Revealed: secret courts that allow energy firms to sue for billions accused of 'bias' as governments exit

Secret court set up under energy charter treaty accused of conflicts of interest, self-regulation issues and institutional bias

Demonstrators protesting against the energy charter treaty near the European Commission in Brussels earlier this year. Photograph: Anadolu Agency/Getty Images

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A secret court system that allows fossil fuel investors to sue governments for vast amounts of money has been accused of institutional bias, self-regulation issues and perceived conflicts of interest, as the drumbeat of EU countries leaving threatens to turn into a samba march.

On Wednesday, the EU will be meeting to discuss reform of the energy charter treaty (ECT) but at the end of last week, Germany became the latest European country to announce its intention to leave the treaty. Slovenia exited earlier in the week, after similar moves by France, the Netherlands, Spain and Poland. The UK is now one of the last large economies to remain in the ECT.

The ECT's investment arbitration courts were set up in 1998 to protect energy firms operating in former Soviet Union countries from government expropriation and regulation. They gave the companies the right to seek compensation if legislation or policies were enacted that could be seen as hostile, using the investor-state dispute mechanism that stirred up much public controversy during the negotiation of the Transatlantic Trade and Investment Partnership (TTIP).

The treaty has since been signed by more than 52 countries across Europe and central Asia, with oil, gas and coal firms being awarded more than $100bn by the ECT tribunals. The UK oil firm Rockhopper was recently awarded $190m in a case it brought against Italy, which is contesting the decision. As countries have sought to curb their emissions in line with the Paris climate agreement after 2015, the number of claims being brought has exploded. Renewables companies have also brought a number of cases.

As its signatories prepare for a crunch meeting in Mongolia on 22 November, the ECT is facing what one critic has called a "crisis of legitimacy" for several reasons, including how the tribunals are composed, feeding growing concerns over perceived conflicts of interest.

The ECT's tribunals can proceed under several systems, but the World Bank's International Centre for Settlement of International Disputes (ICSID) rules are most commonly used. The system is different to most national legal systems, which employ a publicly appointed and independent judiciary. ICSID's courts work with independent arbitrators appointed by the parties, but who may work in different roles for employers with conflicting interests within the system.

Each case is decided by a panel of three arbitrators: one appointed by the state, one by the investor, and a third who acts as president or chair and is selected by the other two arbitrators. The case is then argued before the panel by lawyers acting as counsel for each party. Cases are held behind closed doors, and there is no obligation to release the outcome. A choice of arbitrator can be challenged if a party disagrees, but there is no guarantee it will succeed.

“Double hatting” occurs when a lawyer takes more than one role across different cases – for example – sometimes acting as counsel for an investor, other times acting as a president, who is supposed to adjudicate independently.

An analysis of the cases brought so far under the ECT – carried out by the Guardian, the Transnational Institute and Powershift – has found that in a significant number of cases, an individual who had previously acted as an arbitrator appointed by an investor in one case was appointed to act as counsel (or advocate) for a party in another similar case.

Without full disclosure – which is one of the main reasons to challenge an arbitrator – there can be no guarantee that arbitrators have not had links to the law firm (or lawyers) acting as counsel in cases they are adjudicating, or that they have not acted as counsel in similar cases, leading to the risk of them prejudging the issues in play. Indeed, their reputations in this regard may lead some clients to seek them out.

Of the 191 arbitrators that have been nominated to sit in ECT hearings, just 37 elite lawyers – about 18% of the pool – have heard half of all the ECT’s cases. Seventeen members of this group have acted in the role of arbitrator and legal counsel, in the ECT and other investment courts.

Sixteen of the 17 arbitrators sat in fossil fuel cases – most were chosen by investors – and only three of the 37 have not sat in a fossil fuel-related arbitration panel.

Of the cases in which “double hatters” took part as arbitrators, 58% were won by investors, according to the analysis.

Under ICSID rules, arbitrators should be “persons of high moral character and recognised competence in the fields of law, commerce, industry or finance, who may be relied on to exercise independent judgment”.

However, these rules are self-regulated by the arbitrators – critics say they are unenforceable – and the successful removal of arbitrators is rare. In Spain, for example, just one proposed ECT arbitrator has been blocked, out of 19 challenges.

Many arbitrators believe they can separate the different roles they may play in different cases.

Klaus Sachs, an ECT-focused arbitrator based in Munich, said that "as in every profession, excellence is a way to success and among those arbitrators who are in high demand, you have very qualified people. They are very good lawyers."

There was, he added, "a lot of new talent coming in and so the market is changing as a new generation enters the field".

However, critics argue this is a recent and overstated trend. They say that allowing parties to appoint arbitrators who have acted as counsel in similar cases opens up what Lucía Bárcena, of the Transnational Institute, called "a Pandora's box of conflicts of interest".

It has also caused "long-running and heated debate within the international commercial arbitration community", according to a 2017 study. In it, the international legal expert Philippe Sands asked whether a lawyer could impartially wear the hat of an arbitrator in the morning and counsel in the afternoon. "Speaking for myself, I find it difficult to imagine that I could do so," he said.

George Kahale III, the chair and partner of the law firm Curtis, Mallet-Prevost, Colt & Mosle, which represents states in international arbitration cases, said the small number of arbitrators available to states also caused "a clear structural bias" toward investors in the ECT's courts.

"The pool of arbitration candidates who I would consider to be 'straight shooters' … is very, very small, whereas the pool of investor-friendly arbitrators is as wide as the Pacific Ocean," he said, over a video call from New York.

Kahale, an ECT veteran, said he had sat in many ISDS cases where he knew what the outcome of a tribunal would be as soon as he saw its composition.

"There's virtually no chance of getting someone from that small pool [of arbitrators] that states would normally consider appointing," he said.

Defenders of the system say the pool for defending states is filled with “very prominent and good arbitrators”, and it is “relatively large”, albeit smaller than that for investors.

“When it comes to the chair, obviously it becomes more complicated,” Sachs said. “But I don’t think, when a party learns that I’ve been appointed chair of a case, that they know what the outcome will be, and I feel that is true for a large majority of the real professional arbitrators.”

Sachs stressed that challenging arbitrators could be a lawyerly tactic and that “in most cases, the decisions are well-reasoned and balanced”. But he accepted that arbitrators were “not often” removed under challenge.

Kahale said that factoring in all of this – and what he called “a virtual explosion” in the size of damages claims – the result was “a crisis of legitimacy within the [ISDS] system”. That view is shared by Sands.

Laurence Tubiana, one of the architects of the Paris deal and the chief executive of the European Climate Foundation, said the analysis “clearly shows that the energy charter treaty’s court system reeks of potential conflicts of interests which favour fossil fuel investors and threaten the Paris climate agreement. Once again, the oil and gas industry has found ways to control the game.”

Within a system that could shower fossil fuel investors with more than a trillion dollars of compensation pay-offs by 2050, there are widespread fears the ECT could spark what the UN Intergovernmental Panel on Climate Change (IPCC) called “regulatory chill” at just the moment new climate laws are needed.

“The energy charter treaty is not consistent with the Paris agreement,” said Patrice Dreiski, a former ECT executive. “The main goal of the ECT is to promote and protect fossil fuels investment, which is not at all the goal of the Paris agreement.”

To date, investors have won 64% of concluded ECT cases, three-quarters of which covered the fossil fuel sector, according to the analysis.

The data was compiled mostly by the Transnational Institute from the UN Conference on Trade and Development database, the ECT’s own overview of cases, the ICSID and Permanent Court of Arbitration databases that administer

disputes, public tribunal documents published on italaw.com and specialised media.

The impression of a legal web geared to structurally benefit fossil fuel investors may even be reflected within the ECT secretariat itself, which promotes ECT conferences, oversees treaty rules, and provides institutional support to achieve the ECT's objectives.

Almost three-quarters (72%) of experts on the secretariat's industry advisory panel – which provides policy advice to the body with "a particular focus on risk mitigation and improvement of the business climate" – also work for fossil fuel companies or their financial beneficiaries.

Guy Lentz, the secretary general of the ECT secretariat and a former Shell executive, accepted that the panel was "structurally biased", but added: "We want many more renewable energy companies. We are working really hard on that, but it takes time."

Fabian Flues, a trade and investment adviser for the Berlin-based non-profit Powershift, said the analysis showed the ECT was "dominated by interests with a stake in maintaining the highly lucrative system of investment arbitration. It enables them to rake in huge fees, often coming out of taxpayers' pockets."

France becomes latest country to leave controversial energy charter treaty

However, disquiet at the treaty's threat to timely climate action has now spurred Brussels to propose phasing out the ECT's writ within the EU's border, even as the bloc's own members queue up to jettison the pact.

It appears, however, that the UK will not be joining that queue. A government spokesperson said only that signatories "will decide whether to adopt the modernised energy charter treaty at the energy charter conference on 22 November".