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The German lignite phase-out contract and investment arbitration

Briefing

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Summary

International investment agreements (IIAs) typically allow investors to bring claims against host states for alleged violations of such agreements. Investors have used investor-state dispute settlement (ISDS) proceedings against environmental legislation or other environment-related regulation (e.g. environmental requirements in permits) in the past. They have also used the mere threat of bringing (costly) proceedings in order to push for less ambitious environmental regulation. Germany is a party to a number of bilateral investment treaties (BITs) as well as to the Energy Charter Treaty (ECT), which also contains ISDS clauses. The existence of these IIAs poses the risk of coal companies bringing ISDS challenges in the context of the German coal phase-out.

The German parliament adopted a coal phase-out law on 3 July 2020. The law stipulates that the German government can negotiate a contract with lignite operators on the details of the phase-out. In view of the ISDS-related risks, the draft version of this contract contains a clause according to which lignite operators waive their right to bring an ISDS claim in the context of the German coal phase-out. This briefing discusses the waiver clause, with a view to informing German policy-makers on its strengths and weaknesses as well as contributing to the debate on a coal phase-out in other countries.

The briefing finds that regulating the details of the lignite phase-out law by law would be preferable to agreeing on them in a contract with the lignite operators. At the same time, only the conclusion of a contract makes it possible to oblige lignite operators to agree to not using certain legal remedies, including ISDS. The waiver clause is relatively comprehensive and – importantly – allows the German government to stop paying compensation to lignite operators for closing down their operations and claim back payments already made, should companies resort to investment arbitration in violation of their obligations from the waiver clause. This considerably reduces risks that lignite operators could resort to investment arbitration in the context of the German coal phase-out.

However, significant loopholes and limitations remain. Most importantly, shareholders of lignite companies are not bound by the contract and its waiver clause; foreign shareholders could thus initiate arbitration proceedings. Moreover, it is uncertain whether investment tribunals would take into account the waiver clause and decline jurisdiction. Also, the exact scope of application of the contract and the waiver clause is unclear.

1 Introduction¹

Germany's coal phase-out law was adopted by the German parliament (*Bundestag*) in July 2020.² The law allows the government to conclude a contract with lignite operators with the aim of agreeing on the details of the phase-out, including a waiver of legal remedies.³ Correspondingly, the German government has negotiated a draft contract with these operators. Before the government concludes the contract, it will have to be approved by the *Bundestag*; the final decision is expected for early autumn 2020.

The rationale for concluding contracts with lignite operators (instead of regulating all details of the coal phase-out by law) is achieving legal and planning certainty regarding the coal phase-out. Since contracts require the consent of operators, it is hoped that concluding contracts will reduce the risks of legal action by companies. To these end waiver clauses through which the operators commit to not using certain legal remedies have been included in the contract.

Germany is a party to a considerable number of IIAs that allow foreign investors to sue Germany before private investment arbitration tribunals over alleged breaches of investment agreements,⁴ including the ECT. From an environmental perspective, it is desirable to minimise any legal risks to the coal phase-out in Germany from ISDS challenges. The coal phase out already comes much too late, with the end date for coal set as late as 2038. Furthermore, no taxpayers' money in excess of the amount already agreed should be paid to operators for phasing out coal, which is the most harmful source of energy from a climate change point of view. The sum of money agreed as compensation to operators in Germany (€ 4.35 billion overall) does – already now – not reflect the economically dire situation of lignite.⁵ Also, negative precedents concerning the "costs" of a coal phase-out need to be avoided in order to not discourage other governments from taking measures to phase out coal.

Therefore, it is in principle, positive that the contract with the lignite operators includes a waiver on ISDS. However, as will be discussed below, agreeing on the details of the lignite phase-out in a contract with operators rather than regulating them by law is a questionable choice in several respects. Moreover, the waiver clause comes with certain loopholes and limitations; notably, the contract and its waiver clause do not – and cannot – bind shareholders of the lignite companies. These issues are explored in the remainder of this briefing.

Section 2 discusses the risks of ISDS challenges in the context of the German coal phase-out. Section 3 contains a translation of the relevant parts of the contract with lignite operators. Section 4 contains a general assessment of the waiver clause. Section 5 provides a legal assessment of three specific future scenarios under the waiver clause. Section 6 contains recommendations for improving the waiver clause. Section 7 concludes.

¹ The authors thank Brooke S. Gueven, Matthew Porterfield and Christiane Gerstetter for invaluable comments on an earlier draft version of the briefing.

² Legal text available (in German) at <https://dip21.bundestag.de/dip21/btd/19/173/1917342.pdf>

³ Available (in German) at https://www.bmwi.de/Redaktion/DE/Downloads/M-O/oeffentlich-rechtlicher-vertrag-zur-reduzierung-und-beendigung-der-braunkohleverstromung-entwurf.pdf?__blob=publicationFile&v=4

⁴ See for an overview <https://investmentpolicy.unctad.org/country-navigator/79/germany>

⁵ ClientEarth, No money for old lignite - Is compensation for German lignite operators legally possible?, October 2019, <https://www.documents.clientearth.org/wp-content/uploads/library/2019-10-28-no-money-for-old-lignite-clientearth-legal-analysis-ce-en.pdf>.

2 The risk of ISDS challenges in the context of the German coal phase-out

In recent years, there has been a marked increase in the number of ISDS proceedings. By the end of 2019, there were 674 publicly known⁶ and concluded cases. 37 % of these cases were decided in favour of the defending state and 29 % in favour of the investor. 21 % of the cases were settled, with the content of the settlement being unknown in most cases.⁷ Environment-related measures were at stake in 15 % of known cases between 1987 and 2015.⁸

When winning a case, an investor is usually awarded a certain amount of money as compensation for the violation of the IIA. In cases decided in favour of investors, the average amount claimed by investors was \$ 1.35 billion and the median \$ 113 million. The average amount actually awarded was \$ 522 million and the median \$ 19 million.⁹ Even when winning, the costs of participating in arbitral proceedings can be high for governments, since – different from what often happens in proceedings before national courts – the costs of the proceedings (including those of hiring external lawyers) are not necessarily imposed on the losing party. Moreover, such proceedings also require capacities and staff time in public administrations. In view of the considerable financial risks, the piece-meal case law and the relatively unpredictable outcome of cases, foreign investors sometimes use the mere existence of ISDS as a threat to put pressure on governments and improve their negotiating position. Uniper's threat of challenging the Dutch coal phase-out via ISDS is a pertinent example.¹⁰

So far, Germany has only been involved in four publicly reported ISDS proceedings, two of them still ongoing.¹¹ One of the past cases concerned the Moorburg coal plant; its operator Vattenfall challenged the German government over an environmental permit. The case was settled after the local government had decided to revise the permit and make the environmental conditions more lenient.¹² One of the

⁶ Depending on the procedural rules under which a case is decided, its existence may not become public.

⁷ For the statistical figures (covering the time period 1987-2019), see UNCTAD, World Investment Report 2020, https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf, p. 111f. The remaining cases were discontinued. Given that settlements in investment arbitration are essentially a compromise from both sides, they are likely to involve some concessions from the defendant state; in environment-related cases this could mean a lowering of environmental standards for investors.

⁸ Tarald Laudal Berge and Axel Berger, 'Do Investor-State Dispute Settlement Cases Influence Domestic Environmental Regulation? The Role of Respondent State Capacity', SSRN Scholarly Paper, 2020, 3, <https://doi.org/10.2139/ssrn.3522366>.

⁹ Figure for 1987 - July 2017, see Special update investor-state dispute settlement: fact and figures, p. 5, https://unctad.org/en/PublicationsLibrary/diaepcb2017d7_en.pdf. The substantial difference between median and average amounts is due to exceptionally high amounts of damages being awarded in a small number of cases.

¹⁰ Forbes, "Dutch Lawmakers Under Pressure Over Coal Phase-Out", 2 December 2019, <https://www.forbes.com/sites/davekeating/2019/12/02/dutch-lawmakers-under-pressure-over-coal-phase-out/#3067c6ce4dc8>; ; EJIL:Talk!, "Risky business: Uniper's potential investor-state dispute against the Dutch coal ban", 18 March 2020, <https://www.ejiltalk.org/risky-business-unipers-potential-investor-state-dispute-against-the-dutch-coal-ban/>

¹¹ See <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/78/germany/respondent>. The low number of cases could be related both to and the fact that it is very strong on exports (rather than attracting foreign direct investment) as well as being a rule-of-law state with significant regulatory capacity. Again, since the proceedings are not necessarily public, there could be more proceedings in which Germany is involved, without this having become public.

¹² Vattenfall v. Federal Republic of Germany, ICSID Case No. ARB/09/6, <https://www.italaw.com/cases/1148>.

pending cases concerns the nuclear phase-out in Germany.¹³ These cases show that Germany is, in principle, also vulnerable to ISDS challenges.

In the context of the lignite phase-out, the contracts will likely be concluded with RWE (the main lignite operator in the Rhineland mining area in the west of Germany), LEAG/EPH companies (the main operator in the Lausitz mining area in the East of Germany) as well as a number of other companies. While RWE's lignite business in Western Germany is carried out by companies registered in Germany, the institutional investors of RWE AG are predominantly from abroad.¹⁴ LEAG, the main lignite operator in Eastern Germany, also has foreign investors behind it. The two operative businesses of LEAG are registered under German law, with another company registered in Germany as their holding and majority owner. However, this holding is owned 100 % by a company registered in Czech Republic, LEAG Holding a.s. Behind it is a network of Czech companies, including EPH. In 2016, EPH purchased the lignite operations from Vattenfall. In February 2020, EPH furthermore acquired Schkopau, Uniper's last lignite unit in Germany. Thus, there are foreign investors with shares in the lignite companies that could, in principle, initiate ISDS proceedings against Germany.

As pointed out above, Germany is a party to a considerable number of IIAs, including the ECT.¹⁵ As a consequence of the landmark *Achmea* ruling of the Court of Justice of the European Union (CJEU),¹⁶ 23 Member States of the EU, including Germany and the Czech Republic, have recently agreed on a treaty to terminate all bilateral investment agreements between them.¹⁷ In a declaration issued in January 2019, a majority of Member States, including Germany, moreover committed themselves to informing the investor community that "no new intra-EU investment arbitration proceeding should be initiated" as a result of the *Achmea* ruling. The declaration specified that the application of the ISDS clause in Article 26 of the ECT between EU countries is incompatible with EU law.¹⁸ However the ECT and investors continue to rely on it. So far, arbitration tribunals have found they are not bound by the CJEU ruling; none of them have declined competence in intra-EU ISDS proceedings, whether based on intra-EU BITs or the ECT.¹⁹ Therefore, there is a risk that investors could use either the ECT or bilateral investment treaties with non-EU countries to bring claims against Germany in the context of the German coal phase-out.

¹³ *Vattenfall and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12, <https://www.italaw.com/cases/1654>.

¹⁴ See Shareholder structure of RWE AG, <https://www.group.rwe/en/investor-relations/the-rwe-share/shareholder-structure>

¹⁵ See for an overview <https://investmentpolicy.unctad.org/country-navigator/79/germany>

¹⁶ Judgement of 6 March 2018, *Slovak Republic vs. Achmea*, C-284/16. The CJEU decided that intra-EU investment treaties were against EU law.

¹⁷ Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union, signed on 5 May 2020, https://ec.europa.eu/info/publication/200505-bilateral-investment-treaties-agreement_en. The agreement will enter into force once two member states have ratified it, but any given intra-EU BIT will only be terminated after 30 days after the last of the Member States parties to that BIT deposits its instrument of ratification.

¹⁸ Declaration of the Member States of 15 January 2019 on the legal consequences of the *Achmea* judgment and on investment protection, https://ec.europa.eu/info/publications/190117-bilateral-investment-treaties_en

¹⁹ Investment agreements contain rules determining the responsibility of the tribunals; however, they are formulated in a general manner, giving tribunals a certain leeway to decide whether or not they consider themselves competent in a certain matter. It is not unusual for international tribunals to do without regard to decisions of national courts.

3 The waiver clause in the contract with lignite operators

In order to prevent lignite operators from bringing ISDS claims in the context of the German coal phase-out, the draft contract contains the following clauses:²⁰

§ 21 Modification in the event of a significant change in circumstances

1) If, after the conclusion of this contract, circumstances significantly change to the detriment of one contracting party, the present § 21 regulates the legal consequences of such a significant change. A significant change according to the first sentence shall be deemed to exist if a party to the contract cannot reasonably be expected to adhere to the original contractual provision due to a change in circumstances, in particular due to a regulatory intervention, taking into account all circumstances of the individual case, in particular the contractual and statutory distribution of burdens and risks, which includes the developments associated with that significant change that relieve the burden on the respective party. Taking into account also potential positive developments for the contracting party, such a significant change only occurs in the following cases:

a) Subsequent earlier closure of lignite facilities unless they take place in the context of an earlier closure pursuant to § 22 (2), which has been decided on in accordance with § 22 (2) lit. a) at least five years before the date on which the respective lignite-fired plant is to be closed prematurely,

b) *[Introduction of a CO2 price targeted specifically at lignite emissions]*

c) *[Declaration by the EU Commission of incompatibility with EU law of the compensation to be paid to lignite operators according to the coal]*

d) *[Annulment by an EU court of a permit under EU subsidies law to pay the compensation to lignite operators according to the coal]*

e) other regulatory interventions which significantly affect the relationship of equivalence embodied in this contract; the regulatory intervention is in any case only relevant if it is aimed at and has the direct effect of pushing lignite plants, refineries or opencast mines out of the market and of putting them at a considerable and specific disadvantage compared to other forms of energy generation, with the disadvantage not resulting solely from a proportional additional burden due to the high emission intensity or any other, comparable specific feature of the lignite plants, refineries or opencast mines.

[Clause on procedure]

(2) *[Clause on what constitutes a possible modification of the contract in case of a significant change in circumstances]*

3) Upon receipt of a written request for a modification of the contract pursuant to paragraph (2), the parties concerned shall enter into good faith negotiations on a modification of the contract. If no modification of the contract is agreed on within twelve months of the receipt of the written request for a modification, the contracting parties shall have the right to take legal action before German public courts

²⁰ The legal text has been translated by the authors; it is not an official translation. Parts of the German legal text that are clearly irrelevant for the questions discussed in this briefing have not been translated to English. In the cases of such omissions, either a brief explanation in square brackets and italics on what has been omitted has been added in the English text or the omission is marked by [...].

to enforce the request for modification of the contract. [Modification also possible only between the government and one other party].

4) Subject to paragraph (5), changes in circumstances other than the significant changes referred to in paragraph (1) shall not give rise to a claim by a party for a modification of the contract under paragraph (2). Such insignificant changes shall be deemed to exist in particular in the following cases:

a) *[Changes to CO2 pricing models]*

b) *[Changes regarding support for power plant capacities and/or low-emission power generation with the aim of decarbonising power generation in Germany]*

c) *[Changes in the taxation of energy sources and similar]*

d) *[Implementation of relevant EU BAT conclusions]*

e) *[Modification of EU rules on coal used for electricity production in the framework of the Energy Tax Directive 2003/96]*

5) The provision of in para 4, first sentence shall not apply if changes deemed as insignificant for purposes of this contract, as listed in para. (4) second sentence in an exemplary manner, in their specific form exceptionally amount to an “other regulatory intervention” according to para (1) lit. b) or e) and thus to a significant change in circumstances. Sentence 1 does not apply to the implementation of relevant EU BAT conclusions).

§ 22 Comprehensive regulation

1) The Contracting Parties express their agreement that, as long as there is no significant change in circumstances in accordance with § 21 (1), the compensation provided for in § 44 of the coal phase-out law shall be deemed to cover all possible claims and entitlements of the plant and opencast mine operators under national law or EU law or international law, irrespective of their legal basis, known or unknown, already accrued or not yet accrued, in the context of the final closure of their lignite plants in accordance with the schedule for closures until 2038 and beyond. This also includes the recultivation costs for the open-cast lignite mines as well as the costs of changing plans and approvals of the opencast mines.

2) The lignite-fired plants that, according to the schedule for closures, are due to close later than 2030 - with the exception of lignite-fired plants which are part of the lignite reserve - may, on the basis of decisions by the Federal Republic of Germany, be permanently closed up to three years earlier than is provided for each respective lignite-fired plant in the schedule for closures (“earlier closure”): The following applies to earlier closures:

a) The earlier closure of a lignite facility is not compensated if the Federal Republic of Germany decides on the earlier closures at least five years prior to the date of the earlier closure of the respective lignite-fired plant.

b) Until any early closures the plans of the plant and opencast mine operators assume that the closure will be carried out at according to the dates specified in the schedule for closures. *[Right of operators to be heard before decision on earlier closure]*.

c) *[Clause on what happens when the last facility of an operator is closed earlier than 2038]*

In all other respects, the contracting parties agree that the closures in accordance with the schedule for closures existing at the time of the conclusion of the agreement – subject to § 21 in the event of future significant changes of circumstances and the provisions of this paragraph (2) – are to be understood as a final contribution of the plant and opencast mine operators to the reduction and phase-out of lignite-based electricity generation concerning the lignite facilities mentioned in the schedule for closures.

(3) *[Rules on compensation for plants that are part of the lignite reserve]*

§ 23 Waiver of legal remedies

1) The companies shall refrain from using any form of legal remedy whatsoever and on any basis whatsoever to challenge measures taken on the basis of the coal phase-out law or parts thereof, to the extent that these are related to reducing and phasing-out lignite-based electricity generation ... [no claims based on lack of validity or constitutionality of coal phase-out law].

2) Furthermore, the companies waive any legal remedies of any kind and on any basis whatsoever against the obligations arising from this contract, in particular with regard to the obligations to close lignite plants pursuant to § 1 and § 4 and against any further obligations arising from the closure, and will not base any claims, even implicitly, on the alleged invalidity or partial invalidity of this contract.

3) The companies shall also waive any other legal remedies of any kind and on any basis whatsoever vis-à-vis the federal government and the states and their bodies and authorities which are directly or indirectly connected with the final closure of the lignite facilities.

4) Notwithstanding paragraphs (1) to (3), only the legal remedies described below shall remain admissible before public courts in the context of the reduction and phase-out of lignite-based electricity generation:

a) legal remedies against a reduction of the compensation provided for in [§ 44 coal phase-out law] with particular regard for the contractual equivalence defined in § 20 paragraph (1),

b) legal remedies aimed at securing the fulfilment of obligations under this contract and obligations under the coal phase-out law in connection with the reduction and phase-out of lignite-based electricity generation

c) legal remedies aimed at a modification of the contract in accordance with contract with § 21 (1) in conjunction with (2), including the cases of § 21 (5) first sentence

d) legal remedies with regard to changes in circumstances or related measures covered by § 20 (2), first sentence or § 21 (4), to the extent that they are not based on the coal phase-out law in its version adopted on [...] or a version with identical content, this contract or the rights and obligations regulated therein or related burdens; with the exception of earlier closures decided in good time in accordance with § 22 (2) lit. a)

e) *[Legal remedies concerning decisions of Appeals against decisions of the Bundesnetzagentur]*

f) *[Legal remedies against planning decisions and decisions on permits]*

(5) The companies undertake to ensure that no other company controlled by them within the meaning of §17 of the German Stock Corporation Act (AktG) brings claims or uses legal remedies, which the companies have waived in accordance with paragraphs (1) to (3).

(6) If one of the companies or a company they control in accordance with the meaning of § 17 of the German Stock Corporation Act (AktG) violates its obligations under paragraphs (1) to (3) or (5), the company shall reimburse the legal fees actually incurred by the Federal Republic of Germany and the respective states for legal defense (in particular necessary attorney and expert fees), but at least the fees as defined in the law.

(7) *[Extension of clauses to states]*

§ 24 Exclusion of investor-state arbitration

(1) The Federal Republic of Germany is of the opinion that EU law, in particular Articles 267 and 344 TFEU, excludes arbitration proceedings under international investment law in intra-EU relations arising out of or relating to bilateral or multilateral investment agreements, including the Energy Charter Treaty.

(2) Without prejudice to the other provisions and rights from this contract and legal remedies permitted under it, the companies waive their right to seek legal remedies under international investment law before international arbitration tribunals or to initiate corresponding arbitration proceedings against the Federal Republic of Germany arising out of or relating to rights and obligations under this contract and/or coal phase-out law. This obligation extends in particular to arbitration proceedings arising from or relating to rights under the Energy Charter Treaty, to the rights of the companies and the enterprises they control under Art. 26 of the Energy Charter Treaty, and to any potential rights under other bilateral or multilateral investment agreements.

(3) The companies are obliged to ensure that no other of their controlled enterprises within the meaning of § 17 of the German Stock Corporation Act (AktG) brings claims or uses legal proceedings, which the plant operators have waived in accordance with para (2).

(4) The contracting parties agree that the companies shall also waive any other claims or entitlements arising from or relating to the Energy Charter Treaty or bilateral or multilateral investment agreements to the extent that they are connected to the obligations arising from this contract or the coal phase-out law, without prejudice to other provisions and rights stipulated in this contract or other interests protected by a law or the constitution. The Federal Republic of Germany hereby agrees to this waiver.

(5) If one of the companies or one of its controlled enterprises within the meaning of § 17 German Stock Corporation Act violates its obligations arising from paragraphs (2) to (4), the claim for compensation of RWE Power or LEAG KW, depending on whether the violating company belongs to the group of RWE Power or LEAG KW, shall be forfeited (§ 10). The Federal Republic of Germany is entitled to immediately stop the payment of compensation (§ 11) and to demand its return.

6) *[Extends waiver clause to federal states]*

4 How robust is the waiver clause?

In this section we offer a general assessment of the waiver clause concerning arbitration as contained in § 24 of the contract.

To begin with, it should be noted that the waiver clause is only possible, because the German government has decided to conclude contracts with lignite operators, rather than simply regulating all

details of the phase-out by law. Using a contract rather than regulation has a number of disadvantages from an environmental point of view as: Using a contract can be an obstacle for future climate policy; it is moreover questionable from the viewpoint of democratic decision-making since contracts are subject to weaker transparency requirements or procedural rules than legislation.²¹ The German government has – so far – not disclosed how the amounts of compensation paid to lignite operators are calculated and which assumptions they are based on. The amount is, however, very high given that lignite is no longer a very profitable source of energy.

That being said, the fact that a waiver clause has been included in the contract is a good thing. As explained above, there are general legal risks with regards investment arbitration in the context of the German coal phase-out. The waiver clause is an important step toward addressing and reducing these risks. The explicit inclusion of the ECT into the waiver clause is helpful in this respect.

It is, in principle, possible for states and companies to agree in a legally binding way to waive a company's right in regard to investment arbitration. Tribunal decisions in the last two decades have indicated that investors can waive their right to ISDS for both treaty and contract-based claims if the contract clause is sufficiently clearly worded and explicit.²² The underlying idea is a consent-based model of arbitration. Accordingly, each state party to an investment agreement unilaterally commits to agreeing to future ISDS proceedings. Until filing a claim, an investor does not have a fully vested right to utilize the ISDS mechanism; it merely can accept the unilateral offer of consent from the host state in the relevant international investment agreement. This consent-based arbitration model makes an investor the direct beneficiary of the treaty relationship between its home and its host state, but also provides for an opportunity to limit the extent of those investor privileges.

When assessing the clause in greater detail, a first important question is the relationship between § 23 and § 24 of the contract, since both contain a legal waiver. Unfortunately, the contract does not explicitly clarify the relationship between both clauses; doing so would have enhanced legal certainty. However, because § 23 relates to all types of legal remedies, § 24 relates to a specific type of legal remedy, i.e. international investment arbitration, it can probably be argued that § 24 is the more specific clause as compared to § 23 and would thus take precedence when investment arbitration is concerned.

It should, however, be noted that the clauses differ in one important respect: § 23 (5) stipulates that the companies will have to pay the legal fees of the Federal Republic of Germany if they violate their obligations from the § 23 and initiate proceedings. Conversely, in the case of investment arbitration, the legal consequence of companies not complying with the waiver clause is, according to § 24 (5) the stop of any compensation payments. While it is not immediately clear why the two clauses stipulate different legal consequences when companies violate their obligations from the respective waiver clause, the consequence set forth in § 24 – i.e. compensation payments being stopped and re-payment being requested – appears to be the more severe negative consequence, given the amounts of compensation defined in the contract. It is generally positive that companies face the consequence of no longer receiving compensation payments and/or having to pay back compensation already received. Since it is unclear to which extent investment arbitration tribunals consider themselves to be bound by domestic legal decisions and acts such as the contract between the German government and lignite operators, it

²¹ See ClientEarth, Öffentlich-rechtlicher Vertrag mit Braunkohlebetreibern: Wesentliche Kritikpunkte aus rechtlicher Sicht, Juni 2020, <https://www.documents.clientearth.org/library/download-info/offentlich-rechtlicher-vertrag-mit-braunkohlebetreibern-wesentliche-kritikpunkte-aus-rechtlicher-sicht/>

²² See *Aguas del Tunari S.A. v. Bolivia*, ICSID Case No. ARB/02/3 and *MNSS v. Montenegro*, ICSID Case No. ARB(AF)/12/8, <https://www.italaw.com/cases/57>

is very important that the German government has a contractual avenue for reacting when companies do not comply with the terms of the waiver clause.

It is also positive that the companies' obligations from the waiver clause in § 24 extend to companies they control, i.e. their subsidiaries. § 24 (3) refers to the definition of subsidiaries or "controlled companies" in § 17 of the Stock Corporation Act. § 17 (2) stipulates a presumption that a company, the majority of the shares of which are held by another company, is a subsidiary or "controlled company". If the obligations from the contract were not extended to subsidiaries, the companies could establish subsidiaries that, not being parties to the contract themselves and its waiver clause, could initiate arbitration proceedings in the context of the coal phase-out. However, it should be noted that the contract does not – and cannot²³ – stipulate any obligations for the shareholders of the companies signing the contract; as discussed in the next section, this constitutes a loophole with regards investment arbitration in the context of the German coal phase-out.

In terms of how the contract is worded, some of the clauses refers in various instances to "the companies" in the plural. This could – in the worst case – be used by the companies to argue that they only have a collective responsibility in certain regards.

It is also noteworthy that the waiver clause does not explicitly include later modifications of the coal phase-out law. This might open a door to arbitration proceedings if the coal-phase out law is later modified, unless the contract is also adjusted whenever the law is.

Finally, it should be noted that the scope of the waiver clause is determined by the interpretation of the clause "arising out of or relating to rights and obligations under this contract or the coal phase-out law" in § 24 (2) of the contract, amongst other things. Should a company that is a party to the contract initiate investment arbitration and argue that its claim does not arise out of or relate to rights and obligations under this contract or the coal phase-out law, it would be for the investment tribunal to interpret that clause; the tribunal could thus determine the scope of the waiver at least to a certain extent.

5 Specific issues

In this section we present three hypothetical, but realistic scenarios of actions by the German government on the one hand and the lignite operators and their shareholders on the other. We discuss whether the waiver clause would likely prevent the use of investment arbitration in these scenarios. We discuss the following three scenarios (1) foreign stakeholders of lignite companies that have signed the contract seeking to initiate arbitration proceedings, (2) earlier coal phase-out involving earlier closure of lignite coal plants and (3) changes in water-related regulation affecting lignite plants, and (3).

5.1 Stakeholders of lignite companies initiating arbitration proceedings in the context of the German lignite phase-out

Our first scenario is that (foreign) stakeholders of one of the lignite companies (rather than the company itself) intend to initiate investment arbitration with a view to obtaining (additional) compensation for a

²³ The reason is that the lignite companies do not hold any legal control over their shareholders. They can thus not assume any legal obligations concerning actions of their stakeholders.

decision taken by German policy-makers or authorities in the context of the German coal phase-out and affecting a lignite operator.

As explained above (section 4) foreign stakeholders, which lignite companies such as for example RWE do have, are not bound by the waiver clause in the contract. This does not automatically mean that they can resort to investment arbitration, however. They can only do so if they are investors in the sense of international investments agreements that the German government has concluded, notably the ECT.

With regards bilateral investment treaties, a conclusive legal assessment would require an analysis of each investment treaty and the definition of investor contained therein, which is beyond the scope of this briefing. In the ECT, Art. 1 (6) lit. b explicitly includes in the definition of investments protected under the ECT “*shares, stock or other forms of equity participation in a company or business enterprise*” and lit. e “*returns*”. The ECT’s broad definition of investment thus covers, in principle, the kind of investment that the stakeholders of lignite companies active in Germany have made. These (foreign) stakeholders can thus bring arbitration claims against Germany relating to decisions taken in the context of the German coal phase-out.²⁴ Indeed, it has been observed that claims by company shareholders seeking damages from governments now account for a “substantial part” of ISDS proceedings.²⁵

As pointed out above, investment tribunals have – despite the *Achmea* judgment of the CJEU – continued to take decisions in intra-EU investment arbitration as well; thus even stakeholders from another EU country could initiate such investment proceedings.

Whether or not such claims would be successful would depend, of course, on a finding of the investment tribunal that Germany has violated any of its investment-related obligations under the ECT (or a bilateral IIA). In this context, it is noteworthy that shareholders have regularly been awarded damages for so called “reflective loss” by investment tribunals, i.e. loss incurred as a result of injury to the shareholders’ company, typically in the form of a decline in the value of the shares. This is in contrast to national corporate laws that usually do not allow shareholders to claim damages for reflective loss.²⁶

5.2 Earlier closure date for lignite facilities

Our second scenario is a decision by a future German government/parliament decide to accelerate the lignite phase-out in Germany, which would be very desirable from a climate point of view. Such an earlier phase-out would involve earlier closure dates for individual coal plants. The coal phase-out law defines exact points in time at which each of the lignite facilities currently in operation will have to close down.

§ 22 (2) of the contract stipulates that lignite facilities can be closed three years earlier than planned without the amount of compensation being adjusted, if the corresponding decision is taken by the government five years before the original closure date. Such an earlier closure would not amount to a

²⁴ Investment tribunals have recognised in many cases that foreign shareholders, including minority shareholders, can initiate investment proceedings themselves if they consider that a host state’s behaviour of the company they hold shares in is incompatible with an IIA. This is very clear when an IIA states explicitly that a share constitutes an “investment” in the sense of the respective treaty, as the ECT does. Tribunals have accepted such cases even in cases where a share was not explicitly defined as constituting an investment, however, see Abby Cohen Smutny, Claims of Shareholders in: Christina Binder, Ursula Kriebaum, August Reinisch, and Stephan Wittich (eds): International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer, Oxford University Press, 2009, pp. 363 – 376.

²⁵ David Gaukrodger (2013), “Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency”, OECD Working Papers on International Investment, 2013/03, OECD Publishing, <http://dx.doi.org/10.1787/5k3w9t44mt0v-en>, p. 3.

²⁶ See Gaukrodger (2013), *ibid.*

significant change in circumstances. Any other earlier closure of a power plant will be considered to amount to a significant change in circumstances; § 21 (2) and (3) define a procedure for how parties are to negotiate a modification of the contract in the case of such a significant change in circumstances. Only if they cannot agree on such modification, can any of the parties resort to public German courts, according to § 21 (3).

Could the companies also, instead, resort to investment arbitration? This appears not to be the case. First, § 21 (3) explicitly stipulates that in cases of a significant change in circumstances, companies can resort to public courts in Germany; an investment arbitration tribunal is quite clearly not such a court. Second, claims relating to an earlier closure of lignite facilities would most likely “arise out of or relate to rights and obligations under the contract or the coal phase-out law” in the sense of § 24 (2) and thus would be covered by the waiver on investment arbitration. Thus, companies in the case of an earlier closure of lignite facilities, which is not in line with § 22 (2), could, according to the contract, resort to German public courts, but, not to investment arbitration. It is, however, unclear whether this clause would prevent an investment tribunal from assuming jurisdiction. Yet if companies (or their subsidiaries) did resort to investment arbitration in such cases, the federal government could stop paying the compensation defined in the treaty and claim back payments already made – a risk that the operators might not want to take.

5.3 Changes in water-related regulation affecting lignite plants

Our third scenario is a change in water-related regulation affecting lignite plants and creating additional burdens for them, but not aimed at an earlier phase-out. Examples could be stricter limits for certain contaminants set at EU level or an increase in water-related fees, resulting from increasing water scarcity in a region. Which legal remedies could lignite companies use in such cases?

This is not a situation that the contract deals with explicitly.

A first question is therefore whether such an issue would come within the scope of the contract at all. There are good arguments for assuming that this is not the case. The preamble of the contract states that the contract is aimed at implementing the recommendations of the Coal Commission, which dealt with the lignite phase-out, but not with more general environmental regulations applying to power plants.²⁷ The preamble also states that the contract is about closing down lignite operations in the context of the coal phase-out, whereas more general environmental regulations are not mentioned as being the subject of the contract. Also, the aim of the contract is climate mitigation, which again, the above types of regulation would not contribute to. They are also not explicitly dealt with in the contract. There are thus good arguments for assuming that the contract – and its waiver clause – simply do not apply to such regulation. This would mean that companies could use investment arbitration in such cases in principle.

If conversely, one assumes that the contract does apply in this scenario, the legal situation would depend on whether the regulatory change would amount to a significant change in circumstances as defined in § 21 (1). The most relevant clause in this context is § 21 (1) lit. e on “*other regulatory interventions*”. Accordingly, a regulatory intervention only amounts to a significant change in circumstances if it “*is designed to and has the direct effect of pushing lignite plants, refineries or opencast mines out of the market and to put them at a considerable and specific disadvantage*”

²⁷ There is one exception, which is the implementation of the BAT conclusions for large-combustion plants. This issue is also addressed explicitly in the contract.

compared with other forms of energy generation, with the disadvantage not resulting solely from a proportional additional burden resulting from the high emission intensity or any other, comparably specific feature of the lignite plants, refineries or opencast mines”.

Whether or not a change in water regulation satisfies these conditions would, of course, ultimately depend on the details of the regulation. A good faith regulation taken for an objective reason (e.g. water becoming scarcer and thus more expensive) and also covering other industries is, however, unlikely to meet the conditions set in § 21 (1) lit e. As a consequence, it would have to be considered as non-significant change in circumstances, which would not change the equilibrium of the rights and obligations of parties in the contract to a degree that would warrant a modification of the treaty and allow contracting parties to use legal remedies in line with § 21 (2) and (3).

The question is then whether the waiver in § 24 for investment arbitration would apply. This would require, according to § 24 (2), that claims relating to the changes in water regulation would “arise out of or relate to rights and obligations under the contract or the coal phase-out law”. If one argues that this matter would come within the scope of the contract, it would appear logical to also argue that it is a question “arising of” or “relating to” rights and obligations under the contract. This would lead the waiver in § 24 to apply.

In summary, the legal situation concerning the third scenario is somewhat uncertain since it is not entirely obvious whether it comes within the scope of the contract or not.

6 Recommendations

As shown in the preceding sections, the waiver clause on ISDS contained in the contract is relatively robust in some regards, also comes with certain uncertainties and loopholes.

To further reduce these, the contract should be amended as follows:

- The relationship between § 23 (general waiver for remedies) and § 24 (waiver for ISDS) is not explicitly clarified in the contract. An explicit clarification should be added. In this context, a clause similar to § 23 (6) – requiring the companies to cover the legal fees of the German government in case they violate the waiver clause – should also be made to apply in the context of arbitration proceedings.
- To further reduce the risk of an investment arbitration tribunal assuming competence for interpreting the waiver clause, language explicitly indicating that the intent and effect of the clause is to deny any arbitral tribunal to assert jurisdiction to rule on any aspect of the dispute should be added to the contract.
- To prevent companies from arguing that the ISDS waiver clause only extends to claims arising out of or relating to rights and obligations under the present version of the coal phase-out law, the contract should clarify that any reference to the coal phase-out law also means any version of the law “as amended, restated, replaced, supplemented or otherwise modified from time to time”.
- To ensure that obligations in the contract apply to each of the companies individually, it would be preferable to use “each company” rather than “companies” throughout the contract, unless a specific clause intends to create a collective obligation for all of the companies together.

Again, none of these recommendations for improving the contract should be read as an endorsement of the use of a contract as a legal instrument in the context of the coal phase-out. For the reasons

explained above, regulating the details of the coal phase-out in a law would be preferable to the use of a contract. Moreover, as pointed out above, there is no way how the German government could legally bind the stakeholders of lignite companies through a contract; foreign shareholders of lignite companies will thus continue to be able to file investment arbitration claims in relation to the German coal phase-out.

7 Conclusion

The contract that the German government intends to conclude with lignite operators in the context of the German coal phase-out contains a waiver clause for investment arbitration. While from an environmental and democratic decision-making point of view a contract is a questionable instrument and regulating all details of the phase-out in a law would have been preferable, choosing a contract enables agreeing with the operators on the waiver clause.

The waiver clause is relatively comprehensive and – importantly – allows the German government to stop paying compensation to lignite operators for closing down their operations and claim back payments already made, should companies resort to investment arbitration in violation of their obligations from the waiver clause. This considerably reduces the risk that lignite operators could resort to investment arbitration in the context of the German coal phase-out.

However, significant loopholes and limitations remain. Most importantly, shareholders of lignite companies are not bound by the contract and its waiver clause; they could thus initiate arbitration proceedings. Moreover, it is uncertain whether investment tribunals would take into account the waiver clause and decline jurisdiction. Also, the exact scope of application of the contract and the waiver clause are unclear.

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