

Parliamentary Briefing: Energy Charter Treaty (May 2022)

Overview

- The Energy Charter Treaty (ECT) is incompatible with the Government's ambitions to tackle climate change, and as such, should have no place in UK trade policy. It protects fossil fuel companies by giving them the power to sue national governments for any measures which damage their profits, making it much harder for governments to regulate to reduce emissions.
- The Paris Agreement commits countries to keep any rise in the global temperature to below 1.5 degrees, and to meet the Paris objectives, 75% of all existing reserves of oil, gas and coal need to be left in the ground. In order to meet its Paris commitments, the UK will need to reduce and regulate fossil fuel projects in the UK, which could lead to investor challenges if the UK remains a member of the ECT.
- Reform negotiations have been ongoing for almost two years, and are due to conclude on June 24th. However, these negotiations have proven inadequate and based on weak proposals, making it very unlikely that the ECT can achieve its modernisation objectives. [Support for withdrawal](#) among a number of European countries is growing, including Spain, the Netherlands, Germany and Poland, on the basis that the ECT is incompatible with international climate goals.

The Energy Charter Treaty

The energy sector is hugely important to any action to tackle climate change. The high costs of exploration, production and distribution, combined with the huge potential profits to be made in the energy sector, make one of the largest sectors for foreign direct investment (FDI). Much of this investment is protected by international trade and investment agreements, and most prominent among these is the Energy Charter Treaty (ECT), which entered into force in 1988. The ECT's [stated aim](#) is to "catalyse economic growth by means of measures to liberalise investment and trade in energy."

The ECT has 50 member countries, including the UK, nearly all EU member states and major energy producers. Major oil producers Saudi Arabia and the US are excluded. Italy withdrew from the treaty in 2016, though this was not early enough to avoid an [investor challenge](#) from UK fossil fuel firm Rockhopper, due to the treaty's 20-year sunset clause.

The ECT allows investors to file claims through a system of arbitration known as investor-state dispute settlement (ISDS). ISDS allows companies to sue governments in private tribunals for financial compensation if they consider that a policy or its implementation has negatively affected their investment, including when a government seeks to transition away from fossil fuel use. The ECT has already generated at least 135 investor-state arbitration claims, making it the world's most litigated investment protection agreement. The [average cost](#) of defending an ISDS case is US\$8 million and awards are generally in the millions, if not billions of dollars. The provisions of the ECT offer significant protections to investors. The treaty contains a broad definition of 'investment', including property rights, shares and intellectual property. This means that investors with varying levels of 'presence' in a country – from investment in mining to owning shares – are able to use the treaty to protect their interests.

The UK Government claims to be a world-leader in the fight against climate change. The UK has set a carbon-zero target of 2050, [recently increased](#) to a 78% reduction in emissions by 2035

(compared to 1990 levels). However, it is unclear how this stated aim is consistent with the UK's continued membership of the ECT, as this briefing sets out. Indeed, [recent research](#) shows that if the UK follows the International Energy Agency's recommended pathway and cancels oil and gas projects in the pipeline that it could face legal claims of up to £11 billion. 70% of this risk to the UK comes from the Energy Charter Treaty. Indeed, the terms of the Government's [recent windfall tax announcement](#), including tax relief for further investment in new oil and gas projects, could open the UK up to further potential claims.

The ECT's threat to climate change

The ECT has already been used a number of times against states attempting to limit the production or use of fossil fuels. It is [expected](#) that a lot more cases will arise in future as states take more ambitious steps to phase-out fossil fuels. Fossil fuel infrastructure protected by the ECT regime is estimated to have [a value of €345 billion](#), and [61 coal-fired power plants](#) are currently protected by the ECT. There have been a number of high profile ISDS cases in which important environmental regulations have been challenged under the ECT, including:

- [RWE vs. Netherlands and Uniper vs Netherlands](#). The Netherlands proposed phase-out of coal by 2030 prompted Germany company RWE to seek 1.4 billion euros and Uniper 1 billion euros in compensation. The cases are pending.
- [Vattenfall vs. Germany I & II](#). The Swedish energy company commenced two separate challenges to both the introduction of higher water quality standards and Germany's phase-out of nuclear power in 2009 and 2012 respectively. In both cases, Germany was forced to settle.
- [Ascent vs Slovenia](#). UK firm Ascent Resources launched legal action against the Slovenian Government in 2019, claiming that restrictions on fracking had caused 'considerable harm' to its investment, and the case is pending.
- [Rockhopper vs. Italy](#). Public environmental campaigning led to a national ban on oil and gas projects within 12 nautical miles of the Italian coast, and therefore the removal of Rockhopper's permit. Despite Italy's 2016 withdrawal from the ECT, it is still liable to challenge, as sunset clauses last for a further 20 years.

Regulatory 'chill'

However, these high profile cases are only part of the damage; a significant concern is that the threat of ISDS challenges lead to 'regulatory chill'. The above examples are all cases where a dispute actually led to challenge, but if governments (either the UK or partner countries) fear the possibility of investor challenge, they may delay or decide not to introduce important new regulations designed to combat climate change. Earlier this year, two countries acknowledged [this was already happening](#) - Denmark set climate targets later than the science tells them for fear of being sued and New Zealand did not join one of the initiatives at COP26. In France, in 2017, a draft law that would have seen the majority of extraction programs forced to shut down by 2030 and a total ban of oil and gas extraction by 2040 was shelved when Canadian oil and gas company Vermilion threatened to file an ISDS claim against the French state under the Energy Charter Treaty. In addition, there is a particular risk for [developing country governments](#), which are most vulnerable to challenge and least able to cover the costs of a dispute.

Update on negotiations and European position

In November 2019, the 'Modernisation Group' of the ECT was [established and mandated](#) to seek to reform the Treaty. Since then, two years have elapsed and twelve rounds of negotiations have been held, and all the available information indicates that little has been achieved.

First, hardly any progress has been made to align the ECT with international climate goals under the Paris Agreement and the European Green Deal. Investments on fossil fuels are set to receive continued protection under the ECT throughout the critical years of the energy transition; existing proposals would maintain fossil fuel protection until the mid 2030s for existing investments and possibly up to 2040 for new investment in certain gas related infrastructure. It is possible that eventual compromises will be even weaker. Aligning the ECT with the Paris Agreement requires the immediate end of investment protection for fossil fuels in all ECT contracting parties,

Second, aspects of the ECT in most urgent need of overhaul are not even being discussed; ISDS itself has not been included, and there has been no discussion of the twenty year sunset clause after withdrawal, or the way the high compensations are calculated.

Finally, the proposed timeline to adopt the main results of the modernisation negotiations by June 2022 leaves no space for proper public consultations and debates at both the European and the national level. This situation is compounded by the fact that there has been a severe lack of transparency during the entire process, as no meaningful documents are available about the ongoing negotiations. In addition, individual members of the ECT, particularly Japan, have shown strong resistance to reforms that would phase out fossil fuel protections.

As a result of these failures, [consensus is growing](#) among many states and parliamentarians that the modernisation process does not and can not deliver on the EU's objectives and align with international climate goals. Germany, the Netherlands, Poland and Spain have now invited the European Commission to explore a 'co-ordinated withdrawal' from the Treaty, on the basis that they did not see how it could be adapted to meet commitments made under the Paris Agreement. European parliamentarians from the Progressive Alliance of Socialists and Democrats grouping have increasingly [begun to echo](#) such calls, in [addition to](#) Greens, Renew, the Left and parts of the centre-right. A co-ordinated withdrawal of ECT member states who share the same ambition to ensure climate policies are not undermined would be the most effective way to ensure the Treaty cannot continue to obstruct the phase-out of fossil fuels.

Suggested oral interventions

What assessment has the Minister made of the progress of Energy Charter Treaty modernisation talks? What consideration has the Government given to a coordinated withdrawal from the Energy Charter Treaty should the progress of modernisation talks be deemed insufficient?

What assessment has the minister made of the risk of investor challenge brought against the UK through the Energy Charter Treaty, as the UK seeks to be a world-leader on tackling climate change?

What assessment has the minister made of the Uniper vs Netherlands and RWE vs Netherlands cases, and the clear precedent they set for fossil fuel firms bringing investor challenges against policies designed to tackle climate change?

Given the clear threat to the UK's Paris Commitments, and specifically of its compatibility with Article 4, paragraph 1, which commits parties to "reach global peaking of greenhouse gas emissions as soon as possible ... and to achieve rapid reductions thereafter"?, how is the Government engaging with European partners who are considering a co-ordinated withdrawal from the Energy Charter Treaty?