THE ROLE OF THE ENERGY CHARTER TREATY FOR DECARBONIZATION

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Abstract

Paradoxically, the EU aims to water down the protection that the Energy Charter Treaty provides to energy investors, including in the renewable energy sector, yet emphasizes the importance of regulatory stability for the energy transition under the 2018 Renewable Energy Directive. If adopted, the EU proposals will limit the protection of new investments in clean energy production, in particular in jurisdictions outside of the EU that lack sufficiently clear guarantees of stability for the renewable energy industry, potentially increasing the cost of financing these projects and thus the cost of the clean energy transition.

1 Introduction

Professor Roggenkamp's work on European energy law made an important contribution to understanding the legal architecture that the European Union (EU) created to organize energy supply on a liberalized market basis and transition towards low-carbon energy. Most notably the different editions of *Energy Law in Europe* and the *European Energy Law Reports* edited by Professor Roggenkamp helped shape the energy law discipline and continue to be essential references to the study of EU and national energy law.[2] In the mar-

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2 See e.g. M Roggenkamp et al, *Energy Law in Europe* (OUP, 2016).

ket-based approach that governs the organisation of energy supply in the EU, liberalization and decarbonization go hand in hand.[3] Both liberalization and decarbonization dimensions are at the centre of Professor Roggenkamp's work. Liberalization and decarbonization reforms also closely interact with international economic (trade and investment) law – a discipline to which Professor Roggenkamp also made an important contribution with her early work on energy transit.[4]

In the European context, the interaction of decarbonization with the Energy Charter Treaty (ECT) – the energy-specific trade and investment agreement – is a highly contentious issue. The ECT is under increasing criticism for the obstacles it allegedly creates for decarbonisation.[5] The "right to regulate", and in particular the right to adopt ambitious environmental measures (e.g. regulatory phase out of coal), is at the centre of the discussion on the modernization of the Treaty.[6] For the EU, there is "urgent need for progress in the negotiations for the modernisation of the Energy Charter Treaty, with a view to

3 According to the European Commission, "Proposal for a Directive Establishing a Scheme for Greenhouse Gas Emission Allowance Trading", COM(2001)581 final, OJ 2002 C 75E/33, when opting for emissions trading as cornerstone of the EU climate policy, it was "essential that this instrument [was] compatible with the liberalization of energy markets."

4 M Roggenkamp, "Transit of Networkbound Energy: A New Phenomenon?—Transit Examined from the Barcelona Transit Convention to the Energy charter Treaty" (1995) *World Competition* 119 – 146; M Roggenkamp, "Transit of Network-bound Energy: the European Experience", in Wälde (ed.), The Energy Charter Treaty (London: Kluwer International Law, 1996).

5 See e.g. https://energy-charter-dirty-secrets.org/. See also the analysis in Andrei Belyi, "The Energy Charter Process in the Face of Uncertainties" (2021) *The Journal of World Energy Law & Business* 363–375.

6 See EU Text Proposal for the Modernisation of the Energy Charter Treaty, https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf, proposing to include a new article on "Regulatory Measures" in the ECT (reaffirming the "right to regulate" of Contracting Parties "to achieve legitimate policy objectives, such as the protection of the environment") and EU Additional Submission to its Text Proposal for the Modernisation of the Energy Charter Treaty, https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159436.pdf, proposing to exclude "Coal, Natural Gas, Petroleum and Petroleum Products, Electrical Energy" from the scope of protection of the ECT. See also the December 2020 Report of the ECT Modernisation Group at https://www.euractiv.com/wp-content/uploads/sites/2/2020/12/ECT-report-on-progress-made_FS.pdf; and media coverage, e.g. https://www.theguardian.com/business/2019/dec/09/energy-treaty-risks-undermining-eus-green-new-deal, following different investor claims challenging decarbonisation measures, e.g. the threat of investment arbitration against the regulatory phase out of coal fired power plants in the Netherlands, https://www.euractiv.com/section/energy/news/not-approprite-uniper-seeks-compensation-for-dutch-coal-phase-out/

driving an inclusive global energy transition in alignment with Paris Agreement objectives."[7]

In line with its long term decarbonisation targets,[8] "the EU is bound to discourage all further investments into fossil fuel based energy infrastructure projects, unless they are fully consistent with an ambitious, clearly defined pathway towards climate neutrality".[9] There is growing pressure to withdraw from the ECT, if the negotiations on the modernization of the treaty fail to ensure a sufficiently robust right to regulate to protect the environment and exclude fossil energies from the scope of investment protection.[10]

Building on the ideas first elaborated while I pursued my PhD at the University of Groningen under Professor Roggenkamp's supervision and that I further developed in subsequent publications, this contribution argues that focusing on the tension between the right to property and environmental protection has led the attention away from the positive contribution that the ECT, and investment law more generally, can make to decarbonisation.[11] The controversy on the application of the ECT to intra-EU disputes and on obstacles to the payment of arbitration-related damages under EU state aid law are not covered in the analysis below.

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7 EU Additional Submission, op cit.

8 Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 Establishing the Framework for Achieving Climate Neutrality, OJ 2021 L 243/1.

9 EU Additional Submission, op cit.

10 See e.g. ClientEarth, "EU Must Withdraw from Energy Charter Treaty", 6 July 2021, https://www.clientearth.org/latest/latest-updates/news/eu-must-withdraw-from-energy-charter-treaty/.

11 See e.g. A Boute, "The Potential Contribution of International Investment Protection Law to Combat Climate Change" (2009) *Journal of Energy and Natural Resources Law* 333-376; "Combating Climate Change and Securing Electricity Supply: The Role of Investment Protection Law" (2007) *European Environmental Law Review,* 227-248. See more recently A Boute, "The Rights of Environmental Investors: the Case of Renewable Energy", in S Bogojevic and R Rayfuse (eds), *Environmental Rights in Europe and Beyond* (Oxford: Hart Publishing, 2018) 229-252; A Boute, "Regulatory Stability and Renewable Energy Investment: the Case of Kazakhstan" (2020) *Renewable & Sustainable Energy Reviews* 109673.

2 The environmental criticism of the ECT

The criticism of international investment law, and the right to property more generally, as an obstacle to environmental regulation is not new.[12] First, the argument goes, as the foundation of the current capitalist system, property rights are to an important extent responsible for environmental degradation. Second, the protection of the right to property constraints environmental initiatives because it exposes states that adopt ambitious environmental measures to possible legal claims. According to Tienhaara, "It is evident that arbitrators have *expropriated* certain fundamental aspects of environmental governance from states. As a result, environmental regulation has become riskier, more expansive and less democratic, especially in developing countries."[13]

The criticism of the constraints that international investment law, and in particular the ECT, imposes on states' right to regulate is particularly acute in the context of the debate on the phase out of coal-fired power generation. On the one hand, to achieve carbon neutrality by 2050, all unabated coal plants should be phased out by 2040, and by 2030 in the EU and other advanced economies.[14] Banning the use of coal for electricity production is an effective way of accelerating the closure of polluting facilities.[15] On the other hand, the arbitration proceedings initiated by foreign companies against the forced closure of their installations (e.g. in the Netherlands) emphasize the risk that

12 See Boute, "The Rights of Environmental Investors", op cit., 229-252, discussing P Taylor and D Grinlinton, "Property Rights and Sustainability: Toward a New Vision of Property", in Prue Taylor and David Grinlinton (eds.), *Property Rights and Sustainability: The Evolution of Property Rights to Meet Ecological Challenges* (Martinus Nijhoff Publishers 2011) 1-20, 8; C Rodgers, *The Law of Nature Conservation: Property, Environment, and the Limits of Law* (OUP 2013) 307; K Tienhaara, *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy* (CUP 2009) 3; J Viñuales, *Foreign Investment and the Environment in International Law* (CUP 2015) 253.

13 Tienhaara, op cit., at 3.

14 IEA, "Net Zero by 2050" (2021) <https://www.iea.org/reports/net-zero-by-2050>, at 116 and 165; IEA, "World Energy Outlook 2020", <https://www.iea.org/reports/world-energy-outlook-2020>, at 231; United Nations, "UN Chief Calls for Immediate Global Action to Phase Out Coal", 2 March 2021, <https://unfccc.int/news/un-chief-calls-for-immediate-global-action-to-phase-out-coal.

15 See B Caldecott and J Mitchell, "Premature Retirement of Sub-Critical Coal Assets" (2014) *Seton Hall Journal of Diplomacy and International Relations* 59-70; F Matthes, H Hermann, and R Mendelevitch, "Assessment of the Planned Compensation Payments for Decommissioning German Lignite Power Plants in the Context of Current Developments" (Öko-Institut e.V, 2020), at 30 <https://www.oeko.de/fileadmin/oekodoc/Assessment-of-the-planned-compensation-payments.pdf>.

investor-state arbitration poses to states that decided to ban the use of coal, as governments face the payment of significant damages to investors.[16]

3 The environmental argument for investment law

While the protection of property can be an obstacle to the introduction of ambitious environmental protection policies, it also has a key role to play in facilitating the transition of the economy towards sustainability by protecting the rights of investors in the green economy.[17] Investors have a crucial role to play in delivering the massive investments that are needed in the re-organisation of the economy towards more sustainable – and in particular more climate friendly – patterns.[18] The key role of investors for climate change mitigation is clear in the context of the ambitious EU climate change mitigation policy. This policy requires significant investments in energy production from renewable energy sources, in energy efficiency improvements and in carbon capture and storage.[19]

16 See e.g. ClientEarth, "Should German Coal Companies Get Cash to Close?" (2019), <https://cutt.ly/XjhTplA>; K Tienhaara and L Cotula, "Raising the Cost of Climate Action? Investor-state Dispute Settlement and Compensation for Stranded Fossil Fuel Assets" (International Institute for Environment and Development, 2020), <https://pubs.iied.org/pdfs/17660IIED.pdf>; A Van den Berghe, "Legal Opinion on Uniper's Legally Misconceived ISDS Threat to Dutch Coal Phase-out" (ClientEarth, 2019), <https://www.documents.clientearth.org/wp-content/uploads/library/2019-11-26-clientearth-legal-opinion-isds-threat-uniper-ce-en.pdf>.

17 See Boute, "The Rights of Environmental Investors", op cit., 229-252; and A. Boute, "Combating Climate Change through Investment Arbitration" (2012) *Fordham International Law Journal* 613-664.

18 UNEP, The Financial System We Need: Aligning the Financial System with Sustainable Development (2015) vii; Abbis Ababa Agenda of the Third International Conference on Financing for Development, UNGA Resolution 69/313, 27 July 2015, UN Doc A/RES/69/313; Executive Secretary of the United Nations Framework Convention on Climate Change, Investment and Financial Flows to Address Climate Change (2007) 42.

19 European Commission, Communication: A Policy Framework for Climate and Energy in the Period from 2020 to 2030, COM(2014) 15, 22 January 2014.

The investment community regularly highlights the regulatory and policy risks of investing in clean energy sources.[20] Governments in the EU have repeatedly interfered with the regulatory framework they have created to promote investments in the green economy.[21] The risk of changes to the regulatory and financial foundation of investments increases the cost of capital and delays the making of investments. According to a recent study on the impact of subsidy changes on renewable energy investments in the EU, "a retroactive subsidy change decreases the investment rate by approximately 45% for PV and 16% for onshore wind" and "once the seed of mistrust is sown, it is likely to have a lasting impact."[22] Constant changes to renewable energy regulation negatively impact on the credibility, and thus effectiveness, of future regulatory commitments.[23]

Inversely, mechanisms mitigating the risk of regulatory change reduce the cost of capital and facilitate the transfer of investments.[24] While a certain level of flexibility is needed to adapt support schemes to the rapidly changing energy market environment, the success of renewable energy policies to a significant extent depends on the stability of these policies. The Stern Review on the Economics of Climate Change defines regu-

20 See e.g. A Vaughan, "UK Solar Power Installations Plummet After Government Cuts", *The Guardian*, 8 April 2016,: www.theguardian.com/environment/2016/apr/08/solar-installation-in-british-homes-falls-by-three-quarters-after-subsidy-cuts; T Macalister, 'UK Solar Panel Subsidy Cuts Branded 'Huge and Misguided', *The Guardian*, 17 December 2015, available at: www.theguardian.com/business/2015/dec/17/uk-solar-panel-subsidies-slashed-paris-climate-change; House of Commons Energy and Climate Change Committee, Investor confidence in the UK energy sector, Third Report of Session 2015–16, available at: http://www.publications.parliament.uk/pa/cm201516/cmselect/cmenergy/542/542.pdf; Letter from Institutional Investors Group on Climate Change to Mr. Zapatero on the Proposed Retroactive Reduction of 661 Tariff for Existing Investments (June 23, 2010), available at: http://www.iigcc.org/__data/assets/pdf_file/0010/1009/IIGCC-letter-to-Spanish-government.pdf.

21 For a discussion of these regulatory changes and their impact on renewable energy investments, see EU Commission, Commission Staff Working Document, 'Guidance for the Design of Renewables Support Schemes', SWD (2013)439 final, 3-4.

22 Sendstad et al., "The Impact of Subsidy Retraction on European Renewable Energy Investments" (2022) *Energy* 112675.

23 House of Commons Energy and Climate Change Committee, Investor confidence in the UK Energy Sector, Third Report of Session 2015–16, http://www.publications.parliament.uk/pa/cm201516/cmselect/cmenergy/542/542.pdf.

24 C. Klessmann, M. Rathmann, D. de Jager, A. Gazzo, G. Resch, S. Busch, M. Ragwitz, "Policy Options for Reducing the Costs of Reaching the European Renewables Target" (2013) *Renewable Energy* 390-403; P. Noothout, The Impact of Risks in Renewable Energy Investments and the Role of Smart Policies (Final report) (2016).

latory stability as the "belief that the policy will endure, and be enforced".[25] Investors must be confident that once irreversible investments are made, the government will not act opportunistically by adapting the rules or reneging on commitments.[26] Applied to the renewable energy sector, regulatory stability requires governments to honour promises of support.

The criticism of the ECT too often ignores the role that the Treaty's investment protection regime, and investment arbitration in general, plays in protecting the rights of investors in clean energy investments, in particular against sudden changes to renewable energy subsidies and carbon pricing mechanisms.[27] In fact, the majority of cases brought under the ECT relates to attempts by investors in low-carbon projects to enforce their rights under climate policies,[28] after failing to oppose unilateral changes to renewable energy subsidies based on the principle of legal certainty and the right to property.[29]

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25 N. Stern, *The Economics of Climate Change: The Stern Review* (Cambridge University Press, 2007).

26 C. Hepburn, Regulation by Prices, Quantities, or Both: A Review of Instrument Choice, Oxford Review of Economic Policy 22(2) (2006) 226-247; D. Helm, C. Hepburn, R. Mash, Credible Carbon Policy, Oxford Review of Economic Policy 19(3) (2003) 438-450.

27 See e.g. Andrei Belyi, "Letter: Investors Need Brussels to Stick with Energy Treaty", Financial Times, 19 February 2021, https://www.ft.com/content/bb0e2ac3-7d65-4442-b123-e66475d7ef5d, arguing that "Although it might sound implausible in light of widespread assumptions, the Energy Charter Treaty, as it is known, is the only existing agreement protecting investors in renewable energy against the arbitrary phasing out of the supporting policies that governments use to attract investors in the first place."

28 See https://www.energychartertreaty.org/cases/list-of-cases/. For an example of a non-ECT claim concerning changes to climate policies, see Westmoreland Coal Company v. Government of Canada, ICSID Case No. UNCT/20/3, https://www.italaw.com/cases/7002. See also https://www.iarewporter.com/articles/us-conglomerate-launches-nafta-legacy-claim-against-canada-over-cancellation-of-emissions-trading-program/.

29 On the protection of renewable energy investments based on the principle of legal certainty, see e.g. A. Boute, "The Quest for Regulatory Stability in the EU Energy Market: An analysis Through The Prism of Legal Certainty" (2021) *European Law Review* 675-692. For an analysis under the right to property, see e.g. A Boute, "The Protection of Property Rights under the European Convention on Human Rights and the Promotion of Low-Carbon Investments" (2010) *Climate Law* 93-132.

4 Regulatory stability and the ECT

The ECT contributes to regulatory stability in the energy sector.[30] According to the Energy Charter Treaty (Art. 10, para. 1), "Each Contracting Party shall (…) encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to Make Investments in Its Area. Such conditions shall include a commitment to accord at all times (…) fair and equitable treatment." In investment arbitration proceedings, stability arguments are used to determine whether the state breached the so-called "fair and equitable standard", and in particular the obligation for states to respect "investors' reasonable and legitimate expectations".[31] In *Eiser v. Spain* and *Antin v. Spain*, the tribunals ruled that the ECT necessarily embraces "an obligation to provide fundamental stability in the essential characteristics of the legal regime relied upon by investors in making long-term investments."[32]

According to *Antaris v Czech Republic*, to demonstrate that a state breached the fair and equitable treatment standard, "a claimant must establish that (a) clear and explicit (or implicit) representations were made by or attributable to the state in order to induce the investment, (b) such representations were reasonably relied upon by the claimants, and (c) these representations were subsequently repudiated by the state."[33] Following the investment objective pursued with renewable energy support schemes, states promise support in exchange for investments in the development of renewable energy. Taking into account that investments in renewable energy are made based on these promises of support, terminating or fundamentally changing the "essential characteristics" of sup-

30 This section builds on Boute, "Regulatory Stability", op cit., 109673. See also Boute, "Combating Climate Change" op cit., 613-664.

31 R Dolzer and C Schreuer, *Principles of International Investment Law* (Oxford, Oxford University Press, 2012); M Potestà, "Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept" (2013) *ICSID Review – Foreign Investment Law Journal* 88–122.

32 Eiser Infrastructure Limited and Energia Solar Luxembourg S.A.R.I. v. Spain, ICSID No. ARB/13/36, Award, 4 May 2017, https://www.italaw.com/cases/5721; Antin Infrastructure Services Luxembourg and Antin Energia Termosolar v. Spain, ICSID Case No. ARB/13/31, Award of 15 June 2018, https://www.italaw.com/cases/2319.

33 Antaris GMBH and Dr. Michael Gode v. Czech Republic, PCA Case No. 2014-01, Award of 2 May 2018, https://www.italaw.com/cases/2080.

port schemes can in principle be seen as a failure to honour the expectations of renewable energy investors.[34]

Some arbitration tribunals have restricted the scope of application of the fair and equitable treatment standard by requiring a specific commitment by the state that the support scheme would remain unchanged. In *Charanne v. Spain*, the first renewable energy arbitration decision under the ECT, the tribunal refused to recognise that the solar energy investor had a legitimate expectation to continue to benefit from the support scheme because Spain did not commit that "the regulated tariff would remain untouched for the rest of the regulatory lives of the [solar] plant".[35] According to this interpretation, investors can only shield their investments against changes to the priority access regime if the state committed that the access regime will remain unchanged.

The EU seems to support this narrow interpretation of the legitimate expectations of renewable energy investors. In the EU Text Proposal for the Modernisation of the Energy Charter Treaty, the EU proposes to amend the ECT by clarifying that the investment protection regime of the treaty "shall not be interpreted as a commitment from a Contracting Party that it will not change the legal and regulatory framework, including in a manner that may negatively affect the operation of investments or the investor's expectations of profits."[36] A Contracting Party's decision not to maintain a subsidy "in the absence of any specific commitment under law or contract to … maintain that subsidy" shall not constitute a breach of the ECT investment regime.[37]

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34 Novenergia II – Energy & Environment (SCA), SICAR v. Spain, SCC Arbitration (2015/063), Award of 15 February 2018, https://www.italaw.com/cases/6613; Eiser Infrastructure Limited and Energia Solar Luxembourg S.A.R.I. v. Spain, ICSID No. ARB/13/36, Award, 4 May 2017, https://www.italaw.com/cases/5721; Antin Infrastructure Services Luxembourg and Antin Energia Termosolar v. Spain, ICSID Case No. ARB/13/31, Award of 15 June 2018, https://www.italaw.com/cases/2319.

35 Charanne B.V. Construction Investments S.A.R.L. v. Spain, SCC ARB 062/2012, Award of 21 January 2016, https://www.italaw.com/cases/2082. See also Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic, ICSID Case No. ARB/14/3, Award of 27 December 2016, https://www.italaw.com/cases/5739, "In the absence of a specific commitment, the state has no obligations to grant subsidies such as feed-in tariffs, or to maintain them unchanged once granted. (…) Circumstances change and in the absence of specific commitments, the risk of change is for entrepreneurs to assess and assume".

36 EU Text Proposal for the Modernisation of the Energy Charter Treaty, https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf.

37 Ibid.

5 Stability under EU climate law

Paradoxically in the light of the EU attempts to limit the protection of investors' expectations in the stability of renewable energy subsidy regimes, stability is at the centre of the EU legal framework governing the decarbonization of energy supply. The 2018 Renewable Energy Directive (Recast) includes a specific regulatory stability clause that, at least to some extent, reflects the stabilization commitment demanded by arbitral tribunals to protect investors' legitimate expectations.[38] According to Article 6 Directive (EU) 2018/2001:

1. … Member States shall ensure that the level of, and the conditions attached to, the support granted to renewable energy projects are not revised in a way that negatively affects the rights conferred thereunder and undermines the economic viability of projects that already benefit from support.
2. Member States may adjust the level of support in accordance with objective criteria, provided that such criteria are established in the original design of the support scheme.

The reasoning underlying this stability regime is that "policy unpredictability and instability have a direct impact on capital financing costs, on the costs of project development and therefore on the overall cost of deploying renewable energy in the Union."[39]

Stability is also at the centre of the reform of the EU Emissions Trading System. The EU decarbonization policy is based on the idea that "a well-functioning, reformed EU ETS with an instrument to stabilise the market will be the main European instrument to achieve the Union's greenhouse gas emissions reduction target."[40] The 2009 reform of the EU ETS centralized the allocation of allowances and fixed the rate at which the quantity of allowances in circulation in the ETS will be reduced, aiming to a "predictable path" for the reduction of emissions and to provide to investors 'a clear, undistorted and long-term carbon price signal'.[41] More fundamentally, the Market Stability Reserve was estab-

38 Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources, OJ L 328, 21.12.2018, p. 82.

39 Recital 29, Directive (EU) 2018/2001.

40 Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 Concerning the Establishment and Operation of a Market Stability Reserve for the Union GHG ETS and Amending Directive 2003/87/EC, OJ 2015 L 264/1.

41 Directive 2009/29/EC of 23 April 2009 Amending Directive 2003/87/EC so as to Improve and Extend the Greenhouse Gas Emission Allowance Trading Scheme of the Community OJ 2009 L140/63; European Commission, Proposal for a Directive Amending Directive 2003/87/EC, at 3.

lished "to further enhance the stability of the European carbon market" by controlling the supply of allowances.[42]

6 Conclusion

Paradoxically, the EU aims to water down the protection that the ECT provides to energy investors, including in the renewable energy sector, yet emphasizes the importance of regulatory stability for the energy transition under the 2018 Renewable Energy Directive. If adopted, the EU proposals will limit the protection of new investments in clean energy production, in particular in jurisdictions outside of the EU that lack sufficiently clear guarantees of stability for the renewable energy industry, potentially increasing the cost of financing these projects and thus the cost of the clean energy transition.

42 Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 Concerning the Establishment and Operation of a Market Stability Reserve for the Union GHG ETS and Amending Directive 2003/87/EC, OJ 2015 L 264/1.