there are bilateral investment protection agreements of individual countries such as Austria with non-WTO countries, which contain guarantees that sometimes also refer to trade-related activities of an investor.

Competition

Article 6(1) ECT obliges Contracting Parties to work "to alleviate market distortions and barriers to competition in Economic Activity in the Energy Sector". According to (2), Contracting Party shall ensure that laws exist and are enforced within their jurisdiction "to address unilateral and concerted anti-competitive conduct". Art. 6 ECT thus does not implement an effective competition regime, but provides a target direction. However, this does not create a suitable basis for an energy-related level playing field. The dispute settlement also provided for in Art. 6 ECT essentially reflects general international law and refers to finding a solution through diplomatic channels. It must therefore be noted that the added value of the ECT with regard to competition hardly goes beyond a political declaration of intent and does not offer European companies any effective protection against anti-competitive behaviour.

Transit

Transit provisions are regulated both in Art. 7 ECT and in WTO law in Art V GATT and in the GATS with regard to energy transport-related services. Overall, it can be said that the transit regulations in the ECT have certain advantages over those of the GATT due to their more detailed and clearer formulation. Examples of this are regulations on the obligation to approve the construction of infrastructure facilities, the interruption-free or reduction-free transit of energy in the event of a dispute and the existence of a separate dispute settlement mechanism. In practice, the mechanism of Art. 7 ECT has never been used. The last major energy transit dispute concerned Ukraine and Russia (DS512) and was settled through the WTO.

It should therefore be noted that the level of detail required for effective transit regulation has not been achieved in the ECT: One year after the entry into force, negotiations on a separate transit protocol were started. However, in 2011 these negotiations failed definitively. The contracting countries themselves have drawn up non-binding guidance documents such as Model Agreements for cross-border infrastructure, such as those used in the Nabucco pipeline project.

Indirect effect of the ECT as Union law

In addition to the EU Member States, the EU itself is a party to the ECT. As an international agreement of the Union, the ECT is an integral part of Union law and is binding for EU Member States. Mixed agreements such as the ECT, which also encroaches on the competences of the Member States (Art. 4 (2) TFEU), are also signed by the EU Member States themselves.

In the event that an EU Member State withdraws from a mixed agreement, the provisions of the ECT applicable to the "Contracting Parties" are no longer applicable to the latter. The binding nature of Union law remains and is supplemented by the Member State's duty of loyalty to the Union (Art. 4(3) TEU). As a result, the Member State would in theory still be "indirectly" bound by the trade, competition and transit provisions of the ECT. However, the loyalty requirement applies to both sides: In the event of conflict, the EU must also represent the interests of the withdrawing Member State.

At the same time, the dispute resolution mechanisms of the ECT can no longer take effect due to the lack of "Contracting Party status", which leads to an unsatisfactory intermediate state of affairs. This would be exacerbated by the withdrawal of additional Member States after Italy, so that it would be advantageous in terms of legal clarity for the EU to withdraw from the ECT as a Contracting Party and leave the individual Member States the choice of belonging to the ECT or not.

Conclusions

In an overall assessment of the reasons for and against a possible Austrian withdrawal from the Energy Charter Treaty, the ECT rules on trade, competition and transit should be given rather little weight. There is some legal added value in energy-related trade with non-WTO countries and transit. However, these are de facto only of a theoretical nature and can largely be substituted by invoking WTO law, general international law, special international law agreements and the drafting of contracts under private law.

Demands

In the light of the study and the already mentioned democratic and climate policy considerations, it must be stated that the ECT does not offer any significant benefits for EU Member States. In contrast, there are serious reasons for terminating the treaty. In the interest of strengthening democracy and the rule of law and in order to achieve the climate goals, termination of or withdrawal from the ECT is imperative. This can be implemented as follows:

Termination of the Energy Charter Treaty

In light of the complete incompatibility of the obligations under the Paris Agreement with the provisions of the ECT, an immediate termination of the ECT is appropriate. Termination of the ECT requires the unanimity of all Contracting Parties. In the event of termination, the sunset clause, which extends investment protection for further 20 years upon withdrawal from the treaty, also expires automatically.

Coordinated withdrawal of the EU and all EU Member States

If termination of the ECT is not possible due to lack of unanimity of the Contracting Parties, the EU Member States should jointly develop and implement exit scenarios: According to Art. 47 ECT, Contracting Parties can unilaterally declare their withdrawal from the treaty. In order to exclude the after-effects of the sunset clause within the European Union and its Member States, the Member States can contractually agree on the exclusion of the sunset clause in relation to each other. Also in view of the recent decision of the ECJ in the Komstroy case (C-741/19), a joint phase-out should be pushed: As the ECJ has unequivocally clarified, the arbitration clause in Article 26 ECT is contrary to Union law. The EU and its Member States must therefore take political measures to establish a state of affairs that complies with Union law.

Withdrawal of individual EU Member States

If a coordinated exit of the EU and its Member States is not possible due to a lack of consensus, individual EU Member States may seriously consider following Italy's example and withdrawing from the ECT.

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