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How Does the Energy Charter Treaty Impede National and Global Efforts to Mitigate and Adapt to Climate Change?

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Abstract. This paper examines the structural conflicts between the Energy Charter Treaty (ECT) and global climate governance objectives, particularly in light of the Paris Agreement. It argues that the ECT's strong investor protection provisions—such as Fair and Equitable Treatment (FET), protection against indirect expropriation, and the Investor-State Dispute Settlement (ISDS) mechanism—create a "regulatory chill" that discourages states from adopting ambitious climate policies. Through a qualitative case study of Rockhopper v. Italy, this work demonstrates how the ECT undermines national climate legislation and limits the regulatory space of host states. The analysis reveals that the treaty's pro-investor bias prioritizes fossil fuel interests over environmental goals, thereby hindering the alignment of international investment law with climate action. In response, this paper proposes several reforms, including coordinated withdrawal from the ECT, the incorporation of climate exception clauses in bilateral investment treaties, and enhanced interpretative cooperation among contracting parties. These recommendations aim to reconcile investment protection with climate obligations, ensuring that international investment law supports rather than obstructs the global transition to a low-carbon economy.

Keywords: Energy Charter Treaty, climate policy, Investor-State Dispute Settlement, regulatory chill, international investment law

1. Introduction

With the occurrence of extreme climate change, the divergence between international investment and climate policy has aroused the world community's attention again. As a multilateral treaty concluded in the 1990s with the purpose of protecting energy investment, the Energy Charter Treaty (hereinafter "ECT") has shown its obvious contradiction with the purpose of Paris Agreement and the international requirement of lowcarbon transition. The powerful Investor-State Dispute Settlement (hereinafter "ISDS") process allows fossil fuel investors to dispute a host state's climate policy through a legal morass that hinders national actors from adopting climate measures.

In order to realize their commitment within international agreement such as Paris Agreement, climate- and environment-related regulations are increasingly enforced by national government. Often, the climate or environment-friendly legal standards are in conflict with the legal protection for investment embedded in International Investment Agreements (hereinafter "IIAs"). Due to the structural imbalance, the host states are put into a great financial risk by way of investment

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arbitration, which creates a “regulatory chill” and discourages the host states from taking assertive climate actions.

In terms of existing bilateral investment treaties (hereinafter “BITs”), the protection of foreign investors’ investment interests (national treatment and most-favored-nation treatment) has traditionally been given priority over the protection of host states’ environmental interests and environmental obligations of investors, which has been castigaded in the international sphere.

While the ISDS mechanism—especially under the International Centre for Settlement of Investment Disputes (hereinafter “ICSID”)—has historically been a conflict between investors and states, there is no space for the directly affected communities and little opportunity for representation by civil society organisations.

This paper argues that it is necessary to explore the systemic contradictions within the ECT, especially how it creates regulatory chill, limits domestic climate legislation, and hinders environmental enforcement as a prerequisite to advance the alignment of international investment law with the global climate governance agenda.

Directly incorporating the domestic environmental law into BITs, or stipulating investors’ responsibility to comply with host states’ environmental regulation explicitly will be helpful to effectively incorporate investors’ environmental obligations at the level of treaties.As will be made clear below, by better defining the procedural right of host states to bring environmental counterclaims and referring to the established jurisprudential precedent from international arbitration, the enforceability of such provisions will be strengthened and therefore the proper balance between investment protection and environmental protection will be realized.

At the same time, and as we show below, we must answer the two important questions: how far do investment treaties and the practice of investment arbitration restrain states’ capacity for regulatory action on climate change, and to what extent do we find institutional possibilities to harmonize protection of investments with climate goals?

Yet another protect public interests force are nongovernmental organizations (NGOs) who can investigate environmental and social impacts and who placed an emphasis on human rights protections issues beyond investor-state boundaries.

Legal order For all that the ICSID rules formally permit a very limited degree of third party intervention through amici curiae submissions, procedural and institutional constraints prevent the reality While the 2022 ICSID Rules offer some improvements in terms of opening up the process for non-disputing parties and in terms of providing some clarity in relation to their filings, problems still remain.

This paper responds to these problems in the following manner. First, it will demonstrate how the ECT and arbitral awards undermine climate regulation. Second, it will set out how the new treaties could include binding environmental commitments for investors. The paper will also look at how the procedural reforms particularly increased transparency and the participation of non-state actors like NGOs to the ISDS proceedings can contribute to more balanced solutions.This will thereby make concrete and specific suggestions as to how states, arbitral institutions and the international community can bring these essential areas of law into line?

2. Previous research: the provisions of the Energy Charter Treaty (ECT)

Energy Charter Treaty (ECT) is a treaty in force since 1994 to enhance international cooperation in energy, to protect investments in energy that cross border, and to protect reliable supplies of energy, mainly between Europe and the countries formerly of the Soviet Union.

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The problem with the ECT is this: to do this, they through strong investment protection rules and an investor-state dispute settlement (ISDS) mechanism. focused on fossil fuel infrastructure in production and transport.How the Energy Charter Treaty Impedes National and Global Efforts to Mitigate and Adapt to Climate Change.

The ECT's provisions to give investors policy space to protect investments' rights and to take nonenvironmental measures.

Article 1(6) of ECT defines the meaning of "Investment" broadly to include "equity, contract rights, tangible movable property, real estate, and intellectual property rights rights, etc. in the fossil fuel sector, protecting the existing and expected fossil energy investment.

Fair and Equitable Treatment (FET) standard is defined by Art. 10(1) of ECT FET The scope of FET obligations of the contracting state is vague and expansive, which can present challenges for countries seeking to pursue climate policy. In virtually all cases involving ISDS, investors have alleged that their climate policies violate FET.191 ECT Art. 10(3) and Art. 10(7) explicitly define FET and NT, respectively.

Such nondiscrimination rules limit actions that governments may undertake to encourage domestic clean energy sectors or treat highcarbon activities differently, which in turn could allow non-environmentallyfriendly sectors to exploit regulatory loopholes.

The so-called ECT Art. 13(1) regulates expropriation of and compensation to investors The purpose of expropriation, although it may be public interest including the environmental interest, is sometimes questioned by investors.

The combination of the nondiscrimination rules and the due process obligations prevents host states from properly carrying out their mitigation and adaptation to climate change. It is the central legal mechanism through which the ECT impedes climate policy.

Article 26 of the ECT gives foreign investors the possibility to opt out of disputes with host states' national courts (expropriation and compensation) and to proceed to international arbitral tribunals. The method of this paper is a qualitative case study approach guided by a critical legal studies perspective. The aim of this study is to empirically explore what the framework of ECT and especially its ISDS legal framework has in concrete terms the potential to impose in the form of legal and political constraints to countries adopting climate mitigation and adaptation measures. Our approach aims to give an idea of the causalities involved in this topic not in an abstract legal discourse, but confronting them with the empirical effects.

The present paper attempts to determine if the investment treaties and investorstate arbitral awards have been adequate, or not, to prevent the states to adopt regulations for the protection of climate change. The present paper follows a case study methodology. The present paper is focused on the case Rockhopper v. Italy arbitration case.We choose these cases for their resonance with the central and pertinent question of whether investment arbitration is relevant to environmental and climate policy regulation more broadly.

First of all, the paper will focus on the Rockhopper v. Italy to analyze the relationship between the investment treaty language, i.e. fair and equitable treatment (FET) and expropriation clause and the environmental measures taken by the Italian government and the impact of tribunal's conception of protection of environment on the states' regulatory space as regards climate change.

Here, scholars provide us with some very valuable observations.

There is first an intrinsic tension between ECT and PA. ECT Art. 10 stable regulation requirement flatly conflicts PA Art. 4 obligation to increase efforts progressively [1]. In practice, Germany may be bound to pay €24 billion claim for its coal-fired power phaseout [1].

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Secondly, the 2022 ECT modernization is a failure. Recast Art. 19 still protects gas projects with no enforcement mechanism, leading to “green protectionism” [2].

Thirdly, the inequalities harm developing countries. According to UNCTAD [3], developing countries fail 78% of ISDS cases due to their weak legal assets. Consequently, those countries must seek climate funds to compensate for losses [4].

Fourthly, researchers discuss how to exit. According to PeiYu Huang [5], if ”sunset clause” termination is accompanied with bilateral deal, the risk about post-exit claim may reduce up to \$80\%\$.

In total, valuable legal back doors are provided in the Energy Charter Treaty, that hinder climate policies to be implemented due to flaws in the treaty (and challenges in co-existing with other treaties, such as the PA). Part of the problem is responding to the treaty and various ways forward, including Exit.

3. Methodology

In this paper, a methodology of mixed research using both of legal research and qualitative research (case study) is utilized.

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Second, we will conduct a comparative study of the legal reasoning used in Rockhopper v. Italy [6] with other ECT cases, as well as other cases where other investment protection provisions meet environmental protection regulation, in order to draw broader patterns and divergences in tribunals’ treatment of environmental protection in the investment arbitration context.Our attention will be on determining whether tribunals have continued to treat the establishment of climate aspirations and environmental protection as improper objectives of public policy, or whether there is an increasing trend toward treating environmental aspirations as appropriate goals to enforce via the procedural or substantive adjudication process.

4. Hypothesis

H1: The ECT’s strong investor protection provisions create structural barriers to integrating climate objectives into Bilateral Investment Treaties (BITs).

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That is, the proposed theory argues the existence of the ECT's strong investor protection provisions, such as FET, protection against IEX and ISDS that contribute to generating a regulatory chill, such that states would be less willing to consider ambitious climate-protective provisions in their BITs, given the costs involved in compensation for a potential arbitration request. Thus, ECT would understructurally inhibit compliance of international investment agreements with climate-related agreements such as the Paris agreement; as a result, an effective enforcement mechanism for emissions reduction obligations would be absent in the world of international investment law.

H2: The ECT's broad protections for fossil fuel investors inhibit the adoption and implementation of domestic climate legislation.

Under this premise, the broad guarantees provided by the ECT in this area also dissuade governments from introducing stringent climate reforms (e.g. the decommissioning of coal, restriction of fossil fuel extraction, or carbon pricing policies) out of fear of being subjected to an ISDS claim for harm to their investment.82 Examples of environmental law cases that have led to arbitration include Vattenfall v. Germany [7] and Rockhopper v. Italy [6].83.The "regulatory chill" effect then has a direct impact on the national policy space and national sovereignty in climate policy, as well as on the legal and financial clarity of national domestic climate policies.

H3: The ECT's investor-centric framework weakens host states' capacity to enforce environmental regulations against investors.

Thus, this explanation explains that the investor-oriented view of the ECT prevents host States from deterring investor compliance by sanctions for the emissions-based violations, even if there are sanctions provided in the domestic legislation: investors may be deterred from higher enforcement due to potential ISDS claims. Additionally, under the ECT, there are no provisions to recognize environmental counterclaims, or to provide that the same benefits under the treaty cannot be claimed by different investors to a noncompliant state, that is, to provide mechanisms to enforce its own rulings on environmentally adverse investments. Therefore, the host country cannot behave as a proactive force, but often only tries to assert the counterclaims when the investors bring the case to the arbitral stage.

5. Case study and analysis

Case1: Rockhopper v. Italy [6], Rockhopper, a UK-based oil company, brought a case against Italy before the Energy Charter Treaty (ECT) arbitral tribunal for compensation of investment losses caused by Italy implementing a ban in 2015 on new offshore oil drilling near its coast. Italy initially banned new offshore drilling within 12 nautical miles in 2010, and then made and revoked exemptions for pending oil and gas concessions. Rockhopper already obtained the right to drill and was seeking ${\bf275}$ million Euros. The Tribunal held that Italy's refusal amounted to expropriation 'without effective remedy' within Article 13 ECT and ordered Italy to pay to Rockhopper €190 million in damages in 2022.

The ECT Article 13 (Expropriation) and Article 10 (Investment protection) were central for Rockhopper to bring a claim and for Italy to argue that intraEU ECT claims were precluded by EU law after the CJEU decisions in Achmea and Konstroy, which the tribunal rejected on grounds of ECT's supremacy.The tribunal, fixated on protecting investor rights at the expense of the Italian sovereign right to regulate for environmental protection, read into the ECT the protection of fossil fuel investment against climate policy.

In this case we can identify three positive effects for the climate governance: First, the huge damages for simple compliance with the climate law might be a incentive for the countries as Italy to commit for other climatefriendly measures because they fear to initiate costly ISDS proceedings.

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Second, the tribunal`s interpretation of the ECT shows an profossil fuel investment bias, because it puts capital profits for energy extraction before climate mitigation; so it shows the inherent asymmetry and bias in investment treaties. Third, ISDS tribunals, consisting of commercial lawyers and having a lack of strong climate expertise, tend to place relatively narrow commercial interests before a comparatively broad environmental interest. A broad interpretation of “investment“ leads to environmentrelated challenges, thereby narrowing down the state regulatory space.

We consider this case study as particularly representative for the way in which the ECT hampers effective mitigation of the climatic challenge: An oil and gas drilling ban in Italy – a legitimate measure to address climate change – led to the payment of several billion euros in fines and may discourage similar legislation elsewhere.

In the other case, protection of the sea prevailed over investment claims and ISDS panels dismissed inter alia overlapping climate treaty and EU law as forming a legal double bind.

The fear of costs incurred casts a shadow over ambitious climate policy in countries, resulting in a "regulatory freeze" that discourages sudden policy changes needed to rapidly adapt the climate.

The case illustrates strongly all three hypotheses.

The case illustrates very strongly that investor protection clauses in the ECT function as a form of structural roadblock to climate integration, which is also discernible in the narrow interpretation of Italy's regulatory space by the tribunal. Italy's unhappy experience illustrates how climate legislation is impeded by the ECT at the expense of billions in financial penalties that the government incurs for protecting the environment. All of this underscores what host states face in attempting to enforce environmental regulations, as the Italian government found itself in defensive position with "legitimate environmental concerns."

6. Recommendations

1)Co-ordinated Withdrawal and Modernisation Should ECT modernisation in its current proposed form turn out to be a failure in potential climate negotiations, it would be sensible for states to co-ordinate an withdrawal from an unreformed ECT and to establish a new “Carbon Neutral Investors Club” where investment protection is for climate.

2)Embed Clear Climate Exception Clauses In New Bilateral Investment Treaties (“BITs”) or Domestic Investment Laws, states should embed clear climate exception clauses that state that nondiscriminatory climate policies that states feel they must adopt to fulfil Paris Agreement obligations do not amount to “indirect expropriation” or breach the “Fair and Equitable Treatment” standard.

3)Step Up Interpretative Cooperation Contracting Parties can co-operate and jointly issue a joint interpretative statement concerning ECT provisions that treaty provisions such as FET should not interfere with legitimate climate action. They can also co-operate and play a critical role in helping to guide tribunals and provide a cornerstone that investors cannot use base their complaints against climate measures on.

4)Weakened State Capacity and Dispute Prevention We recommend that governments strengthen coordination between their ministries of the environment, energy, trade and justice in their planning for the impacts of climate policies, and undertake ex ante ISDS risk assessment of climate-related measures. Proactive negotiation and dispute prevention with investors at the project stage enables settlement of grievances with arbitral tribunals, thereby reducing litigation costs and risks.

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7. Conclusion

In this paper we showed how the Energy Charter Treaty creates strong barriers towards an international climate action potential due to the powerful investor protection enshrined in the instrument and also to the ISDS mechanism. We demonstrated using case study methodology that the design features of ECT render it pro-investor and anti-climate from the very beginning and therefore create fundamental conflicts in the interplay between international investment and climate treaties that need to be resolved.

The international system in the future must pursue the modernization of ECT or even coordinated exit from it to create a harmonious relationship between investor privileges and regulatory powers in the environment sphere and active role for nongovernmental organizations in defense of environmental interest in ISDS proceedings. It can only ensure that international investment system is brought in conformity with the needs of climate action only through its modernization.

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