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A SPOTLIGHT ON INVESTMENT DISPUTES IN THE ENERGY SECTOR: *SIMMERING OFF, OR COMING TO THE BOIL?*

Introduction

Investment treaties have generated different sectorial disputes since their diffusion in the 1970s. While financial sector disputes may first spring to mind given the plethora of cases arising from Argentina's financial crash of the 2000s, another sector has firmly rooted itself in centre stage of the investment treaty regime: the energy sector.

The prominence of energy investment disputes and their continued rise within the investment treaty regime will be demonstrated and explained in Section 1. Section 2 will then explore recent developments within the framework of the Energy Charter Treaty ("**the ECT**"), an investment treaty that was once notable for being the only investment treaty exclusively dedicated to the regulation of energy investments; a notoriety that has since been overshadowed by the announced withdrawals of a number of EU Member State contracting parties. Section 3 will finish by contemplating how energy investment disputes may be governed outside the ECT framework as a result of the treaty's ultimate demise or for lack of jurisdiction.

Throughout, key takeaway points will be extracted to provide practical guidance to those involved in existing or future energy investment disputes, whether from perspective of the energy investor or the host State.

1. The Rise (and Rise) of Energy Investment Disputes

According to the recent caseload statistics of the International Centre for the Settlement of Investment Disputes ("**ICSID**"), 25% of all registered ICSID cases relate to the oil, gas and mining sector. A further 17% of all registered ICSID cases relate to the electric power (and other) energy sector. Together, these represent – and quite significantly so – the two largest categories of investment disputes in sectorial terms.

Those statistics should come as no surprise. International energy law has undergone rapid change in recent years, with States committing themselves to more and more binding international obligations in an effort to limit global warming to 1.5°C.[1] However, energy law obligations do not exist in a vacuum. They co-exist with other international law obligations that States have committed themselves to observe. That includes their obligations to protect foreign investments under international investment law, whether through bi- or multi-investment treaties or customary law.

[1] Paris Agreement, adopted 12 December 2015, Article 2(1)(a).

Needless to say, the interface between energy law, on one hand, and international investment law, on the other, is not entirely smooth. Two recently initiated ICSID cases show us why.[2] The owners of Dutch coal-fuelled power plants, RWE and Uniper, have each brought claims seeking damages of over €1 billion from the Netherlands for allegedly having breached their investment protection rights under the ECT. The main impugnable measure at issue in each case is the Netherlands' enactment of a law to reduce, and ultimately prohibit, coal-fuelled energy; a measure that specifically derives from the Netherlands' obligations to limit global warming under international energy law.

This scenario represents a dichotomy for the Netherlands – and indeed for all States – that have committed themselves to binding obligations under both the international energy law and international investment law regimes. Do they push ahead with their climate change agenda notwithstanding the risk of triggering investment treaty disputes? Or does the risk of such disputes, which often entail excessive demands for compensation, induce them to delay – or worse still, abandon – enacting climate change measures? Recognising that such a dichotomy serves neither the push to 'net zero' nor the continued development of international investment law, professional and epistemic communities have been searching for ways to balance an energy investor's right to investment protection with the rights of States to regulate in furtherance of their climate change goals. A key endeavour in that respect is the attempt to modernise the ECT. But to what end?

2. Modernising the ECT – To the Point of Reform or Demise?

As the only investment treaty exclusively governing energy investments, the ECT presented an obvious starting place to strike a more effective balance between the rights of energy investors and regulating host States. Indeed, the ECT contracting parties have been discussing ways to reform its substantive standards of investment protection since as early as 2017. Those discussions culminated in the contracting parties reaching an "*Agreement in Principle*" on 24 June 2022. Based on the Agreement in Principle, and pending disclosure of the final approved modernised text, two proposed reforms warrant brief mention.

The first being a proposal to render more explicit States' power to regulate in the public interest, including in furtherance of their climate law obligations. Currently, ECT Article 19 deals with "*Environmental Aspects*" and includes a variety of environmentally conscious provisions, none of which are worded in binding or mandatory manner. The reforms thus seek to include an express provision by which the "*Contracting Parties*

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[2] *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22.

affirm the right to regulate within their territories to achieve legitimate policy objectives, such as the protection of the environment, including combatting climate change".

The second key proposal is to clarify the scope and meaning of the ECT's fair and equitable treatment ("**FET**") standard of protection. To recall, the FET standard protects investors against State behaviour that falls below international minimum standards of treatment, including gross denials of justice and manifestly arbitrary measures. However, because of its broad and vague wording, the ECT's FET provision was susceptible to much wider interpretations – including those in favour of extending protection to investors' legitimate expectations and providing a guarantee of regulatory stability. The reforms thus seek to narrow the scope of the FET provision to protect against a (seemingly) exhaustive list of State measures, including, inter alia, "*targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief*", while limiting the protectability of investors' legitimate expectations.

McNair International Senior Associate, James McGlaughlin, has co-authored a separate article entitled "*The Modernisation of the Energy Charter Treaty: Implications for Investment, Climate and EU Law*", that comments on the effectiveness of such proposals (available here). Therein, it was noted that the ECT's reforms fall short of removing investment protection for the types of energy supplies that States have committed to phase-out, namely fossil fuel energy. The reality is thus: insofar as investments in fossil fuels continue to qualify for protection under the ECT, States' phase-out measures that affect the economic value and operation of such investments will continue to be potentially liable for breaching the ECT's standards of protection. Such a reality would entrench the spiral of energy investment disputes (like those initiated by RWE and Uniper against the Netherlands), or, worse still, crystallise regulatory chill that prevents States from enacting their progressive climate change measures in the first place.

The ECT's contracting parties have since taken matters into their own hands. At the time of writing, several contracting parties – that are also EU Member States – have announced their intention to withdrawal from the ECT. The list so far includes Germany, Slovenia, Poland, the Netherlands, France, Spain and Luxembourg. Austria is also expected to join the list. Such announcements have been compounded by the European Parliament's resolution of 24 November 2022 which "*urg[ed] the [EU] Commission to initiate immediately the process towards a coordinated exit of the EU from the ECT*" in order to "*prevent the ECT from putting the EU's climate and energy security ambitions in further jeopardy*".[3] These actions are symbolic for underscoring a desire on the part of the EU Member States and EU institutions to remove fossil fuel energy from the scope of

[3] European Parliament Resolution on the Outcome of the Modernisation of the Energy Charter Treaty, Resolution 2022/2934 (RSP), 24 November 2022.

protection under international investment law, particularly as enshrined in the ECT. What thus started out as an earnest modernisation campaign may ultimately lead to the demise of the ECT altogether.

Whether or not this outcome materialises will remain to be seen. In the meantime, four key takeaway points warrant mention for parties involved in existing or future energy investment disputes under the ECT:

- First, the timing of initiating the ECT claim is crucial. Whether the claim is initiated prior to or after the ECT's modernisation will affect the extent of investment protection that investors are owed under the treaty. If it is initiated prior to modernisation, the investor will stand to benefit from a wider scope of investment protection. Conversely, ECT claims initiated after modernisation will provide investors with more limited protections to invoke against the host State. In this regard, it is important to note that while the ECT contracting parties had intended to vote on the modernisation reforms on 22 November 2022, the vote has been postponed until (at least) April 2023. At which time, if the reforms are approved and ratified, the modernised ECT would enter into force within 90 days.

- Second, a host State's announcement to withdraw from the ECT is not immediately effective. The ECT includes a "*sunset clause*" (Article 47(3)) that ensures that pre-existing investments made in the territory of a Contracting Party will continue to receive investment protection for a period of 20 years after the withdrawal has taken effect. Moreover, each host State would have to fulfil its respective constitutional process to implement its withdrawal from the treaty.

- Third, a host State's attempted withdrawal from the ECT will likely be subject to contestation, not least from the ECT Secretariat itself. The ECT Secretariat has indicated in a Guidance Note (available here) that withdrawals from the treaty may need to conform to conditions outlined in Article 62 of the Vienna Convention on the Law of Treaties. According to which, a State is only allowed to withdraw from a treaty upon the occurrence of a "*fundamental change of circumstances*" that was "*not foreseen by the parties*", and where "*the effect of the change is radically to transform the extent of obligations still to be performed under the treaty*". In the Secretariat's view, developments in international energy law cannot have been completely unforeseen by the ECT contracting parties. Thus, withdrawal is by no means guaranteed at this early stage.

- Finally, even if a State were to ratify the modernised ECT in April 2023, it would not be precluded from withdrawing from the ECT at the same time. The two constitutional processes of ratification and withdrawal are separate. In fact, this may be the preferable strategy for certain States that wish to be bound by narrower investment protection standards vis-à-vis investors under the modernised ECT pending their formal withdrawal from the treaty itself.

3. Filling the ECT Governance Lacuna – International, Regional or Domestic Law?

It is worth reminding that not all energy investment disputes are – or ever will be – covered by the ECT. This is for the simple reason that not all States are signatories to the ECT. Its signatory list is currently limited to 53 States. Moreover, this number is set to decrease if the announced withdrawals are indeed to materialise without successful contestation. Accordingly, energy investment disputes will fall outside the jurisdiction of the ECT where the home State of the investor and/or the host State of the investment are not party to the ECT. This begs the question: do such energy disputes fall into a governance lacuna, or are they regulated by other legal frameworks? Three potential frameworks warrant brief mention.

First, international investment law will continue to govern energy investment disputes insofar as the disputing parties fall within the jurisdictional scope of an investment treaty other than the ECT. Most likely, such a treaty would take the form of a bilateral investment treaty, either in freestanding form or as contained in the investment chapter of a free trade agreement, between two contracting State parties. The scope of investment protection offered by the treaty would depend on its precise wording. Such wording will inform not only the grounds that are potentially invocable by the investor and the defences potentially available to the host State, but also the mechanisms that are available for resolving disputes arising under the treaty. The latter could include ICSID arbitration or ad hoc arbitration under the UNCITRAL rules, for example.

Second, irrespective of whether the ECT or another investment treaty applies, the EU legal framework may govern energy investment disputes that display an intra-EU dimension. That is, where both the investor and the host State belong to different EU Member States. This is already a point of contention between the investment treaty regime and the EU regime, with the latter seeking to assert its primacy over the application of investment treaty arbitration clauses invoked in an intra-EU context. Take the aforementioned ICSID cases against the Netherlands by RWE and Uniper as prime examples. Even prior to the ICSID tribunals' constitution, the Netherlands applied to the German courts (as the courts of the investors' home State) for a declaration ruling the ECT's arbitration clause to be inadmissible as a matter of EU law. Its reasoning was that an ICSID tribunal is not permitted to interpret or apply EU law – a scenario purportedly reasonably foreseen by the broad wording of the arbitration clause – because such jurisdiction is reserved exclusively for EU Member State courts or tribunals, not ICSID tribunals. In response, the now-constituted ICSID tribunals insisted that the Netherlands "*not aggravate*" the investment treaty proceedings by pursuing their parallel EU proceedings.

All this to say, the EU legal framework already provides a supplementary, if not a competing, regime of investment protection for energy investment disputes with an intra-EU dimension. To that end, EU law promises to offer investors free movement of capital, fundamental rights protected by the Charter of

Fundamental Rights of the EU (including access to justice, non-discrimination), protections provided under general principles of EU law (including proportionality, the protection of legitimate expectations), and a body of energy sector-specific legislation. Such rights are enforced through EU Member State courts, and also by the European Court of Justice through preliminary rulings or infringement proceedings.

Third, and by no means least, energy investment disputes may be governed by the domestic law of the host State. This can take the form of foreign direct investment legislation, or by the investor and host State entering into an investment contract (for example, a concession contract) that is governed by the latter's domestic law. The extent of investment protection provided by domestic law instruments will depend largely on the legislative or contractual terms. In that respect, domestic law may protect energy investors from changes in law or regulation that might affect their investments, particularly in the fields of tax law and tariff regimes. In the event those rights are violated by the host State, the ensuing energy investment dispute would most likely be resolved through the host State's courts, or, by agreement of the parties, through arbitration.

Whether an energy investment dispute will be governed by one or more of these legal regimes will depend on the circumstances of the case. In the meantime, three key takeaway points warrant mention for parties involved in existing or future energy investment disputes outside the ECT framework:

- First, the terms of the applicable legal instrument governing the energy investment dispute (whether a bilateral investment treaty or EU or domestic legislation) must be carefully reviewed on a case-by-case basis, and ideally prior to the initiation of the dispute. Such a review will help to inform the merits of the dispute and possible damages, since those matters will depend on the scope of the investment protection standards and defences that can be invoked against and by the host State, respectively.

- Second, the applicable legal instruments must also be reviewed to determine the availability of dispute resolution mechanisms. For example, while a bilateral investment treaty may refer to ICSID arbitration, the contracting parties' agreement might be preconditioned on a requirement that the parties first pursue resolution through the host State's national courts for a certain period of time; a failure to observe such a requirement may render the claim inadmissible. Moreover, even if the energy investment dispute were initiated pursuant to an investment treaty, the application of that treaty's dispute resolution mechanism may be contested if the dispute displays an intra-EU dimension. A successful contestation in that respect might result in displacing the investment arbitration in favour of EU Member State court proceedings – an outcome that recently materialised in the investment treaty case of *Green Power v. Spain*.[4]

[4] *Green Power K/S and Obton A/S v. Spain*, SCC Case No. V 2016/135, Award, 16 June 2022.

- Third, the applicable legal instruments, particularly those taking the form of EU and/or domestic legislation, must be reviewed on an ongoing basis. This is because their terms are suspectible to being overridden by subsequent governments deciding to pursue different political agendas in the energy sector. The relatively nascent renewable energy sector is particularly volatile in that regard, as evidenced by the plethora of energy investment disputes launched against Spain in response to its regulatory reforms that removed beneficial tariffs and incentives for energy investors.

Conclusion

The energy sector is currently undergoing a major transition away from fossil fuel energy and toward green energy. If that transition is to succeed, the protections afforded to energy investments must undergo a transition too. Pending a shift in international investment law and policy in that regard, it is clear that energy investment disputes will not be simmering off. They will more likely be brought to the boil. Energy investors will continue to rely on investment protections, whether at international, regional and/or domestic level. While host States will continue to regulate in furtherance of their climate change goals. Navigating this cauldron will hopefully be made easier for investors and host States by remaining alert to the key takeaway points outlined in this article.