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The ECT: Dragging States Down as They Chase a Sustainable Future

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Abstract. The Energy Charter Treaty has interfered with states' efforts at climate action significantly, slowing down and even backtracking regulatory reforms for sustainability. In first giving investors overly broad protections that legally shelter from states' sovereignty, the ECT oversteps its boundaries in arguing for stability – particularly seen in the Rockhopper case, where the tribunal ruled against environmental public interest and Italy's police powers. In second enforcing direct financial burdens on states, the ECT also creates both short- and long-term regulatory chill. Despite arguments for the ECT in hopes of its protection of renewables, the Spanish saga demonstrates how it is easily abused, not for just governance, but used purely as an instrument for private profit, taking advantage of reasonable change to claim compensation. The history of cases that lie behind the ECT has prompted worldwide controversy, and this paper proposes for states to withdraw wholly from the treaty itself, its sunset clause inter se, and to instead establish another treaty exclusively for renewable energy.

Keywords: Energy Charter Treaty, ISDS, Climate Change, Regulatory Chill

1. Introduction

Climate change is driving what scientists now call the "sixth mass extinction", with 1 million species at risk of extinction. The Energy Charter Treaty [1] seems to be expediting this change. Under it, over $52 billion has been claimed by companies, with around $10-15 billion awarded to investors. That same $15 billion that was likely re-invested into fossil fuels could have instead funded the installation of 50,000 megawatts of solar power, which is enough to power 10 million homes and replace 108 million metric tons of natural gas CO2 release.

1.1. Background

The ECT is a plurilateral investment agreement created in 1994 that was designed to promote energy security through the operation of more open and competitive international energy markets. Ratified by more than 50 states, the ECT has become a principal portal through which many private companies claim profit. It has triggered around 150 ISDS cases and, with it, backlash at its ISDS mechanism, particularly where ECT expectations extend over domestic guarantees. Under the pressure of climate change, criticisms are aimed at its prioritisation of fossil fuel investors at the

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expense of the environment. Whilst a modernisation process had been launched in 2017, the ECT's alignment with the Paris Agreement and ISDS' extensive power remains to be addressed.

With private claimants often suing states for their climate regulatory adaptations, the ISDS mechanism has allowed them to obtain record-breaking damages, including a $50 billion in the Yukos v. Russia case. Under popular claims of expropriation (art. 13) and FET (art. 10), most tribunals have awarded private profits and hence also instigated very public financial losses, destabilising states' economies. This causes a lock-in effect, which makes it difficult for countries to transition to more renewable energy sources when the fossil fuel investments are so well protected that any extrapolated possible loss on their part is viewed as valid. In contradiction of the Paris Agreement and respective states' sovereignties, the ECT has overreached to enforce extensive protection. The vagaries in its definitions and clauses further go to perpetuate a regulatory chill where ISDS tribunals have produced a lack of transparency and inconsistent jurisprudence – stretching the legal tension to its breaking point.

1.2. Thesis and roadmap

The ECT has interfered with states' efforts at climate action through, most importantly, its extensive investor protections where environmental and political stances have changed. This has resulted in its inherent incentive purpose to be redirected to justify private corporation claims to profit. Whilst modernization efforts have been underway, they fail to address the sustainability contradictions, which are further enforced by the dispute settlement mechanisms that are so integral to its failure. The ISDS' specific inconsistent enforcements and awards are a second significant hindrance. By promoting uncertainty and unpredictability in the application of law under the ECT, it becomes increasingly difficult for states to navigate legal obligations, and so feeds into regulatory chill around sustainable reform.

Through initial literature reviews, hypotheses will be developed in pursuit of the question of ECT's interference with states' environmental policies. Case studies of Rockhopper v Italy and Spain renewables will then yield to conclusions and ensuing recommendations.

2. Literature review

2.1. Extensive investor protection

Nikos Braoudakis [2] highlights the most significant disadvantage the ECT creates for states: that obligations towards stability trounce sovereignty rights. This is shown through both its FET provisions (art. 10(1)) and resulting tribunal analyses. More specifically, Kyla Tienhaara [3] underscores the arbitrary 'legitimate expectation' claim of "lost future profits", which allows tenuous extrapolations to any possibility of profit, even those highly unlikely.

The compensations states are coerced to pay have become a major obstacle to states' finances and are always at a disadvantage to the public – "if profits are to be private, so too should be losses" [3]. In diverting funds away from social, economic, or environmental improvements, the inherent moral argument of the aftermath should supersede any such claim. The implementation of this only furthers the dogma that the poor get poorer, and the rich get richer.

Against broader comparisons, Kate Miles [4] blatantly displays such protections' specific use to challenge any domestic environmental policies. Whereas there may be only a small proportion of all compensations that have been environmental [5], the implications and knock-on deterrence from these awards are prominent. This not only includes individual states' regulatory chills but also

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Tienhaara's 'cross-border chill' [6] incited by TNCs, creating a private corporation: multiple state ratio. In addition to this, their abuse of the ECT to profit and delay state reform, in comparison to its original intent to combat corruption, certainly makes it undue for such extensive favour, especially contemporarily.

2.2. ISDS enforcement

Yet, it is further the expansive mechanisms under the ECT (art.26) that 1 affects normative practice and 2 supersedes or even contradicts domestic laws. Lisa Sachs and Lise Johnson [7] focus on the "bad faith" in which the ECT's ISDS mechanisms are manipulated: 1) The scope of protection has grown (e.g. protections evolving from direct to both direct and indirect expropriation for results like the Rockhopper award), making it easier to claim breaches in the long-term; 2) the claims are purposeful of ECT expectations that transcend domestic guarantees. The worst thing is that no appellate mechanism allows of inconsistent, "bad faith" precedents. Hence, recurrent cases have resulted in ECT popularity when forum-shopping because of how it gives ease to manipulation of its overly-advantageous terms for profit because of the power it holds – unchanged even after modernisation efforts.

2.3. Original or reform or withdrawal

Modern social and environmental pressures have made it clear that the ECT is outdated. Where Alexander Reuter [8] insists the problem lies instead with states' failure to ensure "stable" and "transparent" investment environments, the current climate change movement is directly contradictory: there can be no immutability where "change" is involved, proving the original ECT can no longer stand.

Since 2017 the ECT has undergone highly inefficient modernisation efforts, totalling at 5 modernisation meetings and none since 2022 [1]. This pace of reform only leaves states, like Spain recently, vulnerable to more ISDS and legal contradictions with the Paris Agreement. Whilst Nikos Lavranos' [9] support of a new "'right to regulate to achieve legitimate policy objectives", past definition inconsistencies of "legitimate" and rejection of environmental concerns as "in the public interest" [10] detracts significantly from Lavranos' anticipations. This suggests that, nevertheless, even the leading alteration of ECT modernisation is not enough.

Henceforth, only Braoudakis' [2] promotion of member withdrawals and annulment of the ECT's sunset clause (art.47) depicts a complete withdrawal and immediately eliminates ISDS risk. Despite previous hopes of ECT protection and investment encouragement transfer from fossil to renewable fuels, Rachel Thrasher [11] disproves this: 1 investment treaties do not produce more investment [12]; 2 renewable cases were mostly in response to rational government crises regulation and not the intended poor and corrupt governance. To states that have ratified the Paris Agreement, the recommendation to withdraw would not only decrease their own financial vulnerability but also eliminate legal contradictions and chilling effects to empower further sustainability promotion. Following the EU's leads, those that withdraw sooner than later only limit their own damages seeing as reform efforts are unlikely to alter long-term protections substantially enough to make a difference.

3. Statement of hypotheses

1.ECT gives investors overly broad protections that legally shelters from states' regulatory sovereignty and attempt at reform.

2.ECT enforces direct financial burdens on states, through compensation or otherwise, to maintain obligation to investors, decreasing states' financial capacities.

3.The ECT has no negative effect on states' efforts to address climate action.

4. Case study I: Rockhopper v. Italy

Under arbitration of ICSID, the Rockhopper vs Italy case awarded Rockhopper with $190.5million for expropriation, compared to a claimed $281.3million [10]. The court dismissed FET and discrimination claims, ruling them unimportant once expropriation of the right to be granted product concession was found, and rejected Italy's defence of legitimate exercise of regulatory powers for environmental protection and no legitimate expectations provided to Rockhopper [10]. This case illustrates the ECT's extensive investor protection, especially when compared to other IIAs, with its resultant compensation straining the state's finances, and in doing so, demonstrates the environmental disregard ISDS leads under the direction of the ECT.

4.1. Background

In 2008, Medoil filed for drilling concession after having confirmed the oil reservoirs' existence, applying for an EIA in 2009 [13]. In 2010, Degree Prestigiacomo prohibited the extraction of oil within five nms, followed by negative advice on the EIA, but no action was taken by the Ministry of Environment, which should have issued a decree of incompatibility [13]. Instead, a positive assessment for the EIA was passed in January 2013, launching the massive protest of 40,000 in Pescara [13] to trigger the Ministry to order integration of the evaluation process with an Integrated Environmental Authorization under public pressure for the necessity of an additional EIA. The protests grew larger until it the No Ombrina protest became a national one, attended by 60,000 in Lanciano in 2014 [14]. It was only in August 2014 that Rockhopper acquired Medoil. The national No Triv referenda started in July 2015, when the people took to a vote on the subject of renewal of existing concessions for gas extraction within 12nm from the Italian coast [15]. In August, Ombrina received the second Decree of Environmental Compatibility; however, public pressure incited the 2016 Stability Law, 2015, which introduced a ban on oil extraction within 12 nm for all projects, including pending ones, causing the denial of Rockhopper's ultimate permit application on 2016 Jan 29 [13]. In 2017 Apr, Rockhopper lodges a complaint before ICSID on the denial of a permit application for production concession under ECT art.26.

4.2. The object of expropriation

The court sees the right to production concession to have given on 14 Aug 2015 with EIA's positive feedback [10]. To reject Italy's defence that lack of authorization meant exactly that nothing "could be expropriated to begin with", the tribunal falls back on "the critical distinction" [10] between Rockhopper's right to be granted the concession and the rights given by the concession itself and emphasises the applicability of the ECT's definition of "investments" to include "intangible property", "property right", or "claims to money" [1]. It is this broad scope rampant in the ECT that allows precarious claims to such a right because of "lost future profits" [3], creating a power imbalance in favour of investors. However, for a right to be the object of expropriation, that

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right but possess a proprietary nature – in this case, Rockhopper's interest under Italian law must have certain established consistency, making the argued preliminary right to contract a fragile one. The fragility, however, is not fully justified and only implied by the tribunal's overreach in its protection of the preliminary right in the same way the concession rights would be, again highlighting how the ECT's broad structure gives too much space for personal interpretation.

The treatment of this preliminary right further comes into question because of the uncertainty of its future profits. Following the 2016 Stability Law, all concessions were nonetheless outlawed, leaving the potential of profit tenuous even if the concession was granted previously. Judge Dupuy himself highlighted that Rockhopper "could not ignore that the entire area in question had been considered off-limits to drilling" [16] when discussing FET claims. Where the investment's profitability would be inherently unpredictable anyway, the ECT's classification of "investment" seems to protect it from any undermining the unpredictability introduced to either cause of action or compensation claims, forcing the use of public money to pay for hypothetical private profits.

4.3. Italy and expropriation breach

The court found expropriation because of Italy's deprivation of Rockhopper's preliminary right to be granted production concession "in one fell swoop" to nothing. On Rockhopper's proposed basis of the need to satisfy all 13(a)-(d) [1] to classify as an exception, the dissatisfaction of any one annuls Italy's eligibility for an exception.

Against 13(a) "in the public interest", the court rejects Italy's defence of "police powers" [10] for environmental concerns to be viable when standing from a "strictly legal" and "objective" standpoint [17]. Instead, the court bases Italy's rationale behind politics, seeing that "the political grounds for [the referendum] were resolved through parliamentary action" [10]. Here, they overlook the incitement of this political contentiousness to be precisely environmental concerns – i.e. public interest – and that there is no reason for any institutional processing to diminish the standing of the environmental rationale behind the 2016 Stability Law [14]. Through this reasoning, the ECT's vagaries again allow ISDS tribunals to rule against the validity of environmental change to set precedents on both subjects of sovereignty and environment, resulting in contrary effects against climate action efforts and discouragement of states' reform.

The second rejection is of satisfaction of 13(d) of compensation, because "no prompt compensation was offered, much less paid" [10], which was Italy's sovereign decision. Despite Italy not thinking compensation was in order and not being under legitimate expectations [10], as Dupuy puts himself above, compensation becomes the principal reason for the court's ruling – highlighting the ultimate danger of the ECT's uncertainties.

The inconsistencies of the ISDS mechanism under the ECT are specifically highlighted here, in this part of the tribunal's reasoning, in comparison to other cases: the AES vs Hungary case [18], for example, ruled against expropriation where 13(d) was not satisfied and differentiated between expropriation and regulatory measures that are within states' sovereign rights [18]. This feeds into the chilling effect, and uncertainty states hold around ISDS under the ECT that deters from climate action under the threat of financial and legal burdens.

4.4. The sunset clause

The premise of this case, however, must additionally be noted – that Italy had previously withdrawn from the ECT following their 2014 announcement. Article 47(3) [1] holds states to the obligation to investments made before the date of withdrawal for an effect of 20 years from when

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the withdrawal takes effect (1 Jan 2016 – 2036). This causes an extremely chilling effect for many states because of the "benchmark for future cases" set for fossil fuel companies, "akin to handing your opponent extra weapons and ammunition before stepping onto the battlefield" [6]. This underscores the importance of collective withdrawal from not just the ECT alone but an inter-se agreement on the annulment of the sunset clause to prevent the ECT's legacy from continuing to hold states captive – solidary withdrawals are no longer enough to uphold the global objective of climate action.

4.5. Relation to hypotheses

Rockhopper v Italy supports hypotheses 1 and 2, so simultaneously disproves hypothesis 3. This is displayed with the ECT's interference with firstly, its overly extensive protection of investors by leaving definitions of "investment" up to interpretation and the rejection of reasonable 'police powers' in favour of the investor and secondly, heavy financial compensations to obstruct Italy's climate action in the short term. The ISDS' continuous dismissal of environmental rationale will also be carried forward to set a precedent in future tribunals, invoking a regulatory chill under both hypotheses 1 and 2 in the longer term.

5. Case study II: Spanish renewables

Since 2011, Spain has been hit with over 50 ECT lawsuits, making it one of the most-sued countries under the ECT [19]. The claimants' successes follow the same strands of FET breaches of legitimate expectation of returns and expectations of regime stability under 10(1); and the rejection of Spain's main defence lack of jurisdiction where claimants are not the ultimate beneficiaries, highlighting the court's protection of any foreign 'investor' to include even inherently domestic companies. This causes a longer-term effect of exaggerating disparities between the smaller investors in comparison to wealthier, more resourceful, or transnational investment corporations because of, first, domestics' capacities to launch holding companies under different countries to classify as foreign investment; and second, their capacities to international recourse and financial costs of arbitration [20].

With 49 ECT cases based on the scaling back of RE initiatives, they hold 96% of Spain's 51 total ECT cases, with 19 of the 23 (86%) awarded being in favour of the investor [11]. The momentum Spain's renewable saga has been gained partially from Spain's regulatory changes, but more importantly the ease of enforceability under the ECT encourages investors to file lawsuits - leading to further promotion by law firms for profit. This series of lawsuits hence goes to exemplify specifically the detrimental domino effects of hypotheses 1 and 2, demonstrating an escalation of long-term damages Spain now faces.

5.1. Background

The saga stems from Spain's 2007 decree guaranteeing feed-in tariffs (i.e. stable revenue) to investors (RD 661/2007) in an attempt to meet EU renewable energy targets of 29.4% renewable energy consumption by 2010 [11]. Despite being initially successful, the rapid amount of uptake resulted in a "tariff deficit" gap between what consumers paid and the costs of the electric system for Spain. This caused Spain to replace FITs with "a reasonable rate of return" instead of investors to cut renewable energy subsidies in 2010 [21,22]. Despite attempts at prior settlement, Spain's

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compensation fees to its 19 of 23 lost cases have totalled totaled to 971 million euros at the time of writing, not including any legal costs Spain had undertaken.

5.2. Question of legitimate expectations

The principal claim had been Spain's frustration of investors' "economic expectations", claiming that their actions have been "contrary to the principles of legal certainty, legitimate expectations and non-retroactivity" [23]. This, however, is not backed by the normative practice of the Spanish court, which sustains that the principle of trust cannot imply the immutability of a specific legal framework when 1. changes can be foreseeable and 2. are derived from general interests - since 2010, the Spanish supreme court has rejected the inherent existence of violations of non-retroactivity, legal certainty, and legal expectations [24,25]. In succumbing in favour of the investors, tribunals here counteract the intrinsic purpose of the court's reasoning for the states' regulatory sovereignty in favour of private interests instead [3]. The long-term impact these rulings enforce is the increasing misalignment of ECT investments with a sustainable future. In key arguments cited as 10(1) in all 19 cases, the resulting ruling highlights how regimes cannot be altered. Despite the context here being as result of economic crises, the same argument can also be extracted against fossil fuel phase-outs and energy transitions, discouraging regulatory change and thus invoking regulatory chill.

However, even cases that reject claims of FET breaches invoke regulatory chill by demonstrating the arbitrations' uncertainty under the ECT as a result of because of its space for interpretation. One example is the difference between the Eiser and Isolux lawsuits: Eiser argued for breach because Spain "intended to significantly reduce subsidies to existing plants" [26], whilst Isolux argued against it because of an "aim of protecting the consumer" [27]. Neither expanded on their respective rulings with reasoning or clarification. Whilst Eiser did recognise the economic difficulties that coerced Spain to address the tariff deficit [26], the tribunal suggested that a more reasonable policy should have allowed inefficient plants to receive the same return as an efficient one, resulting in possible moral contentiousness [28]. Through this comparison, the resulting discrepancy is obvious, and yet, with no appellate mechanism in its dispute settlement clauses, the ECT renders tribunals unavailable to correct inconsistencies - this would then discourage states from regulatory change because of the uncertainty around how to avoid lawsuits and reasons for differentiations between successes and losses.

5.3. Question of beneficiaries

Under article 1(6), tribunals once again demonstrate the dangers of the ECT's overly broad definitions, allowing its protection to extend ultimately to a wide range of possible claimants and so, beneficiaries. Spain's defences of claimants not being the ultimate beneficiary against Antin, NextEra, Baywa, RREEF, Cube Infrastructure, and InfraRed, for higher-up investors over the holding company's sole right to sue, were all rejected. Tribunals cited 1(6)'s definition to be "direct or indirect", emphasising no pointer to the 'ultimate beneficiary' and lack of need for subsidiary interpretation because of the definition's blatant definition [29]. The resulting broad applicability makes it easier for both law firms and investors to cripple Spain - as seen by the saga - where 89% of cases are not claimed by renewable energy companies but by an equity fund or other financial investor – research details that half of these also had investments in non-renewable energy sectors. For example, the 9REN equity fund also managed $32billion with a majority in fossil fuels in contrast to renewable [24]. In turn, this heightens chance for Spain's compensation from public funds to be re-directed counter-intuitively towards fossil fuel projects - further exemplifying another way the ECT hinders climate action through exceptional favour towards states.

Further, the wide range of beneficiaries is not only a result of the ECT's definition of vagaries but also a lack of mechanistic protections from nationality, jurisdiction, or forum shopping. This is exploited by both domestic investors and their respective law firms. This deficiency allows rich domestic investors here to sue their home state, Spain, through shell companies abroad: 10/11, supposedly Dutch investors were shells, e.g. Isolux and Charanne [24]. This makes the regulations largely disadvantageous for poorer domestic investors, creating a discriminatory environment to favour the richer investors, making the rich richer at the cost of the public, and simultaneously making the poor poorer. This deficiency is further exploited by law firms, causing legal successes against Spain to create domino effects to fuel law firm advertisements that encourage investments into Spain and, ensuing, monetizing lawsuits. In addition to charging ridiculously high rates for cases in the saga, firms also guarantee "a strong case" (Steptoe & Johnson) [30] and calls to investor clients on their websites to consider using ISDS for "unfair" (Cuatrecasas) [31], "unlawful government interference" may trigger valid treaty claims (Jones Day) [32], adding fuel to the fire - emphasising the possible considerable scope the ECT goes on to promote, even under false advocations for renewable energies.

5.4. Relation to hypotheses

The Spain saga evidences both hypotheses 1 and 2, and in doing so, disproves hypothesis 3. For 1, the ECT's anomalous, inconsistent acceptances of FET and beneficiaries' claims, in contrast to other normative rulings, highlight its abnormally broad protections. For 2, the compensation totals easily underscore the financial burden Spain has been put under, with it being exacerbated even more through the ECT's broad application to allow a higher influx of claimants. In the long term, such discouraging results has already prompted Spanish proposals of settlements, displaying their frustration, and could, hence, suggest future regulatory chill after the saga.

6. Conclusion

The ECT has significantly impacted states' climate efforts, as proposed via hypotheses 1 and 2. In providing expansive protections and substantial awards, it easily renders state policies wholly ineffective and takes away from public finances in the short-term; and feeds regulatory chill under legal and economic threats in the long-term.

Through cases like Rockhopper, the ECT has emphasised its favour towards investors when: first, disregarding Italy's police powers and second, not considering environmental motivation as one of public interest. Even though the original intention was investment encouragement, ample research has shown the contrary. They suggest that instead of following IIAs, investments correlate instead with consumer and economic indicators. Further, many have proposed that the ECT has been modernized and will similarly take under its wing investments for renewable energies. Yet, modernization has not addressed sustainability contradictions nor the dispute settlement mechanism that are so intrinsic to its failing, causing no other alternative than withdrawal. As the Spanish case has shown, most cases under the ECT have been directed against rational government regulation actions and not the originally-intended government corruption. Thus, this leads to the conclusion that the ECT is too far gone in ways of its normative evolution to become a treaty that seems to encourage investor manipulation and should yield to withdrawal.

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6.1. Recommendations

The conclusion has yielded to the following recommendations, with consideration to the current existing literature:

1.For member states that have ratified the Paris Agreement to withdraw from the ECT. In only select countries taking the lead, others may be incentivized to follow.

2.For member states that have already withdrawn to engage in an inter-se withdrawal from the sunset clause (art.47), an agreement has already started circulating around the EU. States should also pay attention to future BITs made for investors to waive rights under the ECT as a precautionary measure.

3.For member states to collaborate on a new, modernised investment treaty that protects and focuses on encouraging investments in green energies only. This should be detailed with more restricted protections to prevent misuse, only being utilized as a safety net and not an extra source of profit for private corporations.

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