ECONOMY AND ECOLOGY 01.04.2021 | Nico Schmidt

The treaty that threatens to derail Europe's Green Deal

When private courts of arbitration can award transnational energy firms billions in compensation for lost profits, climate protection becomes a farce

The British oil company Rockhopper Exploration is suing Italy in an international court of arbitration for around €225 million in damages – because of an Italian government decree that bans oil drilling. Meanwhile, German energy giant RWE is demanding €1.4bn from the Netherlands because it banned coal burning starting in 2030, which means RWE will have to close down its coal-fired power plant. Thus far, only a few corporations like Rockhopper and RWE have filed suits against EU climate measures. But these are probably just the beginning of a massive wave of lawsuits that could cause the EU and its member states to fall short of their climate targets.

Such lawsuits are permitted through a little-known investment protection agreement, the Energy Charter Treaty (ECT). All EU countries, including Germany, signed the treaty in December 1994. According to figures from Investigate Europe, the ECT protects the fossil-fuel infrastructure in the EU, Great Britain and Switzerland to the tune of €350bn. Fear of ECT-based lawsuits is leading EU countries to postpone and water down their climate laws – or abandon them altogether.

Right after the end of the Cold War, Western states sought to create legal certainty for energy companies wanting to invest in the new post-Soviet countries. Not trusting the local legal systems, they used investment protection treaties to transfer mediation to binding international arbitration. One such treaty is the Energy Charter to protect companies investing in the energy sector. Besides the EU, Afghanistan and post-Soviet countries like Azerbaijan and Kazakhstan also signed the treaty. So did other industrialised countries, including Turkey and Japan. But today, energy companies are using the Charter to sue for billions in compensation when nation states ban the use of coal, oil and gas to achieve their climate goals.

Such lawsuits are negotiated in private arbitration courts. In recent years, criticism of these common procedures for protecting investments has become very shrill: for example, during the Transatlantic Trade and Investment Partnership (TTIP) negotiations. While some details in current trade agreements like the TTIP are more modern than those in the Energy Charter –considered the very first investment protection treaty – they rely on the same system of private arbitration courts: Negotiations are largely shielded from public gaze and it's almost impossible for states to challenge compensation awards.

Can the ECT be reformed?

Many ECT lawsuits, including those of Rockhopper and RWE, are being handled by the International Centre for Settlement of Investment Disputes (ICSID). If one state refuses to accept a judgment and pay compensation, its property may be confiscated in other states that accept ICSID rules. That is, investors can use the ECT to sue states in courts of arbitration and enforce compensation claims even *after* they have left the treaty. So a breach of contract is no way out of the ECT. What options do the EU and its member states have?

EU countries have been trying to reform the Energy Charter Treaty for years. In 2018, the 55 contracting parties agreed to begin a modernisation process. In October 2020, the European Commission presented member states with an EU negotiating position, which was approved a few weeks ago. But EU consensus does not mean that the treaty can be reformed. That takes all contracting parties voting on a new version – and in 2019, the Japanese government opined that 'it is not necessary to amend the current ECT provisions'. *Not* doing that could thwart the goals of the European Green Deal.

The EU and its member states have one last hope for preventing a wave of ECT lawsuits.

Exasperated by the arduous negotiations, two EU members recently resorted to unusual means: Both the French and Spanish governments sent letters to the EU. The French letter states that the modernisation discussions 'are not likely to produce results for several years' and the EU's objectives are 'far from being achieved'. Therefore, '[t]he option of a coordinated withdrawal of the European Union and its member states should be raised publicly'. The Spanish government wrote that quitting the Treaty is the only effective long-term solution if the Charter cannot be

reconciled with EU climate targets.

The EU Commission has long accepted the possibility that negotiations over modernisation could fail. Last December, EU Trade Commissioner Valdis Dombrovskis declared that the Commission 'may consider proposing other options, including the withdrawal from the ECT'. This would apply if 'core EU objectives, including the alignment with the Paris Agreement, are not attained within a reasonable timeframe'. The problem is: Parties are not allowed to quit right away.

'It will be difficult for EU member states to leave the Energy Charter Treaty immediately,' says legal scholar Markus Krajewski, who has been researching investment protection for many years. That's because the Energy Charter was designed to protect companies. Article 47 of the ECT provides that a state can be sued for 20 years after leaving the treaty. Scholars call this the 'sunset' clause, activists call it the 'zombie' clause.

The nuclear option

The EU and its member states have one last hope for preventing a wave of ECT lawsuits. Two thirds of all recent ECT cases have involved EU investors suing EU states, as in RWE vs. the Netherlands. International treaty law, however, allows contracting parties to conclude supplementary agreements that affect only them. Thus, EU member states could simply agree to no longer apply the ECT to intra-European cases.

However, EU members are at loggerheads over this solution. A few years ago, the European Court of Justice (ECJ) ruled that investment protection treaties between EU states are incompatible with EU law. That led many states to conclude that the court's judgment also applies to the only investment protection agreement that exists between many EU countries, the ECT. But some governments vehemently disagree.

Even if EU governments agreed, however, it's possible that arbitrators would not recognise it. Investment protection expert Markus Krajewski says: 'There is certainly a perception that such an inter se agreement between the Parties would curtail investors' rights under the Energy Charter.' Inter-se (Latin for 'amongst themselves') agreements allow parties to derogate from an existing treaty.

Last December, the Belgian government requested the ECJ to clarify whether the Energy Charter Treaty is compatible with EU law. The ECJ could clarify if future intra-European ECT lawsuits will be permitted. That means that the Energy Charter Treaty and the arbitration regime

that jeopardises the EU's climate targets could finally be checked – by a (public) court.



Nico Schmidt
Berlin

Nico Schmidt is a member of the international journalist team Investigate Europe, which publishes reports on topics of Europe-wide relevance. His articles have appeared in *Der Spiegel* and *Die Zeit*, among others.