

The Energy Charter Treaty

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The Energy Charter Treaty: Old and New Dilemmas in Global Energy Governance

Anna Herranz-Surrallés

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Abstract

The Energy Charter Treaty (ECT) is a rare example of rules-based international energy governance, joining consumer, producer, and transit countries. Besides extending the multilateral trade rules to the energy domain, the ECT has also become the most often invoked international investment agreement. However, the evolution of the ECT has remained particularly susceptible to changing international power balances and ideational struggles. In reviewing the main scholarly and practical debates on the ECT, this chapter walks through three decades of European and global energy governance, addressing the emergence, transformation, and the recent mixed signs of modernization and decline of the ECT. The chapter touches on several core debates across disciplines, from the factors explaining the emergence of international regimes, the problem of overlapping regional and international legal orders, or the consequences of politicization of international economic institutions. The chapter concludes with a forward-looking reflection on the main challenges facing the ECT in a context of crisis of the liberal world order and growingly relevant concerns such as climate change and the security implications of foreign investment.

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Keywords

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Introduction

Although largely unknown outside the energy policy community, the Energy Charter Treaty (ECT) has a prominent place in the architecture of global energy governance. With its origins in the immediate post-cold war period, the ECT is still a unique international regime in a domain characterized by institutional fragmentation and weak governance (Van de Graaf 2013, pp. 44–65). Some of the ECT's particularities include its diverse membership, aimed at bridging energy producer, transit, and consumer countries. Besides a core of 48 countries having ratified the 1994 ECT, the so-called Energy Charter Conference also encompasses an outer circle of 91 countries and regional organizations that signed the nonbinding 2015 International Energy Charter (IEC). The ECT is also unique in extending the World Trade Organisation (WTO) multilateral binding rules to the energy sector and, owing to its dispute settlement mechanism, currently considered “one of the most important investment protection agreements in our modernized and globalized economy” (Hobér 2018, p. 201).

However, the ECT has not been free from controversy, among states, EU institutions and, more recently, also the wider public. Following Robert Cox's famous description of international institutions as “particular amalgams of ideas and material power” (Cox 1981, p. 137), the ECT's evolution has been particularly susceptible to changing power balances and international ideational shifts. Therefore, the study of the ECT requires examining wider developments, such as East-West relations, the evolution of European integration, the rise of emerging economies, or the politicization of international institutions and climate change. In reviewing the main practical and theoretical debates surrounding the ECT, this chapter touches on such wider material and ideational international shifts (see Table 1).

The chapter begins discussing the origins of the ECT, negotiated between 1991 and 1994, amidst high hopes for the expansion of (neo)liberal economic ideas and institutions, but also turmoil and uncertainty following the dissolution of the Soviet Union. Section “[Origins and Ratification \(1990s\): A Special Creature in the Energy Governance Landscape](#)” discusses different explanations for the emergence of this remarkable multilateral institution in such a volatile context. However, despite the low energy prices and the favorable winds for liberalization initiatives, negotiations were complex and several times at the verge of collapse. Therefore, the section examines both the drivers of the ECT and the tensions reflected in its design.

The deployment of the ECT provisions and first major hiccups during the 2000s is the focus of section “[The ECT to Test \(2000s\): Gas Transit Disputes and the Decoupling of Legal Orders.](#)” The tightening of global energy markets in the mid-2000s prefigured the growing leverage of producer countries, putting the ECT

Table 1 Overview of key international trends and theoretical/practical debates over the ECT

Period	Material power	Ideational trends	Main debates and questions
1990s	Dissolution of Soviet Union Low energy prices	Ascendancy of neoliberal ideas Tendency towards liberalization of energy sector	What explains the ECT's creation and institutional design? What are the lessons learned from the difficult ECT negotiations?
2000s	Rising non-Western powers Growing energy prices EU Eastern enlargement	Acceleration of EU internal energy market Roll-back of liberalization in producer countries	Why did the Transit Protocol negotiations fail? Why did Russia abandon the ECT?
Early 2010s	Economic crisis hitting the EU and West High energy prices High instability around the EU	Crisis of neoliberal ideas Deterioration of EU-Russia relations, esp. following annexation of Crimea	Did the EU accommodate or entrench into previous positions? To what extent does the 2015 IEC provide the basis for the ECT's relaunch?
Late 2010s	Ascendancy of China and non-Western FDI Moderation in energy prices	Public backlash to integration/globalization Crisis of multilateralism	Are the EU and ECT law compatible? How can the ECT respond to public contestation of ISDS and rising climate activism?

Source: Own elaboration

and its implementation under stress. At the same time, the deepening and widening of the EU also started to impact on the ECT, since the EU focused on the acceleration of its internal energy market and launched more ambitious frameworks to “export” its regulatory model to the countries of its proximity. This section investigates how these tensions played out in the negotiations of the transit protocol and the eruption of the first serious gas crises in 2006 and 2009, as well as the different interpretations for the unexpected move by the Russian government to abandon the ECT.

The 2010s set off amidst a confluence of crises in and around the EU: internally, the EU was absorbed by the fallout of the global financial crisis; and externally, the security environment deteriorated, with new focuses of conflict in both Southern and Eastern neighborhoods and mounting tension in EU-Russia relations. In this context, the ECT launched a reform process, which finalized with the signature of the 2015 IEC. Section “[Modernization and the International Energy Charter \(Early 2010s\): Crisis or Relaunch?](#)” addresses how scholars and commentators interpreted the response by the ECT and the EU to Russia’s withdrawal as well as the prospects of the IEC in re-invigorating the Energy Charter process.

By the mid-2010s, the ECT became object of yet another form of contestation, this time related to the politicization of international trade and, particularly, the so-called Investor State Dispute Settlement (ISDS). Even if the criticism towards

ISDS clauses emerged in the context of mega-trade agreements such as the Transatlantic Trade and Investment Partnership (TTIP), demands for reform eventually reached the ECT, which is by far the world's most litigated international treaty. Moreover, the growing public salience of climate change also placed the ECT under closer public scrutiny. Therefore, section "[New Contestation Fronts \(Late 2010s\): Politicization of ISDS and Climate Change](#)" examines those debates and its consequences on the legitimacy and further reforms undertaken by the ECT.

Finally, the chapter concludes with a discussion on the main challenges at the turn of the 2020s, which anticipates as one of the most delicate phases the ECT has experienced so far. Again, developments in the EU and Russia take center stage. The intra-EU discussion on the competences in foreign investment and the first ever case of arbitration against the EU, in relation to the Nord Stream 2 pipeline, have turned the ECT into a complex legal and (geo)political battleground. The final section concludes with a review of the possible paths the ECT might take and their consequences for global energy governance.

Origins and Ratification (1990s): A Special Creature in the Energy Governance Landscape

The signing of the European Energy Charter declaration in December 1991 by 48 states (plus the European Community and the Interstate Economic Community) and its relatively quick evolution into a binding Treaty in December 1994 is a remarkable achievement. At that time, the governance of international energy was very limited and split into two camps: The Organisation of Petroleum Exporting Countries (OPEC) on the side of producer countries and the International Energy Agency (IEA) created by Western countries highly dependent on energy imports. The ECT was therefore a novelty in that, for the first time, it bridged consuming and producer countries. Moreover, energy policy had remained largely outside liberal trade and investment regimes. Even within the European Community (EC), energy policy remained a strict national competence, despite the repeated efforts by the European Commission to gather support for an Internal Energy Market (McGowan 1989). Therefore, the significance of binding provisions on energy trade and investment including countries emerging out of a planned economy can hardly be exaggerated. It is also remarkable that the Energy Charter was the very first multilateral treaty signed after the end of the Cold War (Axelrod 1996, p. 467).

Studies examining the *creation* of the ECT have emphasized different aspects of this puzzle. On the one hand, some scholars highlighted the economic and geopolitical drivers of the ECT. First proposed by the Dutch government in 1990, the idea of a sectoral agreement on energy with the countries of the Eastern bloc was quickly taken up as a potential win-win solution for all parties. On the West-European side, the initiative was, first, an opportunity for investment in a region that had remained closed to foreign companies for decades and where political risks remained high (Doré 1996). Secondly, boosting energy supplies from Russia and the Caspian Region would increase Europe's energy security in times of severe instability in

the Persian Gulf (*ibid.*). More broadly, a multilateral economic agreement could also help stabilize East-West relations and serve as a “geopolitical instrument to shape the transition” in the Soviet Union and Eastern Europe (Basedow 2018, p. 132). On the side of a Soviet Union in process of dissolution, the prospect of attracting foreign capital and Western technology was also attractive, given the depressed state of the Soviet energy sector, severely hit by a decade of divestment and plummeting oil prices (Konoplyanik 1996).

On the other hand, ideational and institutional factors seem to have played an equal or even more important role. In a detailed account of the birth of the ECT, Basedow (2018, pp. 131–132) argues that the energy business did not push for the initiative. On the contrary, energy companies in the distribution business were against steps towards liberalizing the sector in Europe; and major gas and oil exploration companies remained rather skeptical about the chances of the agreement to improve the investment climate in the Soviet Union (*ibid.*). The economic rationale of the ECT is better explained by the dominant policy paradigm guiding economic policy at that time. In that regard, the ECT coincided with the ascendancy of neoliberal ideas and the EC’s push for the Single Market program. The European Commission thus readily supported the ECT initiative, as a tool to advance the liberalization of the EU electricity and gas sectors (Matlary 1996, p. 265). Moreover, the Commission’s entrepreneurship in the ECT can also be explained by the institutional goal of asserting its role and competences in international affairs (Basedow 2018, p. 129). More broadly, the ECT was also imbued with Western functionalist ideas about the relevance of sectoral cooperation as a first step for regional political cooperation and for “socializing” the countries emerging from a planned economy system into the institutions and rules of market economies (Lubbers 1996, p. xiv).

The confluence of these propitious economic, geopolitical, and ideational factors explains well the swift adoption of the European Energy Charter declaration in December 1991, just a few days before the formal dissolution of the Soviet Union. The *negotiations* for the fully fledged binding Treaty were more protracted, both due to resistance from Russia and the newly independent states and disagreements within the OECD block. On the Eastern side, negotiations were delayed due to the turmoil accompanying the creation of new states and their respective energy policies. Substantively, Russia and other non-EU countries (notably Norway) opposed the liberalization of investment in the form of National Treatment (NT) on the pre-establishment phase. At the most, Russia was open to consider a transition period, which would allow granting only Most-Favored Nation (MFN) treatment, something that was rejected by the EC and the USA as a “blank cheque for investment liberalisation” (Basedow 2018, p. 124).

On the Western side, there were notable disagreements within the OECD itself. First, some EC member states were highly suspicious of the possibility that the ECT would mean the liberalization of the energy sector through the back door. One of the most contentious issues in that regard was the idea of “freedom of transit” (art. 7 ECT), as some member states saw it as the precursor of an obligation of Third Party Access (TPA), which the member states had already rejected in the context of the discussions on the liberalization of the EC gas market (Anders-Speed 1999, p. 127).

Second, the Member States were not eye to eye on the geographical reach of the Treaty. For example, France and Belgium were not in favor of opening the agreement to non-European OECD countries. It was only at the insistence of the USA that the EC extended the invitation to all OECD economies (Doré 1996, p. 140). Finally, this led to frequent transatlantic disagreements, since the USA defended strict liberalization obligations, whereas the EC Member States favored a more flexible and gradual approach that would better accommodate the preferences of Russia and other producer countries (Herranz-Surrallés 2016a, p. 53).

The *outcome* of the negotiation was closer to the flexible option defended by the EC, which still included legally-binding investment protection provisions, if only for the postestablishment phase (art. 13 ECT). More specifically, the ECT provided for a dispute settlement mechanism (art. 26 ECT) that included the possibility of investor-state arbitration. The provisions on preestablishment phase were not included in the ECT and were postponed to a later stage, envisaging a negotiation on a “supplementary protocol.” However, this flexible approach also prompted the withdrawal of the USA, in disagreement with the limited character of the Treaty. Moreover, the outcome of the negotiation and ensuing ratification process was an indication of the difficulties soon to come.

To begin with, the Treaty came into force in 1998 without the ratification of two of the key producing countries involved in the ECT process (Russia and Norway). As foreseen in art. 45 of the ECT, Russia accepted to provisionally apply the Treaty and hence to remain bound by all its obligations. However, the provisional application would become a bone of contention in later stages and was an indication of Russia’s cautious stance on the ECT. Similarly, the negotiations for the Supplementary Protocol on investment liberalization also collapsed (Basedow 2018). According to some key observers at the time, there was some sense that the ECT was coming even ahead of its time, since it reflected more the Western liberal economic ideas than the actual practice, which was still of limited liberalization within the EU. In that sense, Wälde (1996, pp. xix–xx) raised the question “will these ‘Western’ models work in ‘Eastern’ practice?” or in the words of Axelrod (1996), was the ECT “reality or illusion?”

More retrospectively, the birth of the ECT episode has also raised debate about the EU’s international actorness. On the one hand, the sponsorship of such a special international regime has been interpreted as a case of institutional entrepreneurship from the Commission (Basedow 2018) and a paradoxical case of significant international leadership despite the internal divisions and limited sophistication of intra-EU internal market rules (Herranz-Surrallés 2012, p. 166). Conversely, other studies have suggested that the divisions in the OECD block led the EU to miss the window of opportunity of the early 1990s when the most reformist sectors in Russia were receptive to international commitments as a tool to shape the reorganization of domestic interests (Grätz 2011, p. 67). Either way, the European Commission remained the main driving force behind the ECT and the international organization created to support it, with a secretariat in Brussels. This support, however, would start to become more ambiguous already during the 2000s.

The ECT to Test (2000s): Gas Transit Disputes and the Decoupling of Legal Orders

The turn of the millennium was characterized by contradictory trends that soon started to leave a mark on the ECT. On the one hand, the first decade of the 2000s coincided with the gradual tightening of world energy markets, among others due to a growing energy demand by new emerging economies. In just one decade, oil prices went from historical lows (15 USD/barrel in 1998) to the record price spikes (147 USD/barrel in mid-2008). This context of growing economic and strategic importance of the energy sector gave strong leverage to the producer countries, which in many cases halted, or even reversed, the liberalization reforms initiated during the 1990s (Goldthau and Witte 2009). This is the case of Russia, where the newly elected President Putin in 2000, embarked on a process of regaining control of the oil and gas sectors, after a decade of privatizations and investment-friendly measures (Belyi 2014, p. 322). On the other hand, the first decade of the 2000s is also when the recently enlarged EU started making substantial progress in the liberalization of its internal electricity and gas markets, as well as the development of an external energy policy (Herranz-Surrallés 2016b). This section presents the debates on how these two opposite trends impacted on the development of the ECT, particularly on the failure of “Transit Protocol” negotiations and on Russia’s withdrawal from the ECT in 2009.

The initiative of the Transit Protocol was the response to the deterioration of the transit governance in the former Soviet space. During the early 2000s, frequent supply and transit disputes started to occur between Russia and the new transit countries (most notably, Ukraine), due to the lack of transparency of gas prices and transit fees, the poor state of the pipeline systems, and the worsening of political relations in the region (Westphal 2009). However, the negotiations for the Transit Protocol became tangled into broader disagreements between Russia and the EU. In fact, in 2001 Putin’s government made the ratification of the ECT, pending since 1994, conditional to the successful adoption of the Transit Protocol (Belyi 2012, p. 265). The clash of views has been explored in different aspects of the negotiations.

First, the parties disagreed over the very *principles of the transit regime*. For Russia, the main goal of the ECT was to ensure long-term supply stability, which in the view of Moscow, demanded vertically integrated companies (*ibid.*). Conversely, the emerging rules of the EU internal energy market were based on the principle of competition and hence required TPA, the separation between supply and transit (the so-called “unbundling”) as well as a move away from long-term contracts. In this context, one of the main hurdles in the Transit Protocol negotiations was Russia’s request to include a Right of First Refusal (ROFR) clause, namely, the right of exporters to prolong an existing transit contract before the pipeline capacity is offered to other competitors. Russia considered the inclusion of a ROFR as a red line in the negotiations, given that many of its transit contracts were expiring before its supply contracts. Conversely, the EU opposed the inclusion of such a clause, as it was deemed incompatible with TPA and the principle of nondiscrimination in the internal energy market (Yafimava 2011, p. 304). By the mid-2000s, the European

Commission even suggested that Russia should also adopt the TPA model and open its infrastructure network for transit of hydrocarbons from other producers in the Caspian and Central Asia (Herranz-Surrallés 2016a, p. 60). Such demands were totally dismissed by Russia, for which the ECT was understood as a mechanism to ensure the transit of Russian gas to Europe – and in no way an obligation to liberalize its gas and oil transit networks, under the monopoly of Gazprom and Rosneft, respectively.

A second obstacle in the Transit Protocol negotiations was the *legal status of the EU*. The development of the EU internal energy market had led to a growing gap between the minimum standards of the ECT and the much deeper liberalization rules introduced by the Second and Third Energy Directives (Talus 2013, p. 243). In view of the limited prospects that Russia would follow on a liberalized energy model, the EU demanded instead to introduce a Regional Economic Integration Organisation (REIO) clause in the Transit Protocol. The reasoning behind this request was that the 2003 Gas Directive had de facto abolished the categories of transit and distribution within the EU. Accordingly, the Transit Protocol should only apply between the EU and third states, and not to the relations between the EU Member States. However, Russia plainly opposed to introducing such a REIO clause and even suspended the negotiations for almost a year as a reaction (Yafimava 2011, p. 286). According to Russia, the recognition of the EU as a REIO in the Transit Protocol would give instruments to the EU to hinder Russian companies' access to the EU market (Belyi 2008, p. 212). In that sense, it could be argued that the “rapid evolvement of regional institutions inside the EU created a stumbling block to negotiations for an international Transit Protocol” (Bonafé and Mete 2016, p. 180).

Third, the Transit Protocol negotiations were also tainted by broader *geopolitical considerations*. Already since the early 1990s, the EU's technical assistance in the energy sector in the Former Soviet Union, with programs such as INOGATE, had been perceived by Russia as a threat to its influence in the region as well as its dominant position in the European gas markets (Belyi 2012). This sentiment aggravated with the gradual development of EU external energy policy. Since the mid-2000s, the EU started supporting the strategic diversification of gas supplies away from Russia, via legal, political, and financial means (Herranz-Surrallés 2016b). Mistrust grew stronger with the EU's creation of the Energy Community (EnC) in 2005, a new international institution aimed at the integration of candidate countries into the EU's energy regulatory space ahead of their accession (Prange-Gstöhl 2009). The Western Balkans's adoption of the EU internal energy market rules was another challenge to Gazprom's influence in the region and Russian-sponsored diversification projects, such as the South Stream. Moreover, while initially the EnC was designed only for candidate countries, it would soon be open to the countries of the European Neighbourhood Policy (ENP). Therefore, the attempt to create a multilateral transit governance in the ECT, while in parallel, both Russia and the EU were seemingly trying to reduce their mutual interdependence, fits well a classical prisoners' dilemma situation, where no side could trust the intentions of the other (Krikovic 2015).

Finally, the *transit dispute settlement* provisions of the ECT revealed of limited use during the first serious gas crises of 2006 and 2009. The worsening of relations between Russia and Ukraine in the context of the “orange revolution” aggravated the commercial dispute on gas prices between the two countries, leading to a major interruption of gas supplies to Ukraine and Europe in January 2009. The transit dispute settlement measures foreseen in article 7(7) of the ECT envisaged the intervention of a mediator, which would set the tariffs and volumes during a 90-day period. However, these provisions were not used, given that the dispute was more on the supply agreement, rather than the transit (Belyi 2012, pp. 266–267). At the same time, the ECT’s bystander role in this dispute also reflects the lack of political will as well as mistrust on the mediation provisions, since none of the parties notified the ECT Secretary General or raised the possibility to use the conciliatory settlement mechanism (Pominova 2014, p. 16).

In this context of growing gap between EU and Russia’s expectations, in August 2009 the Russian government decided to formally terminate its provisional application of the ECT. This decision was justified on Russia’s disappointment with the limited use of the ECT during the 2009 gas crisis as well as the stalemate of the Transit Protocol negotiations (Yafimava 2011, p. 289). However, the decision took many experts by surprise and was seen with some perplexity, as Russia did not seem to gain much from such a withdrawal. First, Russian companies would lose the ECT rights to challenge the EU or its Member States in case of disputes arising from the application of the EU third energy package. At the same time, in application of a so-called sunset or survival clause, foreign investments in Russia would remain under the protection of the Treaty for another 20 years following the withdrawal notification (Konoplyanik 2009, pp. 2–3). Moreover, Russia’s disengagement with the Energy Charter was ambiguous, since it did not abandon the Conference of the Energy Charter and continued seconding the Vice-Secretary General of the ECT. In that sense, some observers initially interpreted Russia’s move as a manoeuvre to re-establish a reform agenda more in line with Russian preferences (Belyi et al. 2011; Herranz-Surrallés 2012). However, at the turn of the decade, Russia’s withdrawal became clearer, opening a soul-searching period in the ECT.

Modernization and the International Energy Charter (Early 2010s): Crisis or Relaunch?

The opposition of Russia to the ECT became more frontal when in November 2009 an UNCITRAL arbitral tribunal announced its jurisdiction to hear the *Yukos v. Russia* case, which could end up with the obligation by Russia to compensate Yukos with around \$50bn. The arbitral case had been filed in 2005 by the oil company Yukos, following the Russian government’s seizure of its assets amidst a complex political saga against the company’s CEO, Michail Chodorkovski. The decision of the arbitral tribunal to proceed with the case was a backlash to Putin’s government, which had sustained that the ECT dispute settlement provisions were not applicable to Russia, given that the country had never ratified the Treaty (Konoplyanik 2005; Gazzini

2015). In this context, in late 2010 the Russian government launched the initiative of a “Convention on International Energy Security” as an alternative to the ECT. The Convention resembled the ECT in terms of subject matters and pretension of universality, but was clearly less market-centric. For instance, the Convention advocated for a more protectionist investments regime, favored long-term contracts as the centerpiece of market stability, and opposed any REIO clause (Belyi et al. 2011; Selianova 2012). The Convention initiative thus made clear Russia’s intention to eschew any obligations arising from the ECT, thus putting “the ball on the European court” (Westphal 2011).

The unambiguous withdrawal by Russia placed the focus on the EU and ECT’s response. Given its central position in the ECT, Russia’s departure amounted to leave the ECT “like Hamlet without the Prince” (Buchan 2009, p. 84). This situation was puzzling also because it meant that the ECT had “violated the first rule of effective institution building: it alienated the most important player” (Van de Graaf 2013, p. 58). Therefore, this raised the question of whether the EU and ECT responses to this setback would be a shift towards accommodation to Russia’s interests and that of other producer countries, or on the contrary, further entrenchment into previous positions (Herranz-Surrallés 2016a).

On the one hand, some scholars and practitioners emphasized the tendency towards *accommodation*. Most notably, the ECT launched a “modernization process,” with the adoption of a Roadmap for reform in November 2010, and the EU agreed to cancel the negotiations on the Transit Protocol, in order to open a broad consultation process (Belyi et al. 2011; Westphal 2011). Similarly, the Secretary General of the ECT expressed on many occasions the willingness to find ways “to more equally balance out the interests of energy consuming and producing nations” in the ECT and to “strengthen its legitimacy” (Rusnák 2013). The goal was also to bring Russia back on board and to position the institution as a “neutral platform” to deal with transit disputes and to facilitate EU-Russia dialogue (Rusnák 2014). Similarly, with the deterioration of the political situation following Russia’s annexation of Crimea in March 2014, the ECT also established an Energy Security Contact Group, presented again as a neutral platform to exchange information and foster trust (Pominova 2014, p. 16).

The modernization process finalized with the adoption of the political declaration of the IEC in May 2015, aimed at boosting the global character of the Energy Charter. Currently signed by around 90 states and regional organizations, the IEC has been object of mixed assessments. On the bright side, the IEC has been praised for its ability to attract countries outside Europe and Central Asia, with new entrants from East Asia, Middle East, Latin America, and Africa (Bonafé and Piebalgs 2017, p. 5). The signature of China and the USA also added political value and global character, despite some important absences, including fossil fuel producers such as Argentina, Australia, Brazil, Canada, India, Indonesia, Mexico, Russia, and Saudi Arabia (Aalto 2016, p. 94). Content-wise, the IEC has been assessed as a balanced declaration, catering for the consumer, producer, and transit countries, as well as recognizing the simultaneous importance of market principles, national sovereignty, and climate change. Yet, its lack of legal value leads to different assessments. While

for some, the added value of the IEC is its “capability to reveal long-term political commitment and therefore to build trust in the global energy business” (Bonafé and Piebalgs 2017, p. 3); for others, the IEC is a loose political declaration, which offers “few building blocks for a more precise roadmap or eventual Treaty” (Aalto 2016; see also De Jong 2017).

On the other hand, despite these signs of reform and relaunch, there are also more skeptical analyses regarding the EU’s commitment to the ECT process and its reform. Some of the signs of EU *entrenchment* into previous positions include, first, a renewed focus on the internal energy market, with the coming into force of the Third Gas Directive in 2009, and a more pro-active stance to expand the internal energy market towards the Eastern neighboring countries. Internally, the more stringent requirements on unbundling and the third country clause introduced by the new directive led to further clashes between the EU and Russia (Grätz 2011; Romanova 2016). Externally, the EU prioritized the expansion of the EnC, with the accession of Moldova (2010), Ukraine (2011) and Georgia (2017). Therefore, the growing overlap between the ECT and EnC memberships was, quite inevitably, an element of marginalization of the ECT (Herranz-Surrallés 2016a, p. 63).

Secondly, the EU’s position in the negotiations and adoption of the IEC in 2015 is also an indication of entrenchment, at least on the side of the European Commission. Despite the nonbinding character of the IEC, the Commission showed its determination to be recognized as a REIO. Even defying the Council of the EU, the Commission submitted a statement to the IEC conference arguing that, due to the nature of the EU internal legal order, the ECT could not create legally binding effects upon the Member States *inter se* (*ibid.*). This generated an interinstitutional conflict over the limits of competence in the IEC negotiations and ended up with the Council submitting a counter-statement to discredit the European Commission (*ibid.*). This episode shows how the ECT became growingly tangled with broader debates on the external competences of the EU following the Lisbon Treaty and the legality of intra-EU investment treaties (see next section).

Finally, and relatedly, the ambiguity of the EU’s position in the ECT is also reflected in the decision of Italy to abandon the regime in December 2014 – the first case of withdrawal from a full contracting party. The Italian government justified the decision on financial grounds as well as a way to fulfill the European Commission’s request to terminate intra-EU bilateral investment agreements (MENA Chambers 2015; Dreyer 2015). Indeed, in view of the growing number of intra-EU arbitration cases, the relation between the EU and ECT law started to generate real tensions (see next section). Therefore, in contrast to the initial phase of the ECT, when the new international rules were fully in line with the incipient energy liberalization process within the EU, by the mid-2000s a gap had grown between the minimum standards of the ECT and a the much deeper liberalization rules introduced by the Second and Third Gas Directives (Talus 2013, p. 243; see also Hadfield and Amkhan-Bayno 2012, p. 9). As explained in the next section, investment provisions have become a growing source of concern from the legal point of view, as well as for broader political reasons.

New Contestation Fronts (Late 2010s): Politicization of ISDS and Climate Change

Since the mid-2010s, the ECT has been object of further controversies, particularly surrounding its ISDS mechanism, in a context of sharp increase and changing pattern of arbitration cases. With an overall number of 128 known cases until 2019, the ECT has become the world's most often invoked international treaty. Moreover, contrary to the initial purpose of ISDS, which was to protect investors' rights in countries with weak judicial systems, most arbitration cases in recent years are intra-EU, meaning that they involved an EU investor as claimant against an EU member state as respondent (see Fig. 1). This revived the debate on the compatibility between ECT and EU law. However, the adequacy of ISDS in general has also been under discussion, in view of the unprecedented levels of public contestation towards investor-state arbitration. Given the growing concern with the effects of ISDS on the right of states to regulate, for example, in the context of climate change, the ECT has also come under scrutiny on environmental grounds.

The legal discussion about the *compatibility between EU and ECT law* took up another notch after the judgment of the Court of Justice of the EU (CJEU) on the *Slovak Republic v. Achmea* case (6 March 2018). In this landmark judgment, the CJEU Grand Chamber supported the Commission's view that international arbitral courts had no jurisdiction in the concerned intra-EU dispute, ruling that any compensation by Slovakia to Achmea would amount to state aid. Although this judgment concerned an arbitration case in the context of a Bilateral Investment Treaty (BITs), it sparked the discussion on whether the ban of intra-EU BITs also applies to intra-EU cases in the framework of the ECT. While the Commission has for several years been arguing that the ECT does not apply to intra-EU cases (Verburg 2019, p. 433),

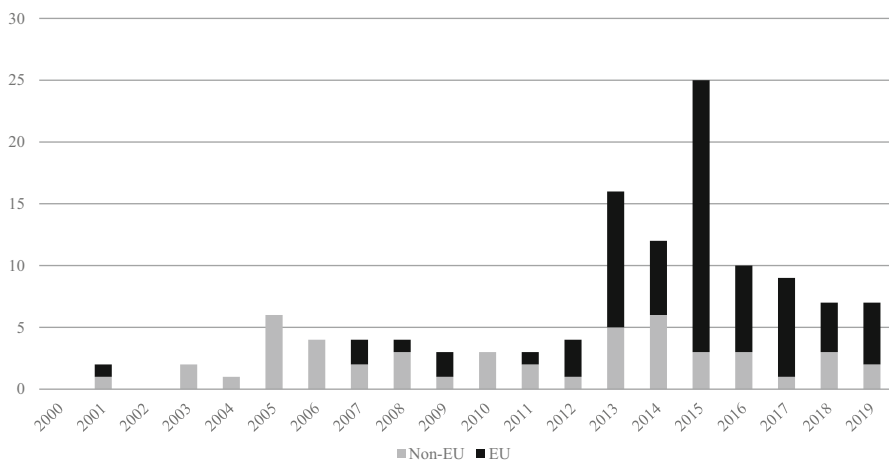


Fig. 1 Evolution in the number of arbitration cases in the ECT (by type of respondent state). (Source: Own elaboration from databases of UNCTAD (2019) and Energy Charter (2019))

legal scholars and practitioners have argued differently. For example, from a historical perspective, Basedow (2020) examined the *travaux préparatoires* of the ECT negotiations during 1990s to demonstrate that, even if reluctantly, the EU eventually accepted the intra-EU applicability of the ECT's dispute settlement provisions. Therefore, in absence of a formal "disconnection clause," the Commission's argument has so far not been successful in ECT arbitral judgments.

The discussion on the relation between EU and ECT law has also become more complicated, as the jurisprudence of the growing number of cases points to different, and sometimes contradictory interpretations. For example, Verburg (2019, p. 432) indicates that in certain cases the arbitral tribunals argued that EU law had precedence over the ECT (e.g., *Electrabel v. Hungary*), whereas in others, the ECT provisions were said to prevail (e.g., *RREEF v. Spain*). While acknowledging the tensions, other legal scholars argue that there are no real normative conflicts between the two legal orders. For instance, Álvarez (2018) argues at length that there should not be debates about the jurisdiction of the ECT in intra-EU disputes, since EU law does not contain any explicit prohibition of investor-state arbitration. Moreover, the ECT deals with substantive protections of investors that are not envisaged in EU law, for example, in cases of expropriation or regarding the notion of Fair and Equitable Treatment (*ibid.*). However, there is a broad agreement that the different paces of market convergence in the EU and elsewhere generate "regulatory tensions" and risk "loosening the bridge between different regions" (Bonafé and Mete 2016, p. 188). The *Nord Stream 2 AG v. European Union* case filed in September 2019 means yet another step in the legal escalation between the EU and the ECT (see next section).

Beyond the EU-ECT relations, reform of the ECT dispute settlement provisions also became politically urgent given the *public and political mobilization against ISDS*. Within the EU, anti-ISDS campaigns gathered more than three million signatures in the context of the TTIP negotiations, and the Comprehensive Economic and Trade Agreement (CETA) almost derailed following the negative vote in the regional Parliament of Wallonia (De Ville and Gheyle 2019; Magnette 2017). The list of criticisms of ISDS is a long one, from a principled opposition to give foreign companies special rights to sue states, to a wide array of procedural concerns, such as the lack of transparency and consistency of arbitration (Herranz-Surrallés 2020). Although the ECT remained for long outside the public radar, anti-ISDS campaigns finally came to target it as "the world's most dangerous investment treaty" (CEO 2018). Besides being the most litigated international treaty, the ECT has been criticized for its vague and broad investment protection provisions, which are more likely to lead to expansive and inconsistent interpretations (Verbrug, 2019). Indeed, already in the 1990s, legal experts expressed concern that "open-ended formulations of the Treaty provide extensive opportunity for individuals to complain and litigate against governments" and that "the more open-ended such obligations, the more interpretation may create considerable surprise for the original negotiators and signatories of the Treaty" (Wälde 1996, p. xx).

Yet another growing source of public contestation and scholarly debate concerns the degree to which the ECT is the right instrument to foster the transition towards renewable forms of energy. In defense of the ECT, some experts have noted that

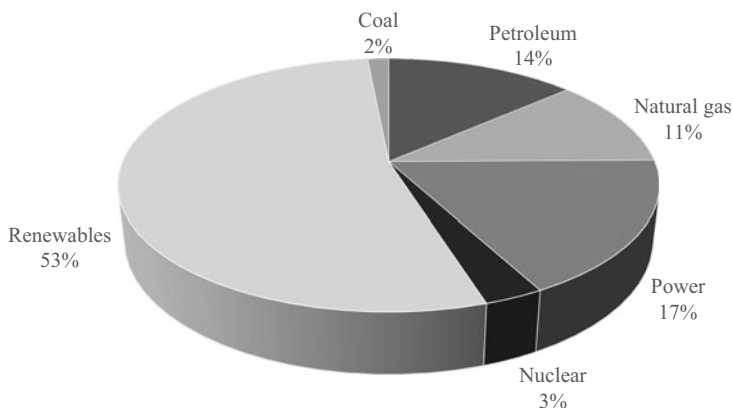


Fig. 2 ECT arbitration cases by sector. (Source: Own calculation from database of the Energy Charter (2019))

rules-based energy governance and strong investment protection mechanisms are necessary for fostering investment confidence in renewable energies, which are particularly susceptible to regulatory risks (Bonafé and Piebalgs 2017, p. 10). The fact that most of the recent arbitration cases within the ECT concern the renewable energy sector (see Fig. 2) seems to back this argument. On the other hand, however, some ECT cases also illustrate the clash between investment protection and the right of states to regulate on environmental matters. Some of the most notorious cases in that regard are the 2012 *Vattenfal v. Germany*, where a Swedish company sued Germany for the decision to phase out nuclear energy, or the 2018 *Rockhopper v. Italy*, whereby a UK-based gas and oil company brought Italy to arbitration for the withdrawal of a drilling concession in the Adriatic Sea (CEO 2018). More broadly, other experts have questioned the contribution of the ECT to fostering renewable energy investment, arguing that political risks are likely to decrease with the gradual phase-out of subsidies and that there is no hard evidence suggesting ISDS' positive effect on investment (Tienhaara and Downie 2018, p. 462).

In view of this public mobilization against ISDS, the ECT Secretariat launched a second modernization process in late 2018 to discuss the reform of its dispute settlement provisions. While most contracting parties are in favor of modernizing ISDS (e.g., via including specific safeguards on the right to regulate and other measures to enhance transparency and participation of third parties), the outcome of the process is still uncertain. To begin with, the reform of dispute settlement provisions in the ECT is difficult to address in isolation, given the wider ISDS reform at the EU and global levels (Herranz-Surrallés 2020). In response to domestic contestation, the EU has been advocating a reformed system of investor-state arbitration with permanent judges, an appeal mechanism, and stronger safeguards against corporate abuse. Since 2016, the EU has advanced the so-called Investment Court System (ICS) in its bilateral agreements and the Multilateral Investment Court (MIC) at a global level (ibid.). The outcome of global ISDS reform might therefore

affect the ECT as well, even if options such as an appellate facility or a roster of arbitrators for ECT disputes are not currently on the table of the modernization discussions (Verburg 2019, p. 437). At the same time, the modernization process has been criticized for not paying enough attention to climate change and the need to align investment provisions with UNFCCC Paris Agreement and UN Sustainable Development Goals (Keay-Bright and Defilla 2019). The unclear contribution of the ECT to climate change mitigation has even been considered as a factor that should tip the balance of the EU's position towards terminating or withdrawing from the ECT (Voon 2019).

Future Directions

At the turn of the 2020s, the ECT is at a crossroads. While on the one hand, the ECT modernization process is underway and efforts to gather new signatories for the IEC continue, on the other, the commitment from the EU institutions and its Member States to the success of these endeavors appears, at best, uncertain. This delicate impasse also raises broader questions about the EU's international actorness as well as the future of global energy governance.

Regarding the EU's role in the ECT, the *Nord Stream 2 AG v. European Union* arbitration case filed in September 2019 brings the legal and political tensions between the EU and the ECT to a new level. Although the resolution of this case might take years, the fact that for the first time the EU as whole is the respondent party in an arbitration case is a significant new development. Quite ironically, despite Russia's withdrawal from the ECT, partly in disagreement with arbitration provisions, the ECT is now being used by a Russian-funded company (Nord Stream 2 AG is a subsidiary of Gazprom registered in Switzerland) to challenge EU regulations on grounds of discriminatory treatment (Gotev 2019). Therefore, as some legal scholars already anticipated, the EU has become a "frontline actor in the international investor-state regime" (Berman 2018, p. 220). This opens a new legal game, since so far, the European Commission was only indirectly involved in intra-EU arbitration cases via *amicus curiae*, arguing for the hierarchical precedence of EU Law to free Member States from liability on ECT provisions. However, in a case where the EU itself is challenged, EU law cannot be used anymore as a defense, as the parties cannot refer to their domestic laws as a reason for not observing international obligations (ibid., p. 205). This is therefore an interesting case for the EU international actorness and its relation to International Law. While the EU has usually been one of the standard-bearers of a rules-based multilateral order, the ECT case reveals that, when international and EU law collide, the EU may opt for defending the latter.

The *Nord Stream 2 AG v. European Union* arbitration case as well as other controversial legal measures in the context of the Nord Stream 2 pipeline, such as Denmark's amendment of its Continental Shelf Act (Schill 2017), bring to the front another rising debate: how to balance investment protection and security concerns. In both cases, the amendments were motivated by security and geopolitical considerations – indirectly in the case of the EU and more directly in the case of Denmark,

where the amendment introduces a new procedure to deny a permit for the construction of a pipeline in case it is deemed incompatible with “national foreign-, security-, and defence policy interests” (ibid., p. 3). Yet, security-related restrictions, regardless of their proportionality and political justifiability, risk violating investment protection obligations. With the rise of sovereign investment, via State-Owned Enterprises (SOEs) or Sovereign Wealth Funds (SWFs), the debate on the security implications of foreign investment has taken up speed (Wehrlé and Pohl 2016). Given its strategic character, foreign control of energy infrastructure is particularly susceptible to generate this type of concerns. Infrastructure diplomacy by China in the context of the Belt and Road Initiative (BRI) is a case in point. Therefore, the role of economic statecraft and investment arbitration will continue to generate debate for the foreseeable future (Boute 2019).

In view of the uncertain commitment from the EU in the ECT, future analyses will have to gauge a broad range of possible scenarios and their consequences for global energy governance. For example, some experts have called for a discussion on the options of termination of the ECT or withdrawal from the treaty by one or more parties (Voon 2019). Such an option, however, would raise questions about the possibility to modify or derogate the applicability of the 20-year survival clause (ibid.). Less drastic scenarios would be, for example, an *inter se* modification of the ECT, whereby the EU and its Member States would modify the investment provisions among them, without affecting their obligations towards non-EU investors (Verburg 2019, p. 447). However, it is not clear whether the ECT provisions allow for an elimination of intra-EU ECT protections and whether all contracting parties (including some EU Member States) would support such an option (Beham and Prantl 2020). Moreover, any scenario where the EU could include a carve-out for intra-EU applicability would certainly open a wider debate on the added value of the ECT, as well as the IEC, compared to other international energy institutions, most notably the IEA, which has for a long time considered widening its membership, or the International Renewable Energy Agency (IRENA), which already encompasses 161 members.

Going back to Robert Cox’s (1981) definition of institutions as amalgams of material power and ideas, the uncertainty over the Energy Charter’s future can be seen as part of the wider erosion of the liberal world order (Alcaro 2018; Ikenberry 2018). Just as in other domains, the epicenter of global energy dynamics continues to shift East-wards, with the centrality of China as both consumer, producer, and investor in energy infrastructure. Therefore, quite interestingly, while the EU is on the defensive regarding the ECT, China has taken some interest in its investment protection provisions. At the same time, with the ideational backlash to globalization in Western countries and ascendancy of state-capitalist ideas elsewhere, the context has become growingly unpropitious for binding trade and investment provisions in the energy sector and beyond. The success of the Energy Charter process is therefore more likely to hinge on its ability to become a testing ground for flexible arrangements, for example, a focus on mediation and conciliation, and its ability to adapt investment arbitration to both climate imperatives and new geopolitical concerns.

Cross-References

- ▶ [Energy Matters in the EU Eastern Partnership](#)
- ▶ [European Union Energy Policy: A Discourse Perspective](#)
- ▶ [EU-Russia Energy Relations](#)
- ▶ [Extending Energy Policy: The Challenge of Sector Integration](#)
- ▶ [Geopolitics of Energy](#)
- ▶ [The European Union in Global Energy Governance](#)

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