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**BRIEFING PAPER** September 2022

## IS THE NEW ENERGY CHARTER TREATY ALIGNED WITH THE PARIS AGREEMENT? A REFORM THAT STILL FALLS SHORT

**IGNACIO ARRONIZ VELASCO**

The EU and UK carveouts under the new Energy Charter Treaty (ECT) are not compatible with the Paris Agreement. They fail to reclaim enough policy space to ensure an orderly and just transition to a decarbonised energy system. Their policy toolbox will continue to be strongly limited under the new ECT until the mid-2030s, far too late to regulate fossil fuel phaseouts.

They also risk investors bringing project approvals forward to get in before the phaseout dates. Moreover, they introduce loopholes that investors and ECT tribunals can abuse to extend protections to investments incompatible with net zero. As a result, the new ECT remains a tall barrier to climate action. The EU and UK should thus consider withdrawing from it together.

### Context

The Energy Charter Treaty (ECT) is imagined as a tool to incentivise Foreign Direct Investments (FDIs) in the energy sector. It attempts this by protecting foreign investors from any state policy that could harm their expected revenues. It is thus intended to function like a signalling tool: the states that sign it indicate they welcome such investments and are willing to limit their policy space in exchange. However, the effectiveness of agreements like the ECT at attracting



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foreign investments has been shown to be very tenuous.<sup>1</sup> Instead, it has become a mechanism to protect special interests and legacy investments, particularly those of the fossil fuel industries, rather than investments supporting modernisation and growth of future-oriented technologies.

Negotiations to reform the ECT ended early this summer. Their stated objective was to align the ECT with the Paris Agreement goals.<sup>2</sup> Removing protections for all fossil fuel investments would have gone a long way, but this option was never on the table.

Negotiators settled instead on a ‘flexibility mechanism’ allowing countries to choose whether to remove certain energy investments from the protections offered by the ECT. However, only the EU, the UK and, minimally, Switzerland have opted to do such a “carve out”, with significant differences in scope and ambition. The European Commission<sup>3</sup> and the UK Department for Energy<sup>4</sup> have interpreted the reformed ECT as aligned with the Paris Agreement but have not demonstrated how or why.

Given the necessity to grow non-fossil energy investment in Europe to handle the current crisis and the urgency to act on climate change, the EU cannot afford a treaty that limits its agency in driving the necessary change.

## What does it mean to be aligned with the Paris Agreement?

One of the main goals of the Paris Agreement is to make all finance flows consistent with the climate transition.<sup>5</sup> Similarly to other forms of insurance, assessing whether investment treaties like the ECT are aligned with such a goal requires looking at the scope of their ‘covered investments’ — on top of other considerations.<sup>6</sup>

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<sup>1</sup> Columbia Center on Sustainable Investment, **Costs And Benefits Of Investment Treaties: Practical Considerations For States** – Literature suggests that international investment agreements work at most as a backstop to protect investments made irrespectively of them.

<sup>2</sup> Council of the EU, **Council adopts negotiation directives for modernisation of Energy Charter Treaty.**

<sup>3</sup> European Commission, **Agreement in principle reached on Modernised Energy Charter Treaty.**

<sup>4</sup> UK Department for Energy, **UK strengthens protections for taxpayers in energy treaty negotiations.**

<sup>5</sup> Article 2.1(c) of the Paris Agreement under the UNFCCC: “Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”.

<sup>6</sup> OECD, **Investment treaties and climate change: The Alignment of finance flows under the Paris Agreement.**



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It is tricky to assess whether individual energy investments comply with the Paris Agreement. A single gas plant could serve different purposes during its lifetime, from providing baseload power to simply balancing the grid. However, system-level scenarios indicate how different countries' energy mix should look at specific times to stay on track to achieve their climate goals.

Thus, a Paris-aligned ECT should, at a minimum, remove protections for investments in technologies that hamper the energy transition. This carveout would signal that the host state does not welcome such investments at scale and is thus unwilling to sacrifice policy space to promote them. Such policy space might indeed be necessary to gradually increase alternative energy sources or solutions, or to put the management processes in place for an orderly phasedown of operations. However, not protecting investments in a certain technology does not imply outright forbidding them.

Based on this logic, we could deduce two main criteria to assess the Paris Agreement alignment of the new ECT:

1. It should not protect investments that hamper the energy transition.
2. It could not be used to challenge policies needed to achieve the energy transition.

Ideally, it would be designed to attract investments that actively contribute to the energy transition. But, as mentioned above, there is strong evidence to suggest that treaty-based investment protection is ineffective when it comes to investment promotion in general. Thus, in the absence of an effort to develop alternative tools tailored to the needs of clean energy investments, an analysis of the protections granted to fossil fuel investments can at least provide clarity over the ECT's compliance with the 'minimum' interpretation of the Paris Agreement.

Looking at whether the EU and UK proposals to remove certain energy investments from the ECT, including their timelines, are compatible with the Paris Agreement is only part of the picture. A full analysis would also include a detailed assessment of the ECT's new investment protection standards.<sup>7</sup>

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<sup>7</sup> IISD, **Modest Modernization or Massive Setback? An analysis of the Energy Charter Treaty agreement in principle.**

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## What is needed for the energy transition?

Recent academic literature has concluded that the International Energy Agency's (IEA) Net Zero 2050 scenario is the only emission scenario aligned with the Paris Agreement temperature goals.<sup>8</sup> This is why we use it in this analysis to benchmark the ECT.

A core aspect of the IEA's net-zero scenario is decarbonised global energy systems. This requires unprecedented investment flows into electrifying the power sector – building enabling infrastructure and end use (storage, grids, digitisation, heat pumps, EVs) and decarbonising its supply.

The IEA benchmark for advanced economies is to fully decarbonise their energy systems by 2035. The IEA indicates some key milestones to hit, such as stopping fossil fuel mining and exploration in 2021, peaking fossil fuel demand in the early 2020s, phasing out coal power by 2030 and getting rid of unabated oil & gas generation in the early 2030s.

## Are the ECT carveouts aligned with Paris?

The following table summarises the EU and UK carveouts from the ECT and the respective timelines they have chosen to implement them, together with the relevant IEA benchmarks for each technology.

*Table 1: EU and UK timelines to remove ECT protections for certain energy investments*

ECT carveout	UK phaseout dates	EU phaseout dates	'Net zero' benchmarks
<b><u>New</u> fossil fuel assets (upstream, midstream, and downstream) except:</b>	August 2023	August 2023	No new production as of 2021, no coal power as of 2030, no unabated gas power as of 2035.

<sup>8</sup> Brecha, Ganti, Lamboll, R.D. *et al.* **Institutional decarbonization scenarios evaluated against the Paris Agreement 1.5 °C goal.**

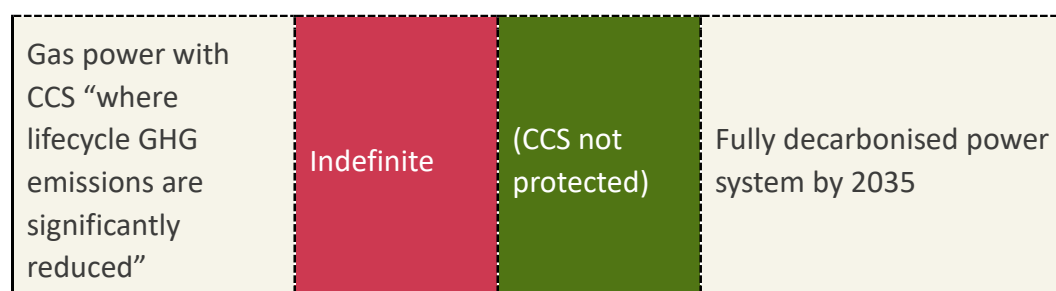


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New gas plants emitting <380g/kWh & “enabling the use of H2”	N/A	2030	New capacity needs to average <i>well below</i> 48g CO2e/kWh today
New hydrogen-ready gas plants but replacing oil/coal	N/A	Ten years after entry into force or 2040	New capacity needs to average <i>well below</i> 48g CO2e/kWh today
New pipelines “capable of transporting” H2	Maintain	Ten years after entry into force or 2040	Fully decarbonised power system by 2035 – one of top 3 users of pipeline system.
Gas power with CCS “where lifecycle GHG emissions are significantly reduced”	Indefinite	(CCS not protected)	New capacity needs to average <i>well below</i> 48g CO2e/kWh today
<b>All existing fossil fuel assets (upstream, midstream, and downstream) except:</b>	Ten years after entry into force or 2040	Ten years after entry into force or 2040	Fully decarbonised power system by 2035
Coal power	October 2024	Ten years after entry into force or 2040	No unabated coal power by 2030
Gas pipelines “capable of transporting” H2	Indefinite	Ten years after entry into force or 2040	Fully decarbonised power system by 2035 – one of top 3 users of pipeline system



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### Carveout for new investments

Both the EU and the UK have chosen to remove protections for new investments in all fossil fuel assets from August 2023 onwards. However, there are some very notable exceptions from upstream to downstream assets.

The IEA is starkly clear regarding investments in new fossil fuel production: they should have stopped last year across the world.<sup>9</sup> This milestone will obviously be missed if the cut-off date for new investments is next summer. Although it feels like a negligible miss, it might be very significant given for instance the strong push to approve in the North Sea,<sup>10</sup> as well as the growing voices in favour of new fields in the EU.

Regarding pipelines, LNG ports and other midstream assets, both the EU and the UK have introduced a very dangerous loophole: new “hydrogen-ready pipelines” will be protected until the early 2030s in the EU and indefinitely in the UK. The ECT simply requires pipelines to be “able to” or “capable of” transporting hydrogen to qualify for protection. This loophole thus maintains the current incentives to build new generation pipelines and LNG ports in Europe without ensuring they are net-zero-aligned. These investments would violate our climate goals without providing energy security.

Pipelines and other midstream assets have lifetimes well above 40 years. The power system is one of its main users (over 30% of gas demand in the EU is from power) — and the IEA benchmark clearly indicates this should switch to 100% clean power sources by 2035. Therefore, if pipelines are constructed now or refurbished to carry only small amounts of those gases, these investments will have a high risk of becoming stranded — risking a wave of ECT cases.<sup>11</sup>

<sup>9</sup> IEA, **Net Zero by 2050**.

<sup>10</sup> Dobson, **Plans for 29 new North Sea oil and gas projects in pipeline despite Cambo delay**.

<sup>11</sup> Even in that case, there is a stranding risk as the overall demand for hydrogen in power will be lower than for hydrogen in gas today if demand side flexibility and energy efficiency measures are taken up.



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We only need new hydrogen-only pipelines or investments into retrofitting the current stock to only hydrogen — unless the pipelines' life expires before 2035. The EU has explored ways to manage the risk of gas pipelines not transitioning to renewable fuels within other legislative files such as the TEN-E<sup>12</sup> and the EU Taxonomy<sup>13</sup> — the principles behind these standards are not met within the new ECT.

The most dangerous exceptions have been introduced for power generation. The EU will maintain ECT protections until 2030 for new investments in unabated natural gas plants “emitting less than 380g CO<sub>2</sub>e/kWh”, granting them some extra few years if they replace oil or coal plants. The only condition is that they “enable the use of” hydrogen, which is an even weaker language than the loophole for pipelines.

This emission intensity cap is incompatible with the IEA Net Zero scenario and would undermine the EU Climate Law. As a rule, to achieve any emission intensity average in the future, the average of new investments *must equal or go below* that target for at least 10-15 years prior (depending on infrastructure lifetimes, the rate of retirement/addition, and the level of emissions intensity of existing capacity).

The current EU's power generation average is 230g CO<sub>2</sub>e/kWh, while the 2030 goal of the Climate Law implies reaching an emissions intensity average of 110g CO<sub>2</sub>e/kWh.<sup>14</sup> E3G's assessment is that new EU capacity needs to average *well below* 48g CO<sub>2</sub>e/kWh today to reach the IEA net zero benchmark by 2035.<sup>15</sup> To reach this goal, every plant emitting just below 380g CO<sub>2</sub>e/kWh would have to be compensated by at least 12 times as much solar capacity.<sup>16</sup>

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<sup>12</sup> European Union, **TEN-E Regulation 2022/869**: “Any financing of those projects pursuant to Regulation (EU) 2021/1153 during the transitional period should be subject to a condition in the grant agreement to repay the financing in the case of a delay of the timely transition of the project to a dedicated hydrogen asset, and to adequate provisions allowing for the enforcement of that condition”.

<sup>13</sup> European Commission, **Taxonomy Delegated Act**: “the facility is designed and constructed to use renewable and/or low-carbon gaseous fuels and the switch to full use of renewable and/or low-carbon gaseous fuels takes place by 31 December 2035, with a commitment and verifiable plan approved by the management body of the undertaking”.

<sup>14</sup> European Environmental Agency, **Greenhouse gas emission intensity of electricity generation**.

<sup>15</sup> The detailed analysis was developed as part of E3G's contribution to the European Investment Bank (EIB) consultation on its “Climate Bank Roadmap 2021-2025”: **The European Investment Bank: Becoming the EU Climate Bank**.

<sup>16</sup> This is a very conservative estimate: new generation gas plants have a **minimum emissions intensity of 365g CO<sub>2</sub>/kWh**, while the least efficient solar PV plants have a life-cycle emissions intensity of 21g CO<sub>2</sub>/kWh.



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Ten or more years of ‘get out of jail’ cards for new unabated gas strongly undermines reaching the IEA milestones and is not a policy aligned with the Paris Agreement.

The bonus years of protection for replacing coal run against the shift in political consensus regarding gas as transitional energy, prompted by Russia’s invasion of Ukraine, and the widely shared assessment that a coal-to-renewable switch is a far better alternative – not only in climate, but also in energy security terms.<sup>17</sup>

The UK has instead chosen the route of Carbon Capture & Storage (CCS), protecting new investments in gas plants with CCS indefinitely. This is a hotly debated choice that is well-reflected in its Net Zero Strategy. However, even if assuming a scenario in which CCS is a viable technology that can be safely deployed at scale, the UK’s choice not to define a specific emissions threshold for gas with CCS is very problematic. The UK carveout instead requires that the lifecycle greenhouse gas emissions of a gas plant be “significantly reduced” by CCS, which ECT tribunals may abuse to extend unwanted protections to gas plants with suboptimal CCS.

### **Carveout for existing investments**

The need to protect the necessary policy space to reach the Paris Agreement goals becomes particularly relevant when assessing the carveout of protections for existing investments. Nominally the EU and UK will stop protecting current fossil fuel assets ten years after the new ECT’s annexes enter into force, so approximately by the mid-2030s. In the UK, however, current investments in gas power plants with CCS and hydrogen-ready pipelines will be kept *indefinitely*, in line with their exceptions for new investments.

The mid-2030s deadline may seem broadly aligned with the IEA targets to phase out coal, oil & gas power. However, this is a misinterpretation of how investment protection may interfere with countries’ efforts to reach their climate goals.

If protections for an energy source are still in place, any proactive intervention by a state to shape its energy system will almost certainly give grounds to an ECT case. Thus, while such protections last, the only means available to decarbonise

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<sup>17</sup> E3G, RAP, Ember & Bellona, [EU can stop Russian gas imports by 2025](#).





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an energy system is hoping that renewables win the head-to-head competition for investments with fossil fuels, slowly replacing existing assets. Any other policy option would risk triggering multi-billion compensations.

While cost signals may help phase out fossil fuels, they can hardly be trusted as the only means to decarbonise Europe's energy systems. It is important to give investors and other stakeholders visibility over the pace of phaseouts in order to reorient supply chains, help workers transition and avoid stranded assets. As the 2030 and 2035 deadlines approach, the need to test new tools and improve strategies to achieve this will only grow, particularly in the phaseout of unabated oil and gas, where carbon pricing will be less reliable.

**Leaving decarbonisation only to the market will result in very disorderly phaseouts that undermine all principles of the just transition and risk missing the IEA benchmarks.**

The Netherlands, Germany and other countries that have started to regulate the phaseout of coal power proactively have recognised this unreliability of the market. Unfortunately, their laws were dramatically challenged by fossil fuel investors under the ECT, demanding billions of euros in compensation.<sup>18</sup> A vast majority of European states have announced a phaseout of coal power by 2030,<sup>19</sup> nine of them before 2025 – although their plans vary in detail. This is also a commitment of the Powering Past Coal Alliance<sup>20</sup> and a goal of the Glasgow Power Breakthrough<sup>21</sup>.

Waiting until the mid-2030s to see how far the market pushes decarbonisation and then abruptly intervening to retire the remaining assets would be a great show of bad governance. Countries need to pre-empt that scenario by recouping enough policy space now, preparing well-governed and just phaseouts.

The UK Government has recognised this need by removing protections for existing coal assets after October 2024, which is aligned with its net-zero strategy. This begs an obvious question: why the same logic has not been applied

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<sup>18</sup> Climate Change Counsel, **The Energy Charter Treaty, Climate Change And Clean Energy Transition**.

<sup>19</sup> Europe Beyond Coal, **Europe's Coal Exit: Overview Of National Coal Phase Out Commitments**.

<sup>20</sup> Powering Past Coal Alliance, **Declaration**.

<sup>21</sup> Race to Zero, **Glasgow Power Breakthrough**.



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to all fossil fuels? Phasing out unabated oil and gas will certainly require similar interventions as coal.

## Conclusion

The carveouts from the new ECT proposed by the EU and the UK are not compatible with the Paris Agreement. Waiting until next summer to remove protections for new fossil fuel production may lead to frontloading the current investment pipeline. Moreover, the exceptions introduced by the EU and the UK create massive loopholes that investors and ECT tribunals can abuse to extend protections to investments incompatible with net zero, such as unabated gas plants, LNG ports and gas pipelines. Indeed, it is hard to imagine what relevant investment flows the EU and UK sought to exclude from the ECT given these loopholes.

Regarding the current investments in fossil fuels, the EU and UK will not reclaim enough policy space to ensure an orderly and just transition to a decarbonised power system. Their available policy toolbox will continue to be strongly limited by the risk of ECT litigation until the mid-2030s. Removing such protections immediately would show good governance and regulatory practice, while ensuring states have enough time to test and improve their decarbonisation strategies.

## About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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