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Redesigning the Energy Charter Treaty to Advance the Low-Carbon Transition by N. Bernasconi-Osterwalder and M.D. Brauch

Redesigning the Energy Charter Treaty to Advance the Low-Carbon Transition

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1. Introduction

The Energy Charter Treaty (ECT) system stands at a crossroads today. On the one hand, cases under the ECT are on the rise, making the ECT the most popular instrument for investors to challenge governments by means of investment arbitration.[2] At the same time, it is facing something close to an existential crisis in view of the uncertainty surrounding the future of intra–European Union (EU) dispute settlement on investment,[3] highly political cases like *Vattenfall v. Germany*,[4] and contradicting outcomes in arbitrations, such as those brought against Spain.[5] The Energy Charter Conference is now taking steps to "update" the ECT, following a first phase of "modernization" of the Energy Charter process, which resulted in the creation of the 2015 International Energy Charter.[6] This charter, updating the initial political declaration signed in 1991 (the European Energy Charter), did nothing to address the much needed "modernization" of the binding instrument with "teeth," the 1994 ECT.

The modernization is taking place at a time when investment regimes are generally undergoing change. Countries and regions around the world are experimenting with wholly new models,[7] with discussions taking place surrounding dispute settlement reform in the United Nations Commission on International Trade Law (UNCITRAL) and elsewhere.[8] The acceptance of the

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[2] International Energy Charter. (2019, January 11). *The Energy Charter Treaty (ECT) remains the most frequently invoked IIA*. Retrieved from https://energycharter.org/media/news/article/the-energy-charter-treaty-ect-remains-the-most-frequently-invoked-iia

[3] Ankersmit, L. (2018). Achmea: The beginning of the end for ISDS in and with Europe? *Investment Treaty News*, *9*(1), 3–6. Retrieved from https://www.iisd.org/itn/2018/04/24/achmea-the-beginning-of-the-end-for-isds-in-and-with-europe-laurens-ankersmit

[4] International Institute for Sustainable Development (IISD). (n.d.). *Vattenfall v. Germany*. Retrieved from https://www.iisd.org/project/vattenfall-v-germany

[5] Schacherer, S. (2018). Eiser v. Spain. In N. Bernasconi-Osterwalder & M. D. Brauch. *International investment law and sustainable development: Key cases from the 2010s*. Geneva: IISD. Retrieved from https://www.iisd.org/itn/2018/10/18/eiser-v-spain

[6] International Energy Charter. (2017, December 14). *Discussions on the Energy Charter Treaty modernisation in Belarus*. Retrieved from https://energycharter.org/media/news/article/discussions-on-the-energy-charter-treaty-modernisation-in-belarus

[7] United Nations Conference on Trade and Development (UNCTAD). (2018). *World investment report 2018: Investment and new industrial policies*. Geneva: UNCTAD. Retrieved from https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf; Bernasconi-Osterwalder, N. (2015). Rethinking investment-related dispute settlement. *Investment Treaty News*, *6*(2), 6–8. Retrieved from https://www.iisd.org/itn/2015/05/21/rethinking-investment-related-dispute-settlement

[8] IISD. (n.d.). *UNCITRAL and reform of investment dispute settlement.* Retrieved from https://iisd.org/project/uncitral-and-reform-investment-dispute-settlement

traditional model of investor–state arbitration is under gradual retreat,[9] and many countries are rejecting the narrow focus of investment protection as the main goal of investment treaties.[10]

Unlike most other investment treaties and chapters in trade agreements covering all sectors and measures indiscriminately,[11] the ECT covers only activities in the energy sector. It covers indiscriminately a large range of activities relating to oil, gas, and coal, as well as wind and solar power and other renewable energy sources.

Given the importance of the energy sector in relation to both contributing to global warming and providing climate change solutions, the ECT, if revised, could have a particularly important role to play.[12] At a time when climate change is a top priority and the most pressing environmental and developmental issue for the future of our planet,[13] a revised ECT should, from a normative perspective, play an important role in the transition from fossil fuel–based energy to renewable, clean energy.[14] It should help advance in tandem the achievement of

[9] See, for example, Magraw, D. B., & Puig, S. (2018). Greening investor-state dispute settlement. *Boston College of Law Review*, *59*, 2717; Roberts, A. (2018). Incremental, systemic, and paradigmatic reform of investor-state arbitration. *American Journal of International Law*, *112*(3), 410–432. Retrieved from https://ssrn.com/abstract=3189984; Bernardini, P. (2017). Reforming investor–state dispute settlement: The need to balance both parties' interests. *ICSID Review-Foreign Investment Law Journal*, *32*(1), 38–57; Kaufmann-Kohler, G. & Potestà, M. (2016). Can the Mauritius Convention serve as a model for the reform of investor-state arbitration in connection with the introduction of a permanent investment tribunal or an appeal mechanism? Analysis and roadmap. *Geneva Center for International Dispute Settlement (CIDS) Research Paper*, *3*. Retrieved from http://www.uncitral.org/pdf/english/CIDS_Research_Paper_Mauritius.pdf; United Nations Conference on Trade and Development (UNCTAD). (2015). *World investment report 2015: Reforming international investment governance*. Geneva: UNCTAD. Retrieved from https://unctad.org/en/PublicationsLibrary/wir2015_en.pdf; United Nations General Assembly. (2015, August 5). *Promotion of a democratic and equitable international order: Note by the Secretary-General. Fourth Report of the Independent Expert on the promotion of a democratic and equitable international order*. UN Doc. A/70/285. Retrieved from http://www.un.org/en/ga/search/view_doc.asp?symbol=A/70/285; Office of the United Nations High Commissioner for Human Rights. (2015, June 2). *UN experts voice concern over adverse impact of free trade and investment agreements on human rights*. Retrieved from https://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16031

[10] Vieira Martins, J. H. (2017). Brazil's cooperation and facilitation investment agreements (CFIA) and recent developments. *Investment Treaty News*, *8*(2), 10–12. Retrieved from https://www.iisd.org/itn/2017/06/12/brazils-cooperation-facilitation-investment-agreements-cfia-recent-developments-jose-henrique-vieira-martins

[11] See, generally, Mann, H. (2013). Reconceptualizing international investment law: its role in sustainable development. *Lewis & Clark Law Review*, *17*(2), 521–544; Alschner, W. & Tuerk, E. (2013). The role of international investment agreements in fostering sustainable development. In F. Baetens (Ed.), *Investment law within international law: integrationist perspectives* (217–231). Cambridge: Cambridge University Press. Retrieved from https://ssrn.com/abstract=2295440; Newcombe, A. (2007). Sustainable development and investment treaty law. *The Journal of World Investment and Trade*, *8*(3), 357–407.

[12] See Sussman, E. (2007). The Energy Charter Treaty's investor protection provisions: potential to foster solutions to global warming and promote sustainable development. *ILSA Journal of International and Comparative Law*, *14*(2), 391–404.

[13] "Climate change presents the single biggest threat to development, and its widespread, unprecedented impacts disproportionately burden the poorest and most vulnerable. Urgent action to combat climate change and minimize its disruptions is integral to the successful implementation of the Sustainable Development Goals." United Nations Economic and Social Council. (2016, June 3). *Progress towards the Sustainable Development Goals Report of the Secretary-General*. U.N. Doc. E/2016/75, para. 89. Retrieved from http://www.un.org/ga/search/view_doc.asp?symbol=E/2016/75&Lang=E

[14] See Marshall, F., Cosbey, A., & Murphy, D. (2010). *Climate change and international investment agreements: obstacles or opportunities?* Winnipeg: IISD. Retrieved from https://www.iisd.org/pdf/2009/bali_2_copenhagen_iias.pdf; Firger, D., & Gerrard, M. (2010). *Harmonizing climate change policy and international investment law: threats, challenges and opportunities*. Retrieved from http://wordpress.ei.columbia.edu/climate-change-law/files/2016/06/Firger-and-Gerrard-2011-06-Climate-Change-Policy-and-International-Investment-Law.pdf; Miles, K. (2008, July 2). International Investment law and

Sustainable Development Goal (SDG) 7 to ensure access to affordable, reliable, sustainable and modern energy for all and SDG 13 on the need to take urgent action to combat climate change and its impacts.

In order to ensure mutual supportiveness between environmental and economic goals set at the international level, the ECT should be redesigned to be brought in line with and help achieve states' international commitment under the Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC); namely, the commitment to limiting global temperature rise to well below 2°C above pre-industrial levels, with efforts to achieve a more ambitious 1.5°C target.[15]

Transforming the energy sector will be crucial to helping ensure that net emissions do not cause these targets to be breached. The Intergovernmental Panel on Climate Change—the pre-eminent international authority on the science and economics of climate change—was tasked by the UNFCCC to outline the pathways by which the ambitious 1.5°C Paris Agreement target could be achieved. The resulting scenarios paint a picture of energy sector transformation whose speed, depth and breadth are unparalleled in human history. Scenarios under which there was limited or no limited overshoot of the target involve reductions in the use coal by 2050 of 97–73 per cent, with the equivalent figures for oil and gas at 81–87 per cent, and 21–74 per cent respectively.[16] In the same time period, the share of renewables in global electricity supply increases by 63–77 per cent.[17]

Not enough low-carbon energy investment is taking place for the global community to meet its agreed climate change mitigation objectives.[18] In the context of renewable energy, for example, there is a massive investment gap between the current levels and what is needed to scale up renewables to a level that can have significant and positive impacts on climate change mitigation. The International Energy Agency (IEA) has found that "low-carbon investments are not on track to meet climate change objectives," with non-solar and wind investment falling "far short" of what is needed.[19]

If the Paris Agreement targets are to be achieved—and the alternative is a distinctly bleak prospect—business as usual is simply no longer an option. Our continued reliance on

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climate change: issues in the transition to a low carbon world. *Society of International Economic Law (SIEL) Inaugural Conference 2008*. Retrieved from: https://ssrn.com/abstract=1154588

[15] Paris Agreement to the United Nations Framework Convention on Climate Change, December 12, 2015, Art. 2(1)(a). Retrieved from https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXVII-7-d&chapter=27&lang=_en&clang=_en [hereafter Paris Agreement].

[16] Reductions are relative to a 2010 baseline. Much of the variability in the scenarios derives from the degree to which they rely on technologies for removing $C0_2$ from the atmosphere that do not currently exist. IPCC (2018). Summary for Policymakers. In: *Global warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty* (V. Masson-Delmotte, P. Zhai, H. O. Pörtner, D. Roberts, J. Skea, P. R. Shukla, A. Pirani, W. Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J. B. R. Matthews, Y. Chen, X. Zhou, M. I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, T. Waterfield (eds.)). World Meteorological Organization: Geneva, p. 16.

[17] Ibid.

[18] Buchner, B., Carswell, C., Meattle, C., Oliver, P., & Wang, X. (2018, January). Global landscape of renewable energy finance 2018. Abu Dhabi: Climate Policy Initiative & International Renewable Energy Agency (IRENA). Retrieved from https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2018/Jan/IRENA_Global_landscape_RE_finance_2018.pdf

[19] IEA. (2017). *World energy investment 2017.* Paris: International Energy Agency, pp. 177–78. Retrieved from https://www.iea.org/publications/wei2017

inexpensive, carbon-intensive and energy-dense fossil fuels constitutes the primary source of greenhouse gas emissions. We need to accelerate the transition to an affordable, stable and sustainable energy model and encourage investment in renewable energy resources, prioritize energy efficient practices, and adopt clean energy technologies and infrastructure. We need to encourage investment in research and development (R&D) and promote innovation in new technologies that transform the energy sector.

The underlying policy rationale of the ECT, as it was developed in the early 90s, is to be neutral as to the source of the energy investment protected under the treaty. Accordingly, under the ECT, fossil-fuel investments are treated no differently to renewable energy investments. This includes extensive and far-reaching international protections of fossil-fuel investments, making it potentially difficult and expensive for governments to transition out of fossil-fuel dependent economies. Rather than discouraging fossil fuel–based investments (both new and existing) with a view to ultimately eliminating them, the ECT, by offering them treaty protections and a right of action, entrenches carbon-intensive investments and discourages bold transitions to renewables.[20]

In October 2017, the Energy Charter Strategy Group decided to start discussions on ECT modernization, to include it into the 2018–2019 work program, and to create the so-called Subgroup on Modernization. The aim was to finalize discussions by end of 2019.[21] At its 28th meeting in November 2017, the Energy Charter Conference approved the 2018 timeline for discussion on modernization and to hold an open consultation with industry and Observers.[22] The Subgroup on Modernization met six times throughout 2018, including consultations with Observers in February and with the industry in May.

In late November 2018, it was announced that the Energy Charter Conference approved the list of topics for the discussion on the modernization of the ECT, after consultations (with the industry and Observers) and internal discussions. The Subgroup on Modernization was mandated to continue to work on identifying policy options for the topics listed. It will decide whether the process will involve a process of clarification or an actual amendment of the text. The subgroup is called to use the "current main international trends" as a primary reference. After identifying policy options, members of the Energy Charter Conference will be invited to confirm (if possible, during the 2019 review provided for in ECT Art. 34(7)) their political will to start negotiations based on the identified list of topics and their specific policy options.[23]

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[20] Tienhaara, K., & Downie, C. (2018). Risky Business? The Energy Charter Treaty, renewable energy, and investor-state disputes. *Global Governance: A Review of Multilateralism and International Organizations*, *24*(3), 451–471.

[21] International Energy Charter. (n.d.). *Subgroup on modernisation*. Retrieved from https://energycharter.org/who-we-are/subsidiary-bodies/strategy-group/subgroup-on-modernisation

[22] Energy Charter Secretariat. (2017, November 28). *Decision of the Energy Charter Conference CCDEC 2017 23 STR: Modernisation of the Energy Charter Treaty*. Retrieved from https://energycharter.org/fileadmin/DocumentsMedia/CCDECS/2017/CCDEC201723.pdf

[23] Topics in the list are: pre-investment; definition of "charter"; definition of "economic activity in the energy sector"; definition of investment; definition of investor; right to regulate; definition of fair and equitable treatment (FET); most-favoured-nation (MFN) clause; clarification of "most constant protection and security"; definition of indirect expropriation; compensation for losses; umbrella clause; denial of benefits; transfers related to investments; frivolous claims; transparency; security for costs; valuation of damages; third-party funding; sustainable development and corporate social responsibility; definition of "transit"; access to infrastructure (including denial of access and available capacities); definition and principles of tariff setting; regional economic integration organization (REIO); obsolete provisions. See International Energy Charter. (2018, November 29).

The topics proposed for ECT modernization include a narrow set of investment protection issues, ranging from definitions to traditional investment protection standards, to related issues like security for costs, valuation of damages, and third-party funding, but also sustainable development and corporate social responsibility. The list of topics also includes access to infrastructure and tariff-setting as newer topics.

However, the most contentious issue, investor–state dispute settlement (ISDS), is not explicitly mentioned. This may be because the issue is being discussed in other fora (UNCITRAL, the International Centre for Settlement of Investment Disputes (ICSID)) that would also impact the ECT, or because there is so much uncertainty surrounding ISDS in the European Union. With the exception of Italy—the only EU member state to have withdrawn from the ECT—all EU member states as well as the European Union itself are ECT members. Given the current political and legal importance of ISDS in Europe and globally, even if the issue is not listed as one of the areas for modernization, it is evident that ECT reform cannot avoid looking at ISDS.

Importantly, there is no mention of climate change and the Paris Agreement, and related issues, such as fossil fuel phase-out and low-carbon transition. In sum, the proposed list covers important issues that need to be addressed to deal with government concerns about policy space and rebalancing rights and obligations in international investment law, but it must be widened if it is to be relevant for the advancement of the priorities set by the international community in relation to climate change.

This paper is structured as follows. We begin Section 2.0 by discussing the two regimes: the ECT (Section 2.1) and the Paris Agreement (Section 2.2), as well as their inter-relationship, highlighting how both regimes pull in different directions (Section 2.3). We then present three building blocks that could be adopted in a revised ECT to align it with the Paris Agreement: encouraging low-carbon energy investments; discouraging carbon-intensive energy investments; and ensuring a just transition to low-carbon economies and societies (Section 2.4). In Section 3.1 we propose ways to reform ISDS in the ECT, still looking at the issue through a climate lens. In Section 3.2, we address various substantive issues in the investment-related topics for the discussion on ECT modernization, through a climate lens as well as through a broader socio-economic sustainability lens. We present our overall conclusions in Section 4.0.

2. Reconciling Two Regimes: The ECT and the Paris Agreement[24]

2.1 The ECT

The 1994 ECT's stated purpose is to establish "a legal framework in order to promote long-term cooperation in the energy field" (Art. 2).[25] Although its framework encompasses multilateral cooperation over transit, trade and energy efficiency, its focus has been on

Approved topics for the modernisation of the Energy Charter Treaty. Retrieved from https://energycharter.org/media/news/article/approved-topics-for-the-modernisation-of-the-energy-charter-treaty

[24] See Bernasconi-Osterwalder, N. (2017). Expansion of the Energy Charter to Africa and Asia: Undoing reform in international investment law? *Investment Treaty News*, *8*(2), 3–6. Retrieved from https://www.iisd.org/itn/2017/06/12/expansion-energy-charter-ect-africa-asia-undoing-reform-international-investment-law-nathalie-bernasconi-osterwalder; Bernasconi-Osterwalder, N. & Haas, J. (2017, November 27). When climate leaders protect dirty investments. Retrieved from https://www.iisd.org/blog/when-climate-leaders-protect-dirty-investments

[25] References in parentheses throughout the body of this paper, unless otherwise indicated, are to provisions of the Energy Charter Treaty, Dec. 17, 1994. 2080 UNTS 95. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3118

investment protection and ISDS. The treaty's investment provisions are its only legally significant rules and bear resemblance to the traditional bilateral investment treaties (BITs) that have been the subject of wide criticism.

Like traditional BITs, the ECT's investment provisions focus exclusively on protecting foreign investors and investments, covering direct and indirect expropriation, unqualified fair and equitable treatment (FET), non-discrimination commitments and a far-reaching umbrella clause, with significant legal risks and consequences for host governments. As noted by Energy Charter Secretariat on its website, the top priority of the ECT is to "[offer] binding protection for foreign energy investors against key non-commercial risks, such as discriminatory treatment, direct or indirect expropriation, or breach of individual investment contracts."[26]

The ECT's ISDS mechanism (Art. 26) has led to 121 known investor–state arbitration cases initiated under the ECT as of February 11, 2019.[27] These cases covered sectors such as mining, oil and gas, electricity, fossil fuels, nuclear and renewable energy, and represented more than 13 per cent of all known treaty-based ISDS cases initiated to date.[28] The largest investment treaty award in history was rendered under the ECT when an arbitral tribunal found Russia liable for over EUR 50 billion.[29]

2.2 The Paris Agreement

The Paris Agreement was adopted by consensus by the 197 parties (196 states and the European Union) to the United Nations Framework Convention on Climate Change (UNFCCC) on December 12, 2015 at the 21st Conference of the Parties of the UNFCCC in Paris, France. The agreement deals with the mitigation of greenhouse gas emissions, adaptation to climate change, and climate finance. As of February 11, 2019, 195 state parties to the UNFCCC have signed the agreement and 184 have ratified it. As mentioned earlier, its stated goal with respect to mitigation is:[30]

> [Art. 2(1)(a)] Holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 °C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change.

To achieve this goal, state parties must determine, plan, and regularly report on the contribution that they are undertaking to mitigate global warming.[31] Specifically, each country must set its

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[26] International Energy Charter. (2019). *Frequently asked question about the Energy Charter process: What does the Energy Charter do?* Retrieved from http://www.energycharter.org/process/frequently-asked-questions
[27] International Energy Charter. (2019). *List of all dispute settlement cases*. Retrieved from http://www.energycharter.org/?id=345
[28] United Nations Conference on Trade and Development (UNCTAD). (2019). *Investment dispute settlement navigator*. Retrieved from http://investmentpolicyhub.unctad.org/ISDS
[29] See Brauch, M. D. (2014, September). Yukos v. Russia: Issues and legal reasoning behind US$50 billion awards. *Investment Treaty News*. Retrieved from http://www.iisd.org/itn/2014/09/04/yukos-v-russiaissues-and-legal-reasoning-behind-us50-billion-awards; Investment Treaty News. (2016, May 15). *US$50 billion awards against Russia in Yukos cases are set aside by Dutch court*. Retrieved from https://www.iisd.org/itn/2016/05/16/us50-billion-awards-against-russia-in-yukos-cases-are-set-aside-by-dutch-court; and Walters, M. (2017, February 6). $50bn Russian oil lawsuit set for next stage. *The Law Society Gazette.* Retrieved from https://www.lawgazette.co.uk/law/50bn-russian-oil-lawsuit-set-for-next-stage-/5059713.article
[30] Paris Agreement, *supra* note 15, Art. 2(1)(a).
[31] Id., Arts. 3 and 4, among others.

nationally determined contributions (NDCs).[32] These are individually set and need to be "ambitious" and to progress over time:[33]

> [Art. 3] As nationally determined contributions to the global response to climate change, all Parties are to undertake and communicate ambitious efforts as defined in Articles 4, 7, 9, 10, 11 and 13 with the view to achieving the purpose of this Agreement as set out in Article 2. The efforts of all Parties will represent a progression over time, while recognizing the need to support developing country Parties for the effective implementation of this Agreement.

The level of NDCs is set by each country, reflecting that country's targets. This bottom–up approach based on which consensus was achieved leaves it to individual governments to determine their voluntary and nationally determined targets. However, countries do have an obligation to report the contributions every five years and to register these with the UNFCCC Secretariat.[34] This transparency and reporting obligation serves to bring light to the progression of the individually set contribution and progression towards the global goal.

Like other multilateral environmental agreements (MEAs), the Paris Agreement focuses on building international cooperation to deal with a global environmental problem that requires a global response and provides a platform to find solutions based on policy consensus and science.[35] It contains a compliance mechanism that focuses on promoting and facilitating parties' compliance, rather than penalizing non-compliance.[36]

2.3 Two Regimes Pulling in Opposite Directions

The key question is whether the ECT's well developed and extensively used framework for protection is appropriate in the context of fossil fuel investments. As noted above, achieving the Paris Agreement targets will involve an unprecedented transformation of global energy systems, turning relatively rapidly away from fossil fuel sources of energy. If the ECT's protection encourages further fossil fuel investment—a proposition subject to some controversy—then it is working against agreed global goals by expanding the supply of fossil fuels, the source of almost two-thirds of anthropogenic greenhouse gas emissions. Furthermore, if such investment locks in fossil fuel–related infrastructure past the date when it should ostensibly be abandoned, the ECT's protections risk giving investors a vehicle to seek compensation for climate policies that prematurely strand their assets—a possibility that would undoubtedly delay urgently needed national climate change mitigation measures.

The Paris Agreement's compliance mechanism—which, as described above, focuses on promoting and facilitating parties' compliance rather than penalizing non-compliance—stands in strong contrast with trade and investment treaties. Unlike MEAs, international economic instruments contain strong enforcement mechanisms with economic sanctions and damages. The resulting situation at the international level is, therefore, an imbalance between effective and enforceable dispute settlement processes for enforcing international economic law, on the

[32] Id., Art. 4.
[33] Id., Art. 3.
[34] Id., Art. 4(9).
[35] United Nations Environment Program. (UNEP). (2007). *Trade-related measures and multilateral environmental agreements*, p. 5. Retrieved from https://unep.ch/etb/areas/pdf/MEA%20Papers/TradeRelated_MeasuresPaper.pdf
[36] Paris Agreement, *supra* note 15, Art. 15.

one hand, and weak or no dispute settlement processes for enforcing climate commitments, on the other.

This is not to say that the international community is less committed to climate change and that countries are not willing to take action. In fact, several countries have already announced bold climate action. Canada has enacted legislation to implement a revenue-neutral carbon tax at the federal level, starting at CAD 20 per ton in 2019 and rising at CAD 10 per ton per year until reaching CAD 50 per ton in 2022.[37] The Coal Commission, a German government-appointed panel, has recommended that Germany stop burning coal to generate electricity by 2038 at the latest.[38] In the new national energy and climate plan to the European Commission, the Greek ministry of energy outlined a framework for EUR 35 billion investments in reducing dependence on lignite power and increasing the use of renewable energy.[39] Other countries leading in taking action against climate change include Sweden, Morocco, Lithuania, Latvia, the United Kingdom and Switzerland.[40]

Nevertheless, the strong enforcement mechanisms in trade and investment agreements are reason for concern for policy-makers pursuing such strong climate measures. The ECT currently allows investors to challenge a wide range of measures that negatively affect their investment, including in those sectors that have been identified as highly problematic from a climate change perspective. This poses a potential threat to governments who are taking action to implement the Paris Agreement, because the ECT does not distinguish between carbon-intensive and low-carbon investments, nor carves out climate measures from protection or challenge. The ECT is therefore a potential stumbling block to achieving the goals under the Paris Agreement, raising questions about the inter-relationship between the two treaty regimes.

The tension between MEAs and trade agreements more generally is not new. Since the early 1990s—even before the creation of the World Trade Organization (WTO)—this complicated relationship has been at the centre of international trade and environment discussions. In 2001, trade ministers agreed to include the issue in the WTO Doha Ministerial Declaration—though, like in other Doha issues, no progress was made in this respect.[41] Nevertheless, WTO jurisprudence gave some hope that MEAs would at least not be ignored by the WTO dispute settlement body. In the famous *U.S. — Shrimp–Turtle* case,[42] the WTO Appellate Body dealt with the inter-relationship between WTO and non-WTO law. Here, the Appellate Body referred to Art. 31(1) of the Vienna Convention on the Law of Treaties (VCLT), according to which the terms of a treaty must be interpreted in accordance with the "ordinary meaning" to be given to its terms "in their context and in the light of its object and purpose." In this sense,

[37] Nuccitelli, D. (2018, October 26). Canada passed a carbon tax that will give most Canadians more money. *The Guardian*. Retrieved from https://www.theguardian.com/environment/climate-consensus-97-per-cent/2018/oct/26/canada-passed-a-carbon-tax-that-will-give-most-canadians-more-money

[38] Grieshaber, K. (2019, January 27). In a pioneering effort to curb climate change, Germany sets goal to end coal use by 2038. *Time*. Retrieved from http://time.com/5514141/germany-coal-use-2038-climate-change

[39] Karaoulanis, T. (2019, February 4). Greece vows €35 billion investment for energy transition. *Euractive*. Retrieved from https://www.euractiv.com/section/energy/news/greece-vows-e35-billion-investment-for-energy-transition

[40] Burck, J. Hagen, U., Marten, F., Höhne, N., & Bals, C. (2018, December). *Climate change performance index: results 2019*. Germanwatch, NewClimate Institute & Climate Action Network. Retrieved from https://www.climate-change-performance-index.org/sites/default/files/documents/ccpi2019_results.pdf

[41] World Trade Organization (WTO). (n.d.). *Negotiations on trade and environment*. Retrieved from https://www.wto.org/english/tratop_e/envir_e/envir_negotiations_e.htm; see als Barkin, J. S. (2015). Trade and Environment. *The Oxford Handbook of the Political Economy of International Trade*, p. 439.

[42] United States — Import Prohibition of Certain Shrimp and Shrimp Products, WTO case Nos. 58 and 61. Ruling adopted on November 6, 1998.

the Appellate Body, for its analysis and interpretation of "exhaustible natural resources" in GATT Article XX, understood MEAs as part of the context and object and purpose of the terms it was to interpret. However, members never agreed on an "MEA exception" or carve-out which would have clarified the interrelationship further.[43]

With the development of investment law and the ever-increasing use of ISDS by investors, the fear of investment rules posing barriers to climate action has resurfaced strongly since the conclusion of the Paris Agreement. Moreover, the situation is more acute in the context of ISDS, since it is initiated by an actor that has no direct commitments under the Paris Agreement and there is no appellate mechanism to give at least some direction as to how to deal with the inter-relationship between the investment agreement and the Paris Agreement.

It is without doubt that strong climate action is likely to be challenged by affected investors under the ECT. The question is whether the Paris Agreement will protect host states in case of an ISDS challenge under the ECT. One could argue after all that the Paris Agreement is incompatible with the ECT and should prevail. In case of incompatibility, and according to VCLT Art. 30, the treaty adopted later in time will prevail as it relates to the same subject-matter (unless parties explicitly agree to another rule of conflict). Therefore, absent agreement otherwise, the Paris Agreement, later in time, would prevail (among the parties to both agreements) over the ECT in case of a dispute. However, ECT Art. 16 (Relation to Other Agreements) does provide another rule of conflict that should be considered:

> Where two or more Contracting Parties have entered into a prior international agreement, or enter into a subsequent international agreement, whose terms in either case concern the subject matter of Part III or V of this Treaty,
>
> 1. (1) nothing in Part III or V of this Treaty shall be construed to derogate from any provision of such terms of the other agreement or from any right to dispute resolution with respect thereto under that agreement; and
>
> 2. (2) nothing in such terms of the other agreement shall be construed to derogate from any provision of Part III or V of this Treaty or from any right to dispute resolution with respect thereto under this Treaty,
>
> where any such provision is more favourable to the Investor or Investment.

Under this rule, if the Paris Agreement is considered as a "subsequent international agreement, whose terms … concern the subject matter of Part III (Investment Promotion and Protection) or V [Dispute Settlement] of [the ECT]," it should not be construed to derogate from any ECT provision that is more favourable to investors or investments.

However, is it really the case that the Paris Agreement "concerns the subject matter" of investment protection, promotion and dispute settlement within the meaning of the ECT? Is there actual incompatibility between the agreements in the first place? From a strictly legal perspective, the answer would most likely be no. Although the treaties steer in different

[43] IISD & UNEP. (2014). *Trade and green economy: A handbook*, pp. 84–85. Geneva: IISD. Retrieved from http://web.unep.org/sites/unep.org.greeneconomy/files/publications/Trade-GE-Handbook-FINAL-FULL-WEB.pdf

directions (one calling on taking climate action, the other protecting all energy investments, including fossil fuels), it is hard to argue that the two treaties are legally inconsistent.

The UNFCCC, the Kyoto Protocol and the Paris Agreement all follow the tradition of not prescribing specific measures. They aim for targets, and it is up to sovereign parties to decide how they will meet those targets. The climate agreements in this sense are actually even less specific than the other trade-related MEAs. As a consequence, given the lack of specific commitments in the Paris Agreement, and in particular the lack of specific investment-related commitments, it is difficult to make the case that there is a conflict between what governments are required to do under the Paris Agreement, on the one hand, and under the ECT, on the other.[44]

An investment tribunal seized under the ECT would therefore apply the rules under the ECT without resorting to the VCLT Art. 30 or ECT Art. 16 conflict rule, but instead apply the general rules of interpretation under VCLT Art. 31. As was the case in the WTO *U.S. — Shrimp–Turtle* decision, a tribunal when interpreting the applicable ECT provisions would interpret these based on Art. 31(1) and could also take into account VCLT Art. 31(3)(c), which lists “any relevant rules of international law applicable in the relations between the parties” as materials to be taken into account together with context. These materials would clearly include the Paris Agreement.

Whether this would affect the outcome of the case, however, and whether the tribunal would in fact interpret ECT standards in a way that takes into account the objectives and purpose of the Paris Agreement is entirely unpredictable and could vary from tribunal to tribunal since. This is because the international investment regime, unlike the WTO system, has no appellate mechanism that would provide guidance on interpretation. This would leave governments in fear that climate action as part of their NDCs could be found in violation of the ECT and subject to damages.

In conclusion, the risk of the ECT posing a barrier to strong climate action cannot be ignored, and any review of the ECT should address this risk. ECT modernization is an opportunity to overhaul the governance of global energy investments. The overprotective investment rights contained in the ECT contrast with its lack of climate change–related provisions—an absence that is no longer appropriate more than 25 years after the signing of the UNFCCC. The main outcome of the ECT modernization process should be a new treaty that is in line with the UNFCCC, the Paris Agreement and the SDGs. We develop our proposals in this respect as follows in the remaining sections of this paper. Should the modernization process fail to achieve this outcome, countries should withdraw from the ECT.

2.4 Aligning the ECT to the Paris Agreement

To accelerate the shift away from carbon-intensive investments to Paris/SDG-compatible investments, we propose three building blocks that could guide the overhaul of the ECT: (1) encouraging low-carbon energy investments, (2) discouraging carbon-intensive energy

[44] See also Organisation for Economic Co-operation and Development (OECD). (1998). *Relationships between the MAI and selected multilateral environmental agreements (MEAs)*. Retrieved from http://www.oecd.org/daf/inv/internationalinvestmentagreements/1922682.pdf

investments and (3) ensuring a just transition to environmentally, socially and economically sustainable, climate-friendly and resilient economies and societies.[45]

Low-carbon energy investors look for clear signals that host governments have prioritized climate change mitigation objectives and other SDGs and are reasonably constant and predictable in their policies and targets. While it is impossible and undesirable to guarantee long-term regulatory stability, ECT modernization efforts could signal long-term ambitions by committing states to encourage, promote and create favourable conditions for low-carbon energy investments, to discourage new carbon-intensive investments and gradually phase out existing ones, and to raise their levels of ambition with respect to the objectives of the Paris Agreement and the SDGs. By providing these strong market signals to investors, a revised ECT would help countries implement their NDCs and achieve the Paris climate targets, ensuring that the two agreements are mutually supportive—rather than the ECT pulling states back from achieving their common climate goal.

Accordingly, a modernized ECT should abandon its energy-source neutrality and, instead, expressly discriminate between carbon-intensive energy investments, which should receive less favourable treatment and ultimately be eliminated, and low-carbon energy investments, which should be encouraged.

One way to legally distinguish low-carbon and carbon-intensive investments in a revised ECT would be to mirror the voluntary approach of the NDCs under the Paris Agreement, through the creation of state-specific lists of low-carbon and carbon-intensive energy investments. As a first step, each state party would create lists of specific sectors, sub-sectors or activities in its schedules to different annexes. In its schedule to one annex, each party would list the types of energy investments for which it intends to provide international treaty-based protection under the ECT, based on the country's bottom–up approach to achieving their international climate change objectives. It would be up for each state party to determine which sectors, sub-sectors and activities pertaining to the generation, transmission, and distribution of renewable energy and other low-carbon energy investments it would list in its schedule. In addition, each party would determine and include in a separate list those sectors, sub-sectors and activities it intends to prohibit or phase out, signalling that no new investment is accepted. Such investments could include the extraction and transport of coal, gas, and oil, and other carbon-intensive energy

[45] The Creative Disrupters—a team of international lawyers, economists, policy advisers and communications experts, including the authors of this piece and several individuals who work for IISD—have proposed the Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation. The treaty is one of the winners of the Stockholm Treaty Lab contest. See The Creative Disrupters. (2018). *Treaty on sustainable investment for climate change mitigation and adaptation*. Stockholm Treaty Lab. Retrieved from http://stockholmtreatylab.org/wp-content/uploads/2018/07/Treaty-on-Sustainable-Investment-for-Climate-Change-Mitigation-and-Adaptation-1.pdf [hereafter Climate Investment Treaty Model]. The following sections are based on the Climate Investment Treaty Model; Brauch, M. D., Touchette, Y., Cosbey, A., Gerasimchuk, I., Sanchez, L., Bernasconi-Osterwalder, N., Torao Garcia, M. B., Potaskaevi, T., & Petrofsky, E. (2019). Treaty on sustainable investment for climate change mitigation and adaptation: aligning international investment law with the urgent need for climate change action. *Journal of International Arbitration*, 36(1), 7–35; Brauch, M. D. (2018, August 16). Tackling climate change through sustainable investment: All in a treaty? *SDG Knowledge Hub*. Retrieved from http://sdg.iisd.org/commentary/guest-articles/tackling-climate-change-through-sustainable-investment-all-in-a-treaty; and The Creative Disrupters. (2018). *Treaty on sustainable investment for climate change mitigation and adaptation: Argumentation demonstrating how the model treaty meets the assessment criteria*. Stockholm Treaty Lab. Retrieved from http://stockholmtreatylab.org/wp-content/uploads/2018/07/The-Creative-Disrupters-Argumentation.pdf

investments.[46] They could also agree to modalities and timelines to phase out existing carbon-intensive energy investments.

This flexible, state-specific approach to defining covered energy investments has several advantages over a universal definition applicable to all ECT member states. It allows individual ECT member states to determine for themselves the specific means by which they will achieve their climate change objectives and commitments, in line with their respective circumstances and capabilities. It also allows for states to adopt differentiated commitments within the broader agreed frameworks for climate action. At the same time, it provides foreign investors with clear signals from host governments of their long-term commitment to climate change mitigation and adaptation objectives and of their reasonably constant and predictable policies and targets.

In May 2018, in the context of its efforts to channel investments into sustainable activities, the European Commission adopted a package of measures including proposals for regulations aimed at (1) creating a unified EU classification system ("taxonomy") on what can be considered an environmentally sustainable economic activity, (2) improving disclosures requirements on how investors integrate environmental, social and governance (ESG) factors in their risk processes, and (3) creating a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, to provide investors with better information on the carbon footprint of their investments.[47] The work underlying these EU initiatives could inspire and inform states in determining the best approach to define what can be considered low-carbon energy investments that will benefit from treaty-based protection under a modernized ECT.

After distinguishing carbon-intensive and low-carbon investment, the second step would be to design the scope of the treaty, its investment protection provisions, or its ISDS mechanism in line with that distinction. From general to specific, states could adopt the following alternative approaches:

- **Definition of investment, positive-list approach**: states could adopt a definition of investment under which only low-carbon energy investments listed in a party's schedule will be considered, for that party, as covered investments under the ECT.
- **Definition of investment, negative-list approach**: states could adopt a definition of investment under which all energy investments will be considered, for a party, covered investments under the ECT, except for those listed by that party in its schedule of carbon-intensive energy investments.
- **Scope of investment protection, positive-list approach**: all energy investments will be governed by the ECT, but only those included in a party's list of low-carbon energy investments will benefit from the investment protection provisions of the treaty.
- **Scope of investment protection, negative-list approach**: all energy investments will benefit from the investment protection provisions of the treaty, except for those included in a party's list of carbon-intensive energy investments.
- **Scope of ISDS, positive-list approach**: all energy investments will be covered by the ECT, but only those included in a party's list of low-carbon energy investments will have access to the ISDS mechanism against that party.
- **Scope of ISDS, negative-list approach (ISDS carve-out)**: all energy investments will have access to the ISDS mechanism, except for those included in a party's list of

[46] Climate Investment Treaty Model, *supra* note 45, Annexes I and II.
[47] European Commission. (2018, May 24). *Commission legislative proposals on sustainable finance*. Retrieved from https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_en#investment

carbon-intensive energy investments, which will not have access to ISDS against that party.

The more general the approach adopted, the stronger the signal that will be sent by ECT member states to low-carbon energy investors that their investments are desirable and will be encouraged, and to carbon-intensive investors that their investments are undesirable and will be discouraged.

To address the market failures that may act as barriers to the flows of low-carbon energy investments needed to ensure the achievement of climate change goals and help speed the rate and volume of such investments, ECT member states could include market incentives in a revamped treaty. They could encourage low-carbon energy investments through state cooperation, including through guarantee facilities and export finance for or reducing interest on loans to low-carbon investments.[48] They could also explicitly allow for and promote various green industrial policy measures (local content requirements, local employment requirements, R&D requirements, training requirements), while limiting the quantum of support, requiring specific performance benchmarks and mandating sunset clauses.[49] A modernized ECT should also commit states to agree on modalities and timelines for phasing out incentives for carbon-intensive energy investments, such as fossil fuel subsidies.[50]

Finally, the revised ECT should operate in acknowledgment of the Paris Agreement's commitment to "the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities."[51] This could be done by including express reference to two instruments of the International Labour Organization (ILO): the Resolution Concerning Sustainable Development, Decent Work and Green Jobs adopted on June 19, 2013 by the General Conference of the International Labour Organization, meeting in Geneva at its 102nd Session; and the Guidelines for a Just Transition Towards Environmentally Sustainable Economies and Societies for All agreed by the experts gathered at the Tripartite Meeting of Experts convened in Geneva by the International Labour Office from October 5 to 9, 2015.[52] These instruments lay out non-exhaustive illustrative lists of actions Parties may take to fulfil their obligations for ensuring a just transition, including the strengthening social safety nets, the creation of targeted education and training programs and the provision of pension savings for energy sector workers, responding to the necessary divestment from fossil fuel investments.

3. Safeguarding the Policy Space Needed to Take Climate Action: Rethinking investment protection in the ECT

3.1 The Issue of ISDS

The Subgroup on Modernization has identified a number of issues for discussion and reform. These were approved by the Energy Charter Conference on November 27, 2018.[53] Three ISDS-related issues—frivolous claims, security for costs, and third-party funding—are listed as topics for ECT modernization. However, we note with surprise that the provision on the

[48] See Climate Investment Treaty Model, *supra* note 45, Art. 2.3.
[49] See Climate Investment Treaty Model, *supra* note 45, Art. 5.3.
[50] See Climate Investment Treaty Model, *supra* note 45, Art. 2.5(4)(a).
[51] Paris Agreement, *supra* note 15, preamble.
[52] See Climate Investment Treaty Model, *supra* note 45, Art. 2.6(2).
[53] International Energy Charter (2018), *supra* note 23.

Settlement of Disputes between an Investor and a Contracting Party (Art. 26) itself was not included in the Energy Charter Conference's list of topics for review, even though ISDS is high on the list of reform priorities in the EU as well as international forums, such as the United Nations Conference on Trade and Development (UNCTAD) and UNCITRAL, where a working group has been tasked with looking into ISDS reform.

As the European Union stated in one of its submissions to UNCITRAL,[54] investor–state arbitration raises concerns of lack of consistency, coherence, predictability and correctness of arbitral decisions. Different tribunals will interpret the same rules differently and this will continue to be the case even if the substantive rules are changed, as long disputes are settled through arbitration, and as long as investors retain the right to challenge legitimate governmental measures, particularly on climate.[55] At the same time, changing only the process and not the substance may also lead to undesired results. We do argue that ECT member states should re-evaluate the substantive rules (see Section 3.2), while emphasizing that addressing substance is not enough.

We are of the view that ISDS should be at the centre of any discussion around policy space in international investment law and safeguarding states' right to regulate, including in relation to climate change. ISDS should be looked at in light of its *raison d'être* and scope (what are we trying to achieve and what are we trying to protect?), the problems relating to its form (as identified in the UNCITRAL discussions), and so forth. The discussion on modernization would be incomplete if ISDS were not to be addressed. The omission may be due to the most recent developments in the European Union relating to the validity of ISDS provisions in intra-EU BITs and the ECT, and related uncertainty. However, avoiding the topic altogether remains problematic given that much of the concern from a climate perspective centres around the fact that investors can challenge climate change mitigation actions of states. Literature increasingly suggests that ISDS or threat thereof may dissuade states from adopting laws and regulations aimed at achieving climate change and sustainable development objectives.[56] From this

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[54] United Nations General Assembly. (2017, December 17). *Possible reform of investor-State dispute settlement (ISDS): Submission from the European Union*. UN Doc. A/CN.9/WG.III/WP.145. Retrieved from https://undocs.org/en/A/CN.9/WG.III/WP.145

[55] See Kidane, B. B. (2018). Defragmenting Investment disputes. *Sorbonne Student Law Review-Revue juridique des étudiants de la Sorbonne*, *1*(1), 255–294. Retrieved from http://sorbonnestudentlawreview.org/journal/article/download/9/6; Nilsson, A., & Englesson, O. (2013). Inconsistent awards in investment treaty arbitration: is an appeals court needed? *Journal of International Arbitration*, *30*, 561; Sornarajah, M. (2008). A coming crisis: expansionary trends in investment treaty arbitration. *Appeals Mechanism in International Investment Disputes*, *39*, 40–66; Franck, S. D. (2004). The Legitimacy crisis in investment treaty arbitration: Privatizing public international law through inconsistent decisions. *Fordham Law Review*, *73*, 1521. Retrieved from https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4062&context=flr

[56] See Tienhaara, K. (2018). Regulatory chill in a warming world: The threat to climate policy posed by investor-state dispute settlement. *Transnational Environmental Law*, *7*(2), 229–250. Retrieved from https://www.cambridge.org/core/services/aop-cambridge-core/content/view/C1103F92D8A9386D33679A649FEF7C84/S2047102517000309a.pdf/regulatory_chill_in_a_warming_world_the_threat_to_climate_policy_posed_by_investorstate_dispute_settlement.pdf; Kelsey, J. (2017). Regulatory chill: learnings from New Zealand's plain packaging tobacco law. *QUT Law Review*, *17*, 21; Gaukrodger, D. (2017). The balance between investor protection and the right to regulate in investment treaties: A scoping paper. *OECD Working Papers on International Investment, 2017/02,* OECD Publishing, Paris. Retrieved from https://www.oecd-ilibrary.org/finance-and-investment/the-balance-between-investor-protection-and-the-right-to-regulate-in-investment-treaties_82786801-en; Pelc, K. (2016). Does the international investment regime induce frivolous litigation? Retrieved from https://ssrn.com/abstract=2778056; Brown, J. G. (2013). International investment agreements: regulatory chill in the face of litigious heat. *WJ Legal Stud.*, *3*(1). Retrieved from https://ir.lib.uwo.ca/uwojls/vol3/iss1/3; Tienhaara, K. (2010). Regulatory chill and the threat of arbitration:

perspective, ECT member states should have a frank discussion on how this type of chilling effect could best be avoided.

In this context, ECT member states should discuss ECT Art. 26, which, in line with traditional ISDS, allows foreign investors in the energy sector to have direct recourse to international arbitration against their host states, without prior exhaustion of local remedies. Would the requirement to try to resolve disputes at the domestic level first not lead to better outcomes? Some will no doubt suffer from this clean energy transition. Governments will have to balance out needs and put in place transition and compensation schemes through their own laws and regulations in line with their constitutions. Having to do this against the backdrop of an ECT claim makes it more difficult for governments to proceed and arrive at balanced solutions. Proceeding first with domestic channels would arguably be the more appropriate solution. Exhaustion of local remedies before acceding ISDS is now required for ISDS disputes between Mexico and the United States under the United States–Mexico–Canada Agreement (USMCA).[57] It is also recommended, for example, in the Indian Model BIT and the SADC Model BIT.[58]

ECT member states should also assess state–state dispute settlement as a less risky option from a climate change perspective. States would arguably be less likely to challenge certain types of measures needed to achieve the goals of the Paris Agreement, a treaty to which most states are party. State–state dispute settlement in the investment context is no longer a taboo topic today: the recently concluded USMCA, unlike its predecessor North American Free Trade Agreement (NAFTA), largely removes the possibility of ISDS between Canada and the United States.[59] This is also the case of the Australia–United States FTA, the Japan–Philippines FTA and the EU–Japan FTA.[60] Investment treaties concluded by Brazil also provide for state–state dispute settlement only.[61] These place a much stronger emphasis on the prevention of legal disputes

a view from political science. In C. Brown & K. Miles (Eds.). *Evolution in investment treaty law and arbitration*. Cambridge University Press, 2011. Retrieved from https://ssrn.com/abstract=2065706; Van Harten, G. (2007). *Investment treaty arbitration and public law.* New York: Oxford University Press.

[57] Agreement between the United States of America, the United Mexican States, and Canada, November 30, 2018, Annex 14-D. Retrieved from https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between [hereafter USMCA].

[58] Southern African Development Community (SADC). (2012, July). *SADC model bilateral investment treaty template with commentary*. Gaborone: SADC. Retrieved from http://www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf [hereafter SADC Model BIT]; Government of the Republic of India. (2015, December). *Model text for the Indian bilateral investment treaty*, Art. 12, Retrieved from http://investmentpolicyhub.unctad.org/Download/TreatyFile/3560 [hereafter Indian Model BIT]; see also Brauch, M. D. (2017, January). Exhaustion of local remedies in international investment law. *IISD Best Practices Series*. Geneva: IISD. Retrieved from https://www.iisd.org/library/iisd-best-practices-series-exhaustion-local-remedies-international-investment-law

[59] USMCA, *supra* note 57. Another way to circumscribe the scope of ISDS would be to limit the clauses that energy investors could invoke in arbitration proceedings. For example, between Mexico and the United States, ISDS subsists in the recently concluded USMCA, but generally investors may only initiate international arbitration based on direct (not indirect) expropriation, and post-establishment (not pre-establishment) national treatment and MFN treatment.

[60] Free trade agreement between Australia and the United States of America, May 18, 2004. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3345 [hereafter Australia–U.S. FTA]; Economic partnership agreement between Japan and the Philippines, September 9, 2006. Retrieved from https://investmentpolicyhub.unctad.org/IIA/country/166/treaty/3386 [hereafter Japan–Philippines EPA]; Agreement between the EU and Japan for an economic partnership, July 17, 2018. Retrieved from https://investmentpolicyhub.unctad.org/IIA/countryGrouping/28/treaty/3827 [hereafter EU–Japan EPA].

[61] See Brazil's Cooperation Facilitation Investment Agreements (CFIAs) concluded since 2015 at https://investmentpolicyhub.unctad.org/IIA/CountryBits/27 [hereafter Brazil's CFIAs]; Intra-MERCOSUR

through institutional mechanisms such as Joint Committees between the state parties and National Contact Points (or Ombudsmen) to address concerns raised by investors.[62]

Another option for ECT member states to consider would be to limit the scope of the ISDS clause. This could be done, as described above (Section 2.4), by listing in or out the types of investment that are subject to ISDS in line with their climate targets under the Paris Agreement.[63]

Furthermore, ISDS access could be limited by allowing a state to deny treaty benefits in case an investor brought a claim that a climate measure violated the ECT. This is one of the procedural issues that is in fact listed as an area for modernization, so we continue to discuss it in more detail. Under the denial of benefits clause in ECT Art. 17, state parties "reserve the right to deny the advantages" of Part III of the treaty (encompassing substantive rights on "Investment Promotion and Protection") to foreign investors in certain cases—for example, when the investor is owned or controlled by natural or legal persons of a third state who do not have substantial business activities in the ECT state party. This provision can be useful for states as a tool to avoid treaty shopping.

However, in view of the wording of the clause in the ECT, denials of benefits operated by states have been interpreted as denying investors' substantive advantages under the treaty (Part III), but not their right to access dispute settlement (Part V). As a result, arbitral tribunals have affirmed their jurisdiction over ECT-based disputes, even after the respondent state had denied the benefits of the treaty to the claimant investor, and have decided that the exercise of right to deny benefits would have prospective (and not retrospective) effects.[64] In light of this interpretation, a state would need to assess the nationality of each investor and notify her in advance of a legal dispute that they will deny her the benefits of the treaty. This requirement is unrealistic as the need for a nationality analysis typically only arises after an investor–state dispute exists.

Cooperation and Facilitation Investment Protocol, April 7, 2017, Art. 4(1)–(2). Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3772 [hereafter Intra-MERCOSUR Investment Protocol].

[62] Vieira Martins, J. H. (2017). Brazil's cooperation and facilitation investment agreements (CFIA) and recent developments. *Investment Treaty News*, *8*(2), 10–12. Retrieved from https://www.iisd.org/itn/2017/06/12/brazils-cooperation-facilitation-investment-agreements-cfia-recent-developments-jose-henrique-vieira-martins; Bernasconi-Osterwalder, N., & Brauch, M. D. (2015, September). *Comparative commentary to Brazil's cooperation and investment facilitation agreements (CIFAs) with Mozambique, Angola, Mexico, and Malawi*. Geneva: IISD. Retrieved from http://www.iisd.org/library/comparative-commentary-brazil-cooperation-and-investment-facilitation-agreements-cifas; and Morosini, F., & Sanchez Badin, M. R. (2015, August). The Brazilian agreement on cooperation and facilitation of investments (ACFI): A new formula for international investment agreements? *Investment Treaty News*, *6*(3), 3–5. Retrieved from https://www.iisd.org/itn/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements; IISD. (2015, June 16). *Side-by-side comparison of the Brazil–Mozambique and Brazil–Angola Cooperation and Investment Facilitation Agreements*. Retrieved from http://www.iisd.org/publications/side-side-comparison-brazil-mozambique-and-brazil-angola-cooperation-and-investment; Brauch, M. D. (2015, May). The Brazil–Mozambique and Brazil–Angola Cooperation and Investment Facilitation Agreements (CIFAs): A descriptive overview. *Investment Treaty News*, *6*(2), 14–16. Retrieved from https://www.iisd.org/sites/default/files/publications/iisd-itn-may-2015-en.pdf

[63] Climate Investment Treaty Model, *supra* note 45, Art. 9.1(3). See also Tienhaara (2018), *supra* note 56; Van Harten, G. (2015, September 20). An ISDS carve-out to support action on climate change. *Osgoode Legal Studies Research Paper No. 38/2015*. Retrieved from https://ssrn.com/abstract=2663504 or http://dx.doi.org/10.2139/ssrn.2663504

[64] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8, 2005. Retrieved from https://www.italaw.com/sites/default/files/case-documents/ita0669.pdf

When revising the ECT, member states should clarify that the denial of benefits covers both substantive (Part III) and procedural (Part V) elements. Rather than referring to a denial of benefits of a certain part of the treaty, the clause should refer to a denial of benefits of the entire treaty.[65] They should also follow recent developments in international investment law to grant denials of benefits retrospective effects, by allowing states to exercise this clause "at any time, including after the institution of arbitration proceedings."[66] The clause allowing states to deny treaty benefits with respect to claims challenging tobacco control measures, included in the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) agreement, provides further clarifications. ECT member states should consider this language to provide greater certainty regarding the timing and the legal consequences of the exercise of a denial of benefits:[67]

> A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For greater certainty, if a Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.

If other options to address the risks of ISDS are not adopted, the reform of the denial-of-benefits clause as suggested above will be crucial. A revised denial-of-benefits clause in the ECT could allow states taking measures to achieve climate change objectives to deny the benefits of the treaty to investors and investments not aligned with the achievement of such global public policy objectives.

Finally, while rethinking the ISDS provisions in the ECT, member states should seize the opportunity to go beyond the investor-to-state model and grant broad access to justice to stakeholders involved in investment processes—including individuals and communities affected by energy investment projects, including in the context of a just transition to low-carbon economies and societies.[68] In particular, a modernized ECT could include an accountability mechanism with a multi-stakeholder mediation function and a compliance function. Inspired by the accountability mechanisms developed by international financial institutions, such a mechanism would aim to resolve and respond to issues and concerns raised in complaints brought by individuals, communities and civil society organizations, and to ensure compliance of investors, investments and states with their treaty obligations.[69]

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[65] Comprehensive Economic and Trade Agreement, Canada–European Union, October 30, 2016, Arts. 8.16. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3546 [hereafter CETA]; Comprehensive and Progressive Agreement for Trans-Pacific Partnership, March 8, 2018, Art. 9.15. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3808 [hereafter CPTPP].
[66] Indian Model BIT, *supra* note 58, Art. 35.
[67] CPTPP, *supra* note 65, Art. 29.5.
[68] See meeting reports in IISD. (n.d.) Investment Law and Policy Reform: A series of expert meetings. Retrieved from https://www.iisd.org/project/investment-related-dispute-settlement-expert-meetings
[69] Climate Investment Treaty Model, *supra* note 45, Part 7.

3.2 Substantive Issues

Until now we have discussed the ECT through a climate lens. As explained, we are of the view that an ECT review must take into account the most pressing global issue of our time: climate change. The ECT simply cannot pose barriers to the clean energy transition. Instead, it should promote and facilitate low-carbon investments while dissuading carbon-intense investments.

At the same time as we urge ECT member states to redesign the treaty from a climate perspective, we also acknowledge that investment in energy and energy infrastructure is desperately needed, especially in the developing world. Moreover, all large-scale energy investments (whether carbon-intensive or low-carbon) raise risks not related to climate change: the government may have to address social and environmental risks that will have similarly negative consequences on investors as climate change action. An environmental impact assessment may lead to a permit denial or harsher conditions. Indigenous Peoples might force the government to stop a project because the investment site turned out to be on sacred land. The government might see itself compelled to put into place a new law to adapt feed-in tariffs agreed with an investor due to unexpected changes in the market and a domestic financial crisis. These types risks and challenges may arise to all types of investment—including energy investments, whether carbon-intensive or low-carbon—and government measures will aim at resolving socio-environmental sustainability issues other than climate change.

Accordingly, for our discussion of the substantive issues of the ECT—which, unlike ISDS, are in large part included in the list of issues for ECT modernization—we approach with a broader perspective. In addition to stressing the narrower climate change angle, where appropriate, we add wider socio-environmental sustainability considerations to our analysis, bearing in mind that a revised ECT should also support the achievement of the SDGs. Under this extended approach, we address various substantive issues in the investment-related topics for the discussion on ECT modernization.

a. Objective and Scope

Objective (Art. 2 and Preamble)

The purpose of the ECT, according to its current language, is to establish "a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter" (Art. 2). The imperatives of a low-carbon transition and sustainable development do not require a fundamental change to the core part of the purpose. Promoting "long-term cooperation in the energy field" is in fact required in view of such imperatives. What a modernization effort must not overlook is the need to update the "objectives and principles" in accordance with which such cooperation must occur.

Beyond "the objectives and principles of the [European Energy] Charter," the ECT's legal framework must be informed by the objectives and principles of—and member states' commitments under—the UNFCCC, the Paris Agreement and the SDGs. The text of the article should be amended to mention these objectives, principles and commitments specifically, reaffirming them as a fundamental part of the ECT framework.

The treaty could also include more general mentions, in Art. 2 as well as in the preamble, of member states' national and international commitments concerning climate change mitigation and adaptation, a just transition to low-carbon economies and societies, and sustainable development. In addition to setting a broader context in which the ECT should be interpreted, this wording would make the purpose article dynamic and responsive to increased levels of ambition of member states in those energy-relevant policy areas.

Scope: Definition of investment (Art. 1)

ECT Art. 1 sets out the types of activities in the energy sector that will be considered covered investments under the treaty, without distinction between carbon-intensive and low-carbon activities: the investment protection standards apply to all types of energy investment.

As explained above (see Section 2.4 above), reforming the ECT to take into account climate change considerations must necessarily lead to unpacking the definition of investment. We have presented above our proposed approach for a state-specific definition of investment, following the voluntary approach of the NDCs under the Paris Agreement. In line with this proposal, carbon-intensive energy investments should be appropriately defined and distinguished from low-carbon energy investments. In order to promote and reward low-carbon investments and discourage carbon-intense investments, we proposed list-in and list-out approaches for defining investment. As noted above, we think that this is best done through listing by each state, so that each state can decide what is most suited to its situation. This would ensure better buy-in, be easier to negotiate, send clear signals to investors and help hold governments accountable. Our proposed approach would require an overhaul of the system of cross-referenced definitions and annexes referred to in ECT Art. 1 as currently drafted.

The necessary distinction can be achieved through a new definition of investment, but alternatively a similar outcome could be achieved by making the distinction at the level of the substantive obligations on treatment or non-discrimination (see Section 3.2(d) below). That approach would allow a broad definition at the treaty level to allow for cooperation on a wide range of issues, while avoiding the extension of benefits and protections to carbon-intensive investments. A further option would be to list in or out investments covered or not by ISDS (see Section 2.4 above).

Furthermore, ECT member states should consider ensuring that only investments are covered that were constituted and are operated in compliance with host state law.[70] From an environmental perspective this is particularly important as it would incentivize investors to comply with environmental standards and conduct environmental and social impact assessments.

Scope: Umbrella clause (Art. 10(1))

ECT Art. 10(1) contains an umbrella clause, requiring states to “observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.” Umbrella clauses such as the one contained in the current ECT text have allowed investors to “assert state obligations from beyond the treaty itself—legislative, contractual and treaty-based—under the coverage of the treaty and its dispute settlement mechanisms,” and to forum shop by initiating proceedings before domestic courts as well as contract-based and treaty-

[70] Indian Model BIT, *supra* note 58, Art. 1.4; Agreement between the government of the United Mexican States and the Government of the Republic of India on the promotion and protection of investments, May 21, 2017, Art. 1.7. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/1933 [hereafter India–Mexico BIT].

based dispute settlement clauses.[71] Accordingly, umbrella clauses may "may make desirable public welfare measures more costly and less likely to be enacted … shrinking the policy space governments may have to enact measures for purposes such as protection of the environment, health and safety."[72] Following the approach of most recent investment treaties and chapters, problems such as forum shopping and the initiation of multiple proceedings can be avoided by not including an umbrella clause.[73]

b. Right to Regulate, Sustainable Development and Corporate Social Responsibility

The text of the ECT only mentions sustainable development once, in the context of a best-efforts obligation of states in the article on Environmental Aspects (Art. 19). The treaty does not otherwise mention or safeguard states' right to regulate to achieve legitimate public policy objectives; neither does it impose any hard or even best-efforts obligations on covered investors and investments.

Many recent investment treaties and models feature specific clauses on states' right to regulate and explicit mentions to sustainable development in the preamble, the objectives clause, or both.[74] These types of clauses should also be included in a modernized ECT.

A revised ECT should also be more balanced, holding investors accountable for their behaviour abroad. It should ensure that investors abide by domestic host state law or, where the law or its implementation is below international standards, with internationally recognized standards. An increasing number of treaties and models include corporate social responsibility (CSR) clauses with best-efforts obligations on investors[75] and binding treaty obligations on investors in matters ranging from compliance with domestic laws and anti-corruption efforts.[76] In the CETA, investors who have made their investment "through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process" may not initiate ISDS claims.[77] The 2018 Dutch model BIT includes a similar provision, clarifying that in such cases "the tribunal shall decline jurisdiction."[78] Under the Dutch model, tribunals are also devoid of

[71] IISD & UNEP. (2018). *Sustainability toolkit for trade negotiators*, Section 5.4.6. Retrieved from http://www.iisd.org/toolkits/sustainability-toolkit-for-trade-negotiators [hereafter IISD & UNEP Toolkit].
[72] Bernasconi-Osterwalder, N., Cosbey, A., & Johnson, L. (2000). *Investment treaties and why they matter to sustainable development: Questions and answers*. Geneva: IISD. Retrieved from https://www.iisd.org/pdf/2011/investment_treaties_why_they_matter_sd.pdf
[73] CPTPP, *supra* note 65, Chapter 9; Indian Model BIT, *supra* note 58; CETA, *supra* note 65, Chapter 8; Canada–China BIT, *supra* note 84.
[74] For example, the CETA included Article 8.9 on investment and regulatory measures, reaffirming the parties' right to regulate. The preamble also mentions recognizes that CETA provisions preserve the right of the Parties to regulate and flexibly to achieve legitimate policy objectives, and reaffirms parties' commitment to promote sustainable development. See CETA, *supra* note 65, Art. 8.18. See also Netherlands Model BIT 2018, Art. 2(2). Retrieved from https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/publicaties/2018/10/26/modeltekst-voor-bilaterale-investeringsakkoorden/modeltekst-voor-bilaterale-investeringsakkoorden.pdf [hereafter Dutch Model BIT].
[75] Indian Model BIT, *supra* note 58, Art. 12; Pan-African Investment Code, draft of December 31, 2016, Arts. 22 and 24. Retrieved from https://au.int/en/documents/20161231/pan-african-investment-code-paic [hereafter PAIC]; see Brazil's CFIAs, *supra* note 61; Intra-MERCOSUR Investment Protocol, *supra* note 61; Dutch Model BIT, *supra* note 74, Art. 7.
[76] SADC Model BIT, *supra* note 58, Arts. 10–18; PAIC, *supra* note 75, Art. 21; Indian Model BIT, *supra* note 58, Art. 11.
[77] CETA, *supra* note 65, Art. 8.18(3).
[78] Dutch Model BIT, *supra* note 74, Art. 16(2).

jurisdiction when the investor changed its corporate structure to gain protection under the agreement or to submit a claim against its original home state.[79]

ECT member states should consider including these innovative elements in the revised treaty, to ensure that covered energy investors and their investments behave responsibly and contribute to the achievement of the SDGs as well as other public policy goals. This can be done by making compliance with these a conditionality to access ISDS (like under the CETA). However, a modernized ECT should go beyond this and, in addition, put an accountability process in place to ensure compliance. This could be designed based on the accountability mechanisms of international financial institutions to complement the national contact point system of the Organisation for Economic Co-operation and Development (OECD). The ECT should also support tort proceedings in home states for victims of transnational investment projects.[80]

c. Investment Liberalization and Market Access

Under the current language of the ECT, states accord non-discriminatory treatment only to existing investments. Regarding the pre-establishment phase, defined as the "Making of Investments," the ECT only includes best-efforts obligations for states to accord foreign investors national and MFN treatment and progressively reduce their restrictions to such treatment (ECT Art. 10(2)–(3) and 10(5)). The text also provides that states may adopt voluntary commitments to national and MFN treatment in the pre-establishment phase (ECT Art. 10(6)), and that the adoption of mandatory commitments would depend on a supplementary treaty (ECT Art. 10(4)).

"Pre-investment" is among the topics for consideration in the ECT modernization process. Should the consideration of this topic result in an expansion of the non-discriminatory treatment provisions under the ECT to the pre-investment phase, it would be important for purposes of the achievement of climate change and other sustainability goals that no pre-establishment rights are granted to carbon-intensive energy investments. These could be excluded through a specific carve-out to the pre-establishment national treatment and MFN provisions.[81] It would be more effective, however, to exclude carbon-intensive energy investments altogether from the scope of the treaty, as explained above (see Section 2.4). In addition, following state practice in recent investment treaties and chapters, including EU agreements, any pre-establishment obligations granted under the revised ECT should be carved out from ISDS mechanisms, if included.[82]

ECT Art. 5 prohibits member states from adopting trade-related investment measures that are inconsistent with the provisions of Art. III or XI of the General Agreement on Tariffs and Trade (GATT). Accordingly, Art. 5 prohibits member states from requiring or conditioning advantages on requirements related to local purchasing and export performance, replicating the

[79] Dutch Model BIT, *supra* note 74, Art. 16(3).

[80] Climate Investment Treaty Model, *supra* note 45, Part 7; IISD. (2017, July). *Investment-related dispute settlement: Lessons from international accountability mechanisms*. Geneva: IISD. Retrieved from https://www.iisd.org/library/investment-related-dispute-settlement-lessons-international-accountability-mechanisms

[81] See Miles, K. (2008, July 2). International Investment law and climate change: issues in the transition to a low carbon world. *Society of International Economic Law (SIEL) Inaugural Conference 2008*. Retrieved from: https://ssrn.com/abstract=1154588 or http://dx.doi.org/10.2139/ssrn.1154588

[82] CETA, *supra* note 65, Art. 8.18.

language of the World Trade Organization (WTO) Agreement on Trade-Related Investment Measures (TRIMs).

While there is a trend in recent investment treaties and investment chapters in free trade agreements (FTAs) to go beyond TRIMs language, expanding the list of prohibited performance requirements, well-designed and applied performance requirements can be "effective tools to maximize the economic, environmental and social benefits of foreign investment in the host state."[83] Such requirements could be particularly relevant in the low-carbon transition, in which member states may wish to establish performance requirements to foster the development of domestic renewable energy markets. Accordingly, in the ECT modernization process, it would be important not to go beyond performance requirement prohibitions already prohibited under the TRIMs. Art. 5 could be substantially simplified, simply incorporating by reference member states' obligations under the TRIMs,[84] or could be deleted.

d. National Treatment and MFN (Art. 10(7))

The combined national treatment and MFN clause in ECT Art. 10(7) is notably open and unqualified: states promise to accord investments of ECT member states, in their activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that accorded to investors of the host state or any third state. In the context of a transition to low-carbon economies, it will be important for states to adopt policy measures that deliberately distinguish between energy investments that advance climate change mitigation objectives and those that hinder their achievement. "For example, to encourage the production of renewable energy, states may want to treat it more favourably than fossil fuel production."[85]

Following the approach of the GATT, national and MFN treatment clauses in most recent investment treaties and chapters clarify that the prohibition against discrimination only applies as between investors or investments that are in "like circumstances"[86] or "like situations."[87] Many new agreements also clarify what constitutes "like circumstances" or "like situations," requiring an overall examination of all circumstances or situations of an investment, on a case-by-case basis.[88] Should ECT member states maintain carbon-intensive energy investments in the scope of the treaty, its investment protections and its ISDS mechanism, they could adopt appropriate criteria—in the context of "like circumstances" or "like situations"—in order to allow host states to discriminate between carbon-intensive and low-carbon energy investments, according them legally different treatment in order to achieve climate change goals.[89]

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[83] IISD & UNEP Toolkit, *supra* note 71, Section 5.4.3.
[84] Agreement between the Government of Canada and the Government of the People's Republic of China for the promotion and reciprocal protection of investments, September 9, 2012, Art. 9. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/778 [hereafter Canada–China BIT].
[85] IISD & UNEP Toolkit, *supra* note 71, Section 5.4.2.
[86] CPTPP, *supra* note 65, Art. 9.4(1)–(2); Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United Mexican States for the promotion and reciprocal protection of investments, May 12, 2006, Art. 4(1). Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/2545 [hereafter Mexico–United Kingdom BIT].
[87] CETA, *supra* note 65, Art. 8.6(1) and 8.7(1).
[88] CPTPP, *supra* note 65, Art. 9(4), footnote 14; Investment agreement for COMESA common investment area, May 23, 2007, Art. 17.2. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3225 [hereafter COMESA CIA].
[89] See, for example, Climate Investment Treaty Model, *supra* note 45, Art. 3.2(3).

International arbitral tribunals have interpreted the MFN clause to allow investors to benefit from more favourable substantive or procedural elements contained in other treaties concluded by the host state. Reacting to this trend, in most new investment treaties states have added clarifications or carve-outs to the MFN clause. While some clarify that provisions in other treaties do not constitute "treatment" that could be considered to breach the MFN clause,[90] others expressly carve out other agreements from the scope of MFN.[91] Yet, other states omit MFN provisions.[92] Without such safeguards, any ECT modernization efforts would risk being undermined or reversed through importation of substantive or procedural standards from other treaties.

e. Fair and Equitable Treatment (Art. 10(1))

ECT Art. 10(1) contains an unqualified promise of member states to accord foreign investors and investments "fair and equitable treatment" (FET). FET clauses in investment treaties have been widely interpreted and can become "catch-all" clauses, allowing investors to succeed where other claims have failed.[93] FET clauses—and particularly the protection of legitimate expectations, often understood to be included in the FET standard[94]—pose risks to the achievement of climate change and other sustainable development objectives.[95] For example, in recently decided ISDS cases, investors have successfully invoked FET to challenge states' decisions not to grant or not to renew environmental permits to foreign investors.[96] Similarly,

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[90] CETA, *supra* note 65, Art. 8.7(4); Free trade agreement between the European Union and the Socialist Republic of Vietnam (in negotiation), Chapter II (Investment), Art. 4.6. Retrieved from https://investmentpolicyhub.unctad.org/Download/TreatyFile/3563 [hereafter EU–Vietnam FTA].

[91] Canadian Model FIPA 2004, Annex III. Retrieved from https://investmentpolicyhub.unctad.org/Download/TreatyFile/2820 [hereafter Canadian Model FIPA]; COMESA CIA, *supra* note 102, Art. 19; Agreement between the Government of the People's Republic of China and the Government of the Republic of Korea on the promotion and protection of investments, September 7, 2007, Art. 12.4(2). Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/924 [hereafter China–Korea FTA]; EU–Vietnam FTA, *supra* note 90, Arts. 4.3, 4.4.

[92] Agreement establishing the ASEAN–Australia–New Zealand free trade area, February 27, 2009. Retrieved from https://investmentpolicyhub.unctad.org/IIA/country/150/treaty/3268 [hereafter AANZFTA]; Bilateral investment treaty between the Government of the Hashemite Kingdom of Jordan and the Government of the Republic of Singapore, May 16, 2004. Retrieved from https://investmentpolicyhub.unctad.org/IIA/mappedContent/treaty/2180 [hereafter Jordan–Singapore BIT]; Indian Model BIT, *supra* note 58.

[93] Picherack, J. R. (2008). The expanding scope of the fair and equitable treatment standard: Have recent tribunals gone too far? *Journal of World Investment & Trade*, *9*, 255; Marshall, F. (2007, October). Fair and equitable treatment in international investment agreements. In *Forum for Developing Country Investment Negotiators, Singapore*. Retrieved from https://www.iisd.org/pdf/2007/inv_fair_treatment.pdf; Dolzer, R. (2005). Fair and equitable treatment: a key standard in investment treaties. *The International Lawyer*, 87–106.

[94] See Bonnitcha, J. The problem of moral hazard and its implications for the protection of "legitimate expectations" under the fair and equitable treatment standard. *Investment Treaty News*, *3*(1), 5–8. Retrieved from https://www.iisd.org/pdf/2011/iisd_itn_april_2011_en.pdf

[95] On the relationship between FET and sustainable development, see Kläger, R. (2011). Fair and equitable treatment and sustainable development. In M. C. C. Segger, M. W. Gehring & A. P. Newcombe, A. P. (Eds.). (2011). *Sustainable development in world investment law* (241–260). Alphen aan den Rijn: Kluwer Law International; Kläger, R. (2011). Sustainable development. In *Fair and equitable treatment in international investment law* (197–212). Cambridge: Cambridge University Press.

[96] See, for example, the *Clayton/Bilcon v. Canada*, *Crystallex v. Venezuela* and *Tecmed v. Mexico* cases: Schacherer, S. (2018, October). Bilcon v. Canada. In N. Bernasconi-Osterwalder & M. D. Brauch. *International investment law and sustainable development: key cases from the 2010s* (54–60). Geneva: IISD. Retrieved from https://www.iisd.org/sites/default/files/publications/investment-law-sustainable-development-ten-cases-2010s.pdf; Schacherer, S. (2018, October). Crystallex v. Venezuela. In N. Bernasconi-Osterwalder & M. D. Brauch. *International investment law and sustainable development: key cases from the 2010s* (48–53). Geneva: IISD. Retrieved from https://www.iisd.org/sites/default/files/publications/investment-law-sustainable-

it may be envisaged that foreign investors could invoke FET to challenge legitimate public policy measures host states may adopt in pursuance of public policies objectives related to the low-carbon transition and other objectives relating to sustainable development.

Some states have attempted to qualify the standard and give interpretative guidance to tribunals, by expressly clarifying that FET does not mean more than the customary international law minimum standard of treatment of aliens.[97]

As even this approach has resulted in broad and unintended interpretations by arbitral tribunals, states are becoming even more specific, by expressly and exhaustively indicating the situations that amount to an FET breach.[98] Countries have used different listing approaches. The EU approach, for example in the CETA, continues to be problematic. Importantly, it does not resolve the problems that have arisen in investment arbitration in relation to "legitimate expectations." It allows tribunals to rely on the legitimate expectation of an investor to assess whether or not the government violated the FET standard. The CETA provision does not require a written promise or commitment for the expectation to be created. Instead, any form of representation by any government official—with or without authority—seems sufficient.[99]

India has taken a different listing approach. It avoids the reference to "fair and equitable treatment" by name but lists certain actions that amount to a treaty violation, such as denial of justice, fundamental breach of due process, targeted discrimination or manifestly abusive treatment. Some states exclude the "fair and equitable" or similar provisions altogether,[100] providing instead that states shall not deny access to justice and to administrative proceedings, in accordance with domestic laws, and guaranteeing investors treatment in accordance with due process of law.[101]

We are of the view that this is the provision most likely to having a chilling effect. Its open-ended formulation is highly unpredictable. The continued reliance on the notion of "legitimate expectations" makes this particularly prone to abuse by investors to challenge legitimate government and legislative actions. Because the CETA language retains this element, it continues to be a potential threat from an environmental perspective. The Indian approach,

development-ten-cases-2010s.pdf; Johnson, L. (2011). Tecmed v. Mexico. In N. Bernasconi-Osterwalder & L. Johnson. (Eds). *International investment law and sustainable development: key cases from 2000–2010* (137–144). Geneva: IISD. Retrieved from https://www.iisd.org/sites/default/files/publications/int_investment_law_and_sd_key_cases_2010.pdf

[97] North American Free Trade Agreement, December 17, 1992, entered into force January 1, 1994. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3104 [hereafter NAFTA]; Canadian Model FIPA, *supra* note 91; U.S. Model BIT 2012, retrieved from https://investmentpolicyhub.unctad.org/Download/TreatyFile/2870; Agreement between the Government of the Kingdom of Morocco and the Government of the Socialist Republic of Viet Nam on the promotion and protection of investments, June 15, 2012, Art. 2.2(c) https://investmentpolicyhub.unctad.org/IIA/treaty/2611 [hereafter Morocco–Vietnam BIT]; Canada–China BIT, *supra* note 84, Art. 4; Agreement between Japan and the Republic of Peru for the promotion, protection and liberalisation of investment, November 21, 2008, Art. 5. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/2158 [hereafter Japan–Peru BIT].

[98] CETA, *supra* note 65, Art. 8.10, paras 2-3; Indian Model BIT, *supra* note 58, Art. 3.

[99] CETA, *supra* note 65, Art. 8.10(4).

[100] See Brazil's CFIAs, *supra* note 61; Comprehensive economic cooperation agreement between the Republic of India and the Republic of Singapore, June 29, 2005. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3365 [hereafter India–Singapore CECA].

[101] Intra-MERCOSUR Investment Protocol, *supra* note 61, Art. 4(1)–(2).

which focuses on due process and manifest abuse, leaves less room to second-guess legitimately adopted environmental measures.[102]

f. Expropriation (Art. 13)

The current language of Art. 13 protects foreign investors against nationalization, expropriation or equivalent measures. While the treaty thus intends to cover both direct and indirect expropriation, neither is defined in the text. Determining whether an indirect expropriation has occurred will vary considerably depending on the interpretation by an arbitral tribunal of a specific case. Recent investment treaties carefully define indirect expropriation, list factors that should be considered to determine whether an indirect expropriation has occurred, and clarify that non-discriminatory measures designed and applied to protect legitimate public welfare objectives do not constitute an indirect expropriation.[103] In this way, disruptive regulatory measures taken to achieve climate objectives and other SDGs can be protected from indirect expropriation claims.

g. Valuation of Damages (Arts. 12 and 13)

Both Art. 12 on compensation for losses and Art. 13 on expropriation could be substantially improved in the ECT modernization process by including rules on how compensation should be calculated in such cases. Adopting rules and criteria on valuation would provide interpretative guidance to arbitral tribunals and greater certainty for foreign investors as well as states.[104] For example, the approach adopted in the *Bear Creek v. Peru* case could be adopted for the valuation of damages resulting from the necessary phase-out of carbon-intensive investments. In *Bear Creek*, given that the mine expropriated was at an early, non-producing stage, the tribunal dismissed the application of forward-looking valuation methodologies (encompassing both the amounts invested and lost profits). Instead, it preferred the application of backward-looking cost approach, awarding the investors compensation for sunk costs (amounts invested) only.[105] A sunk-costs approach was also adopted in the more recent (yet unpublished) award in *South American Silver v. Bolivia*.[106]

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[102] Indian Model BIT, *supra* note 58, Art. 3.

[103] Agreement on investment of the framework agreement on comprehensive economic co-operation between the People's Republic of China and the Association of Southeast Asian Nations, August 15, 2009, Annex 2. Retrieved from https://investmentpolicyhub.unctad.org/IIA/treaty/3272 [hereafter ASEAN–China Investment Agreement]; CPTPP, *supra* note 65, Annex 9-B; CETA, *supra* note 65, Annex 8-A.

[104] SADC Model BIT, *supra* note 58, Art. 6, options 1, 2 and 3; see also: Nikièma, S. (2012, March). Indirect expropriation. *IISD Best Practices Series*. Geneva: IISD. Retrieved from https://www.iisd.org/library/best-practices-indirect-expropriation

[105] Bear Creek Mining Corporation v. Republic of Peru, ICSID Case No. ARB/14/21, Award, November 30, 2017, paras. 595–604. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw9381.pdf; see also Schacherer, S. (2018, October). Bear Creek v. Peru. In N. Bernasconi-Osterwalder & M. D. Brauch. *International investment law and sustainable development: key cases from the 2010s* (4–9). Geneva: IISD. Retrieved from https://www.iisd.org/sites/default/files/publications/investment-law-sustainable-development-ten-cases-2010s.pdf

[106] Charlotin, D. (2018, November 23). South American Silver wins on expropriation in long-running bilateral investment treaty case – but collects only sunk costs from Bolivia. *Investment Arbitration Reporter*. Retrieved from http://tinyurl.com/yajug259; TriMetals Mining Inc. (2018, November 23). *TriMetals Mining Inc.'s subsidiary, South American Silver, awarded approximately US$28 million (including interest) in arbitration proceedings against the government of Bolivia*. Retrieved from http://stockhouse.com/news/press-releases/2018/11/23/trimetals-mining-inc-s-subsidiary-south-american-silver-awarded-approximately

h. Relation to Other Agreements (Art. 16)

The ECT provision governing its relationship with other international agreements (Art. 16) establishes that any substantive rights or procedural guarantees that are more favourable to foreign investors or investments, whether contained in prior or newly concluded treaties, must prevail over the rights and guarantees under the ECT.

ECT member states should seize the modernization process to revise this approach, which gives absolute priority to the rights of foreign investors and investments. To achieve climate change and other sustainable development objectives, as well as meaningful reform of international investment law and dispute settlement, states may adopt international agreements that limit substantive and procedural rights accorded to foreign investors under older treaties, such as carbon-intensive energy investors. Provisions such as ECT Art. 16 lock in the rights of foreign investors and their investments, hindering the ability of states to adopt necessary reforms, and as such are undesirable from a public policy perspective.

4. Conclusion

All ECT member states have committed to the goals under the Paris Agreement on climate change as well as under the broader SDGs. There is no disagreement among ECT member states on the need to achieve such goals. In fact, Energy Charter Conference statements suggest that its members states are aware of the fundamental link between ECT modernization and their achievement. For example, a 2017 decision refers to "a sustainable energy future" and "decarbonization." It also recognizes that:[107]

> International investment policy has evolved considerably since the ECT was adopted. It is therefore essential to bring the investment protection of the ECT in line with modern standards, in order to ensure that the Treaty can effectively play its role as an important instrument to protect investment in the energy sector while considering the legitimate right of governments to regulate.

While we may not agree with the weight given to investment protection, we agree with the essence of the above excerpt, which suggests that Energy Charter Conference states have appropriate public policy goals at heart. Accordingly, they must move away from and beyond a narrow investment protection focus and take a step toward achieving climate change and other global policy goals.

As we have argued in this paper, to achieve global climate change and broader sustainability goals, ECT member states have an important role to play in encouraging capital flows to shift swiftly away from investments in fossil fuels and other carbon-intensive energy sources toward low-carbon investments in clean, renewable energy. The ECT, in its current form, protects carbon-intensive and low-carbon energy investments as if they were equally desirable. By maintaining such treaty, ECT member states are effectively sponsoring an investment protection and dispute settlement regime that hinders their own climate change objectives.

The ongoing ECT modernization process is an opportunity for member states to fix the incongruence between the ECT's governance regime for energy investments, on the one hand, and the climate change and sustainability goals to which they have committed, on the other.

[107] Energy Charter Conference CCDEC 2017 23 STR, *supra* note 22.

The Paris Agreement and SDG imperatives dictate the need for reform. At the same time, recent developments in international investment law and policy—as shown above through numerous examples of modern treaty models and recently concluded treaties—supply the tools that ECT member states need to reform the substantive and procedural provisions so as to reorient the ECT toward the Paris Agreement and the SDGs and, ultimately, toward low-carbon and sustainable economies and societies.

The Subgroup on Modernization has a mandate to identify potential policy options for each modernization topic, including the context and legal instruments that could be used, such as clarification or amendment. In our view, even if certain aspects of the ECT might be amenable to reform through clarification in interpretative statements by ECT member states, the amendment option is overall preferable. Amendment would ensure the greatest degrees of commitment by ECT member states and of certainty in the interpretation of the reformed ECT text.

The new way forward for ECT modernization we have proposed in this article depends on a structural revision of the list of topics for discussion as approved by the Energy Charter Conference. In terms of process, the revision of the list must result from consultations that seek input not only from ECT member states, observer states and the energy industry, but also the broadest possible base of stakeholders interested in or affected by global energy investment processes. As to its content, the list must be significantly expanded beyond minor tweaks in existing substantive and procedural provisions. To result in true modernization of the ECT, the modernization efforts should lead to an overhaul of the ECT rationale and framework, bringing it in line with ECT member states' international law commitments with respect to climate change and sustainable development.