

MORE THAN ENTHUSIASM: the EU, the energy transition and the Energy Charter Treaty

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Beyond the immediate Covid-19 health crisis and subsequent economic recovery looms the climate change crisis. The EU has committed itself principally via the Paris Agreement to seek to suppress the production of CO2 emissions within the Union and assist in their suppression outwith the Union. While the commitment of the EU and its institutions is not in doubt there is a danger that in its enthusiasm to suppress fossil fuel generating CO2 emissions it may take steps that backfire. One example that is now in train is the Commission's modernisation proposals for the Energy Charter Treaty.

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As the world's only multilateral investment agreement the Energy Charter Treaty (ECT) could potentially be an ideal platform to assist in mobilising the enormous amount of capital that will be required to transform the global energy system. However, the Commission's proposals to modernise the ECT seem to ignore the modern competitiveness of renewables which could transform the role of the Treaty in the delivery of the transition. Its proposals it appears are likely to have either a marginal effect or in fact undermine the potential of the ECT to mobilise capital to deliver the energy transition. The Commission needs to rethink its approach to modernisation of the ECT. It needs to recognise the potential value of the Treaty to delivering the transition and the need to incentivise many more states to join the ECT. Currently the Commission is instead seeking to impose new burdens on ECT members which are likely to disincentivise any other states from joining.

The ECT was adopted in 1994. There are already 53 states who are members including all EU Member States save Italy. The European Union is a member in its own right. The Treaty's original purpose was to encourage the opening of energy markets principally via providing protection for investments in Eurasia after the collapse of the USSR. While the Treaty asserts the accepted principle in public international law of state sovereignty over natural resources, it also seeks to protect foreign investment in those resources. It does this by providing for a legal right to compensation where an ECT member undertakes to expropriate or otherwise substantially compromise the interests of an investor. Investment protection applies not just to investment in direct natural resources such as oil and gas fields but to a whole range of energy investments including transmission networks, storage facilities, power generation plants and renewable generation.

After a slow start in the late 1990s it became a major source of investor-state disputes with over 120 cases being raised under the ECT, the largest number of any investment treaty. Most notably in 2014 in the *Yukos* arbitration, Yukos shareholders were awarded \$50 billion against the Russian Federation. However, most of the criticism that the ECT has received is not from that case but from a flood of other cases in the late 2000s and early 2010s. These arbitration cases principally involved Spain and Italy. Both countries had had to make hundreds of millions of euros in ECT award payments. The scale of these payments moved Italy to leave the ECT in 2016. These cases stimulated the campaign to reform the Treaty, particularly at European level. However, it is worth pointing out that almost all of those cases involved *renewable* energy investments. The payouts largely derived from the ill thought through design of the first generation of renewable subsidies rather than any issue surrounding the ECT itself.

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Nevertheless, supported by some Member States and a number of NGOs, the Commission developed a line of argument that the ECT by providing investment protection for fossil fuels would undermine the energy transition. The argument was made that the ECT would via its investor protection provisions lock in any further investment of fossil fuels into the energy mix for the foreseeable future. This view of the ECT led to an ambition to eliminate fossil fuels from the investor protection provisions of the ECT which Energy Commissioner Kadri Simson discussed in her plenary speech to the European Parliament in October 2020. More specifically the Commission's modernisation proposals included a range of amendments to green the treaty such as imposing an environmental impact assessment on new energy investments and protection of the state's right to regulate for sustainable development. The Commission's modernisation proposals also include introducing a state to state dispute settlement mechanism which would provide a means to enforce the Paris Agreement. These reform proposals are now being negotiated with the other members of the ECT.

In addition to the somewhat ironical point that the trigger for much EU Member State concern involved cases where the ECT was deployed to protect *renewable* investments, the Commission's entire approach to reform here is open to question. The primary issue is that the Commission's analysis seems to overlook the collapse in the price of renewable power. Utility solar pv has fallen 80% in cost since 2010. As the International Energy Agency (IEA) explained in its latest *World Energy Outlook Report*, utility solar pv now provides the lowest cost electrical power ever produced. Onshore wind has also seen significant price falls of around 40% in the last decade. In such a context why would global financial capital continued to be available at scale for fossil fuels if renewables are more competitive in the marketplace? This collapse in the cost of renewables and its competitiveness against fossil fuels is also one of the reasons why the energy services firm DNV in its annual *Energy Transition* report estimated that peak investment in fossil fuels has already occurred, in 2019.

The reality now is that the price competitiveness of renewables will ensure that the dominant form of energy investment will now be in renewables. As a consequence, why should the Commission be spending precious political capital on persuading other states to remove fossil fuels from the ECT when the market will do that job in any event?

Furthermore, the Commission's proposals also do not take account of the scale of investment that is going to be required to deliver the transition. The International Renewable Energy Agency (IRENA) estimates that the world will need to invest around \$27 trillion over the next 30 years to deliver the Paris targets. The IEA estimates that in order to deliver a sustainable development scenario with a rise in temperatures to approximately 2C we will need to increase investment in clean energy from \$0.9 trillion a year in 2019 to \$2.7 trillion a year in 2030. It also estimates that most this capital call will be from the private sector, in the order of 70% of the public-private investment mix.

Critically, in order to effectively suppress fossil fuels the delivery of clean energy and the capital underpinning it has to be global. One cannot rely on just delivering the energy transition by delivering capital at scale just to states with developed legal orders. This has to be genuinely global effort to transform the world's energy system.

However, unfortunately much of the world outside North America, Western Europe and Australasia do not have developed legal orders with effective application of the rule of law. The reasons are varied: underfunding, bureaucratic delays, technical incapacity, susceptibility to state pressure or outright corruption. However, these shortcomings separately and sometimes cumulatively undermine the willingness of investors to support the energy transition at the scale required. Given the substantial majority of the capital that has to be mobilised to deliver the global energy transition is private it is going to be very difficult to mobilise that capital without an effective mechanism to protect it.

This is where the ECT potentially comes into its own. It is the only multilateral investment treaty. It already has 53 members. It has potential to grow to its platform as a mechanism to deliver the global energy transition. In that light one has to ask some questions about the Commission's reform proposals. Some of the proposals such as to remove fossil fuels from the protection of the ECT are now economically redundant. Others are marginal such as the proposal for an environmental impact assessment for energy projects in a world where most new investments will be renewables.

Most questionable is the proposal to introduce a state to state dispute mechanism to underpin the enforcement of the Paris Agreement. At one level it is understandable that the Commission is seeking to underpin these agreements. However, does a significant re-purposing of the ECT make sense from the perspective of trying to mobilise the capital necessary for the energy transition? One of the dangers with the Commission's proposal here is that it will dissuade more states from joining the ECT. Surely the priority should be to incentivise and not disincentive states to join the ECT in order to make it easier to mobilise the necessary capital at scale?

The Commission should reconsider its modernisation proposals. It should focus perhaps instead on a more practical approach to greening the Treaty

by providing more clarity on the scope of the ECT. For example, by making it clear that hydrogen and carbon capture and storage investments are fully covered by the ECT. More broadly it should be supporting the ECT's secretariat to seek to increase the number of members to make it easier to mobilise the capital at the scale necessary to deliver the energy transition.