Investment Treaties and Climate Change

OECD Public Consultation | January - March 2022

Compilation of Submissions

13 April 2022

Investment Division, Directorate for Financial and Enterprise Affairs,
Organisation for Economic Co-operation and Development
Paris, France

Note from Chair

In its 2022 report, Working Group III of the United Nations' Intergovernmental Panel on Climate Change (IPCC) expressed concern that much of international governance still promotes fossil fuels and highlighted the role of investment treaties and investor-state dispute settlement. The OECD's initiative on investment treaties and climate change is the first major multilateral effort to consider this issue, and the inputs to the public consultation compiled here show the strong interest from stakeholders and experts from within and beyond the investment policy field.

The submissions highlight the relevance of the Paris Agreement for investment treaty policymakers and point to efforts undertaken in other areas of international economic governance to support climate goals. Together with analysis by the OECD Secretariat, these valuable inputs provide fresh ideas for governments as they align their investment treaties to address the climate emergency.

Prof Lauge N Skovgaard Poulsen
Chair of OECD's Future of Investment Treaties initiative, Track I

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Contact

David Gaukrodger, Senior Legal Adviser, Investment Division
(david.gaukrodger@oecd.org; +33 1 4524 1848)

Submissions

Ways of Reforming International Investment Agreements to Make them More Compatible with Climate Change Goals

Anne van Aaken[1]/Tomer Broude[2]

1. Introduction

The climate change catastrophe requires highest attention and urgency. It also requires hundreds of billions of investment for climate mitigation and adaptation, much of it foreign investment.[3] Hitherto, investment law and climate change law have stood side by side. The reform of the Energy Charter Treaty is ongoing and the reader is reminded to look at the discussions there.[4] It is highest time to incorporate climate friendly policies in International Investment Agreements (IIAs) in order to produce the correct incentives. IIAs are not the only tools for creating such incentives,[5] but an important one, whose potential is far from fully realized. This short piece will concentrate on short-term possibilities to put international investment law to the service of combatting climate change. Given the urgency of the matter, it will first focus on the procedural possibilities to move quickly (2), before turning to the substantive law in IIAs which could enhance climate change compatibility (3). All hinges upon the possibility of distinction between carbon-intensive and climate-friendly investments. We briefly look at that problem in section 4. The last part concludes.

2. Process: Ways of Changing Investment Law quickly

The negotiation of IIAs and surely their renegotiation can take a long time before they take effect and have enough geographical reach – given that the vast majority of the over 2500 IIAs in force today are concluded on a bilateral basis. But action needs to be taken in the light of climate urgency. There are in principle two ways in which investment law can be changed quickly: multilateral and bilateral. Furthermore, they can be amended and modified or their interpretation can be changed by subsequent agreement or authoritative interpretation by the parties. The latter leaves the text of the original treaty unchanged and leaves more discretion to the respective interpreter of the treaty in the case of a dispute, mostly international arbitrators. Subsequent agreements serve the interpretation of IIAs through the methods of interpretation

[1] Alexander von Humboldt Professor for Law and Economics, Legal Theory, Public International Law and European Law, Director, Institute of Law and Economics, University of Hamburg, email: anne.van.aaken@uni-hamburg.de.
[2] Bessie and Michael Greenblatt, Q.C., Chair in Public and International Law at the Faculty of Law and Department of International Relations at the Hebrew University of Jerusalem, and currently a Fellow at the Berlin-Potsdam KFG "The International Rule of Law - Rise or Decline?", Email: tomerbroude@gmail.com.
[3] UNCTAD, TRADE AND DEVELOPMENT REPORT 2021 FROM RECOVERY TO RESILIENCE: THE DEVELOPMENT DIMENSION.
[4] E.g. the Reform Proposal by the EU: European Union text proposal for the modernisation of the Energy Charter Treaty (europa.eu).
[5] Home states can take measures, e.g., via giving better guarantee conditions in their Export Credit Agencies to clean technology; host states can regulate and incentivize foreign investors to use clean technology through legislation, infrastructure tenders etc.

of articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT).[6] Subsequent agreements may be a faster way but they are more legally uncertain. To these one must add the possibility of IIA termination, in accordance with the principles of the VCLT and subject to whichever specific rules on termination exist in the particular treaty. Treaty termination largely cleans the slate on which new, modernized IIAs can be written. Although treaty termination has increased in recent years, it is not popular with states, given the negative signals it can send to investors.[7]

Whether through multilateral or bilateral tracks, the renegotiation, modification and termination of IIAs must take into account two particular design elements of IIAs. First, most IIAs include a clause granting investors and investments Most-Favoured Nation (MFN) treatment. Formulations of MFN vary, but in general their prevalence means that a party interested in reforming its IIAs for climate-related reasons in ways that alter the level of protection granted to foreign investors (as will be discussed in Section 3 below), will continue to be exposed to liabilities that do not incorporate these changes, so long as it is bound by MFN in the applicable IIA, and by other unamended IIAs. Second, many IIAs include 'sunset' or 'survival' clauses, under which investor's rights continue for a predetermined period after the termination of a treaty – often for 5 years, but in some cases (such as the ECT) for as much as 20 years. Thus, new climate-related mechanisms in amended IIAs may 'kick in' in practice only after several years and with respect to new investments. The intra-EU IIA termination process endeavoured to end the effect of sunset clauses on an agreed basis.[8] However, it remains unclear how this will be interpreted inInvestor-State Dispute Settlement (ISDS). Other uncertainties exist, such as the application of sunset clauses when a treaty has been amended rather than terminated.[9]

a. Multilateral

One multilateral approach would follow the model of the negotiation of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (the "Transparency Rules"). Those were adopted on 11 July 2013 by the United Nations Commission on International Trade Law (UNCITRAL). It was negotiated in about 3 years and the Rules have global reach, being in effect an amendment of the UNCITRAL rules on commercial arbitration, as applied to ISDS. Although the Transparency Rules constitute a set of procedural, not substantive rules, the law-making model may lend itself also to the change of substantive rules. Although for now, UNCITRAL Working Group III has focused only on dispute settlement and not on the substantive revisions of IIAs, it could, if so requested by UNCITRAL members, take up the issue as well. The advantage would be a more global reach on a competitive equality level for investors. Alternatively, such a treaty could be used as a subsequent agreement for the interpretation of existing IIAs as long as both state parties to the IIA in dispute are also party to an – what we call for working purposes - "UNCITRAL Rules on Climate Friendly Investment Law". They could be incorporated – as the Transparency Rules – in the UNCITRAL Arbitration Rules. Those Rules would not be limited to arbitrations

[6] ILC, Draft conclusions on subsequent agreements and subsequent practice in relation to the interpretation of treaties 2018.

[7] On renegotiation, termination and regulatory space in ISDS, see Tomer Broude, Yoram Z. Haftel and Alexander Thompson, "Legitimation through Modification: Do States Seek More Regulatory Space in Their Investment Agreements?", in Daniel Behn, Ole Kristian Fauchauld and Malcom Langford (eds.), The Legitimacy of Investment Arbitration: Empirical Perspectives (Cambridge: Cambridge University Presss, 2020), 531-554.

[8] For discussion, see Johannes Tropper, "The treaty to end all investment treaties. The Termination Agreement of intra-EU BITs and its effect on sunset clauses", May 12, 2020 https://voelkerrechtsblog.org/de/the-treaty-to-end-all-investment-treaties.

[9] For discussion, see inter alia Tania Voon and Andrew D. Mitchell, "Denunciation, Termination and Survival: The Interplay of Treaty Law and International Investment Law (2016) 31 *ICSID Review* 413.

conducted under the UNCITRAL Arbitration Rules, but could be also available for use in investor-State arbitrations initiated under rules other than the UNCITRAL Arbitration Rules, such as ICSID or in ad hoc proceedings. Multilateral negotiations could be conducted in other international fora, such as UNCTAD, given its focus on investment and sustainable development.[10]

b. Bilateral

Existing bilateral treaties could also be amended. This takes time and would not easily reach a global scale. But if some important players, such as the US, the UK and the EU make a first move, that may help. How could that be achieved more quickly? One possibility could be to have annexes for the most carbon influencing industries. The OECD could work on a model annex which states could adopt quickly. Those annexes would include both – encouragement of clean industries/technology and reduction of carbon intensive industries since both are crucial for climate change.

3. Substance of Reform Law: Incentives for climate friendly investment

In general, incentives for sustainable investment can, and should, take two distinct, yet complementary, forms; both can, we contend, find their place in reforms of IIAs, beyond domestic regulatory measures, financial incentives and trade regulation. First, there should be *negative* incentives for investments in sectors and enterprises that although are generally legal and indeed might still be necessary for the functioning of economies during transition to greener infrastructures, impact climate goals. Second, *positive* incentives should be provided for investment in green sectors and clean technology. The crucial question is thus whether the international protection of carbon intensive investments should be scaled down, and/or climate-friendly, sustainable investment should be privileged. In other words, should carrots or sticks be used or a smart mix of those? Given the problem of how to separate these two types of incentives, and the various legal issues they may raise in IIAs it is apposite here to draw attention to evolving definitions and measurements of "clean" and "sustainable". We mention this only in passing, as it is not the focus of our suggestions, but it is ultimately a pivotal issue for any reform, that we return to briefly at the end of this paper .

a. Negative incentives for carbon intensive investment

Negative incentives in IIAs would make the investment in carbon intensive industries more costly from the perspective of investor expectations for compensation. That is, IIAs and/or their interpretation would penalize investors for choosing to invest in those industries in that the protective function of IIAs for carbon-intensive investors would be diminished. From an investor perspective, IIAs provide protection against risk, but from domestic and global public good perspectives investment in carbon-intensive sectors and industries lowers aggregate welfare and creates environmental and societal risks. Negative incentives in IIAs should be designed to recalibrate the division of risks, causing foreign investors to internalize a greater proportion of the risk and damage in which their investment decisions are implicit.

[10] On the different roles played by UNCITRAL and UNCTAD in the global investment regime, see Yoram Haftel and Tomer Broude, "Fiddlers on the Roof? International Organizations in the International Investment Regime as Traditional Global Governance", Working Paper on file with authors, GLOBE – The European Union and the Future of Global Governance (2022).

i. Damage caps

UNCITRAL Working Group III is already concerned with the issue of damages and compensation in ISDS.[11] Here, we want to focus only on the problem of damages in the context of climate change.[12] One possibility would be damage caps for investment disputes which involve carbon-intensive industries in cases where the host state has taken regulatory measures to cap emissions (and damage caps should be in place only for measures with this explicit purpose and not be a "free-for-all"). Most IIAs take the standard of 'fair market value' or full reparation, but they do not provide guidance on how these general principles governing compensation/damages should be operationalized in specific disputes. Thus, tribunals have used a variety of different valuation techniques to calculate the amount owed to the investor. Most common is the Discounted Cash Flow method which relies on future income streams. This may lead to very high damages, especially in extractive sectors which are often also carbon-intensive in their operation as well as their inputs to downstream industries. Another calculation approach is asset-based and relies on the 'book value' or the replacement value of affected assets. The valuation of the affected investment is then the sum of the value of each of its assets and liabilities. A variant of this is the 'sunk cost' approach which is even simpler. Here, the costs incurred or sunk invested costs are the benchmark for valuation of compensation. This offers the advantage of relative certainty as expenditure that an investor has actually incurred will normally be clear and the method does not require forecasts or assumptions.[13]

Pre-defined damage caps would determine an upper limit on compensation that may be owed under general IIA disciplines – operating in principle like a maximum coverage in insurance policies. Such caps could either be determined on a flat basis, or as a proportion of the investment. Thus, foreign investment in carbon-intensive industries would be less protected in that foreign investors cannot harbor expectations to be indemnified for foregone gains, or (in a more assertive approach) even for full asset value or sunk costs. Damage caps can designed with the justification that the legitimate expectations of the foreign investor (relevant, for example, in fair and equitable treatment as well as in indirect expropriation cases) must be adjusted in the sense that investors can no longer legitimately expect that states do not take measures to fulfil their obligations from the Paris Agreement. Damage caps would thus disincentivise carbon-intensive investors since their protection would be diminished. These could be accompanied with commitments by states whereby any compensation foregone above the cap, or portions thereof, would be directed by the host state to other purposes, including climate change adaptation or mitigation. As with respect to other negative incentives, care should be taken to ensure that they are applied in a non-discriminatory manner, e.g., that like domestic investors are subject to the same measures. We turn now to the issue of discrimination.

ii. Change of NT/MFN for carbon intensive industries

[11] Possible reform of investor-State dispute settlement (ISDS): Assessment of damages and compensation, Note by the Secretariat, UNCITRAL, 21 July 2021.

[12] For an excellent overview on the other problems discussed in the context of damages, see M. Langford, J. M. Alvarez-Zarate and D. Behn, Damages and ISDS Reform: Between Procedure and Substance Jonathan Bonnitcha, Academic Forum Paper: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/damages_and_isds_-_uncitral_af_paper.pdf.

[13] Ibid and N. Rubins, V. Sinha and B. Roberts, Approaches to Valuation in Investment Treaty Arbitration, in Ch.L. Beharry, Ed (2018). Contemporary and emerging issues on the law of damages and valuation in international investment arbitration. Boston, Publisher: Brill Nijhoff, 197.

Discriminating between carbon-intensive and carbon-friendly industries and investment is the main point of adapting IIAs to climate policies. IIAs must be adapted in the sense that it must be permissible to discriminate on the grounds of carbon intensity. Non-discrimination is, though, the gold standard of investment protection.[14] Thus, the proposed discrimination has to be applied carefully and the measurement and thresholds formulated are crucial. They also need to be reflected and well justified in any measures taken by the host state within the measure, not only ex post in a potential dispute, in order to constitute valid grounds for discrimination.[15]

National treatment (NT) proscribes 'less favorable treatment' of a foreign investor that stands 'in like circumstances' or in 'like situations' with a domestic actor. With respect to IIA reforms, first, NT clauses could be adjusted in the treaty text – that would be the most legally certain way – akin to the Annex II on indirect expropriation in the US Model BIT 2012 for measures which are not to be understood as expropriation. For example, an Annex could clarify that different treatment based on carbon-intensity of an investment does not constitute discrimination in the meaning of NT, MFN or Fair and Equitable Treatment. That would suggest that NT would only be afforded to comparable carbon emitting industries. That would mean in practice that more carbon-intensive foreign investors can be subject to different regulation without incurring violations of NT clauses, if the measures have as their purpose carbon reduction.

If the treaty text is not changed, tribunals could still discriminate between national and foreign investors on the grounds of different carbon emitting practices on environmental grounds. But that would mean a departure from the competitiveness test. As a starting point, most of the early cases—including SD Myers v Canada (NAFTA, 2000), Pope & Talbot v Canada (NAFTA, 2001), Feldman v Mexico (NAFTA, 2002); and ADF v USA (NAFTA, 2003)—endorse some form of competition as a condition of likeness in a NT inquiry. Under this line of reasoning, a foreign investor will be 'like' a competing domestic investor. This jurisprudential line is disrupted by the awards in Occidental v Ecuador (U.S-Ecuador BIT, 2004) and Methanex v U.S (NAFTA, 2005). The Occidental Tribunal adopted a much broader approach by ruling that a foreign investor involved in oil exports was 'like' domestic companies exporting non oil-related goods such as flowers and seafood products.[16] The broad Occidental test remains largely an outlier in the jurisprudence. The later Methanex Tribunal adopted a much narrower approach requiring identification of an 'identical' comparator to the foreign investor.[17] This narrow test has not found reflection in later case law, which has largely returned to a competition-based reading of NT. If there are only foreign investors, the regulation could still withstand scrutiny for the purpose of regulation – carbon intensity. In light of this diverging tribunal practice, explicit statements on legitimate distinctions between sectors in new or renegotiated IIAs (as well as in subsequent agreements or authoritative interpretations by IIA parties) should be expressed as clarifications 'ex abundante cautela'.

[14] There could also be a change made to the OECD National Treatment Instrument. This forms part of the OECD Declaration on International Investment and Multinational Enterprises together with an OECD Council Decision obliging adhering countries to notify their exceptions to the Instrument.

[15] There are parallels with the measures taken after the Financial Crisis. For an analysis, see A. van Aaken and J. Kurtz, Prudence or Discrimination? Emergency Measures, the Global Financial Crisis and International Economic Law (2009) 12 Journal of International Economic Law 859.

[16] Occidental Exploration and Production Company v Ecuador, Award, LCIA Case No UN 3467, IIC 202 (1 July 2004) para 173.

[17] Methanex Corporation v USA, UNCITRAL, Final Award (3 August 2008) pt IV, ch B, para 17.

Analogous arguments and adjustments can be made for MFN and fair and equitable clauses.

iii. Jurisdictional hurdles

Climate change law can be included in the jurisdictional phase via a legality clause (similar to corruption or other national law requirements, as has recently been done). In principle, using the legality clause has been possible under even the older IIAs, but was not often used so far. This is an all-or-nothing approach which seems very blunt. One might also consider a 'carveout' for explicit carbon emission reduction measures, similar to the 'tobacco measure carveout' in Article 29.5 of the CPTPP, with language that is not so broad as to deny benefits from non-carbon intensive sectors. Similarly, a Salini Test could be applied for the definition of investment with a view on climate change sustainability. These also seems problematic in various respects. First, these also verge on an all-or-nothing approach, which may be worked around in ISDS; second, and as a consequence, it would retain the legal uncertainty found in the case law concerning the interaction of IIAs and the ICSID Convention.

b. Positive Incentives for climate friendly industries

Lowering protection (and increasing risk) for foreign investors in carbon intensive industries is one possibility, but a complementary (or perhaps even better) way would seek to encourage climate friendly investment and technology. The advantage is not only that investment keeps being protected generally, but also that climate friendly industries would be required to provide the respective information in order to receive the benefits (i.e., an information disclosure duty on carbon intensity) which would alleviate the measurement problem (see below 4). It also would be perceived differently – negative incentives would be experienced as penalizing and taken away entitlements, whereas positive incentives would be experienced as encouraging.[18]

i. Climate policy space recognition as protection/insurance for investor

Of primarily symbolic value, but with potentially operative and interpretative effects, revised IIAs and derivative instruments should include explicit language in their preambles and operative clauses, whereby special regard is to be given to the sustainability of the investment in granting the full force of IIA protection to climate-friendly and 'green' investments. Although ever more IIAs contain a reference to sustainable development in their preambles, this is likely to be insufficient for guiding tribunals, especially if they are asked to distinguish between investments on the basis of carbon-intensity. Thus inclusion in operative clauses is desirable for greater certainty.

ii. Special protection

Specialized incentives for investment for climate friendly industries could be incorporated in IIAs. The majority of IIAs do not have market access or 'pre-investment' provisions (IIAs of the United States are an exception). But it would be possible to give special market access to clean technology investments either in IIAs or national investment laws, also in those IIAs which hitherto do not contain market access provisions. Furthermore, they could be provided with shorter waiting periods or other special treatment.

Further possibilities would be performance requirements connected to climate friendliness, e.g. the sourcing of clean energy in the production processes of companies. However, performance requirements pose problems under IIAs as well as international trade law (including government procurement). Therefore, express exceptions would be required. Alternatively, positive incentives could be provided to enhance the transfer of environmental knowledge and technology. The first could, e.g., be to provide access to and promote collaboration of investors with research institutions and local universities in the

[18] A. van Aaken and B. Simsek, Rewarding in International Law (2021) 115 American Journal of International Law 195.

host state. This could be done through public research funding programs of local universities made contingent on collaboration with foreign investors (to the point of joint ventures), mirrored by a presumption of climate-friendliness in the case of such cooperation, with enhanced protection under domestic law or IIAs . To be sure, this would be desirable also when the host state is a developing country, which face particular environmental problems and have the local expertise in their regard. Direct subsidies are also a means of fostering desired investment. But subsidies come with costs for the host states and it is difficult to calculate subsidies correctly to not overpay the positive externalities generated by the industry. Direct subsidies may also create liabilities under IIAs if they are withdrawn at a later stage.

iii. Investment facilitation

"Investment facilitation" has become a hot topic of discussion in the process of international investment policy formulation, and more and more international organizations and states have repeatedly mentioned this concept in negotiating investment policies and investment agreements.[19] Under WTO auspices, investment facilitation is currently negotiated but access to the material is restricted.[20] Although investment (facilitation) for sustainable development and the achievement of the SDGs has been widely discussed,[21] there is hitherto no special focus on carbon intensity. But it would be possible to include special positive incentives and facilitation for carbon-friendly industries or clean technology by providing enhanced services in the facilitation process by the host state. One possibility would be a fast track procedure for permits.[22] Another one would be special office within a “one stop shop” for investment permits which renders special services to climate friendly industry. These options could be guaranteed to the right investors and incorporated, with proper caveats, in IIAs. They could also stand alone in investment laws of the host states.

4. Thresholds and Measurement

The distinction of which investments count as climate friendly and are to receive positive incentives and which ones count as carbon-intensive creating highly climate risks is of preeminent importance in order to set incentives right and justify discrimination. Measurement of carbon intensity is not easy and states would need to find a consensus which measurement to take. One possibility would be to fall back on the assessments done by the firms themselves. The Financial Stability Board’s Task Force on Climate-related Financial Disclosures (TCFD) provided recommendations, which provide a framework for companies and other organizations to develop more effective climate-related financial disclosures through their existing reporting processes. Those range from 1.2. to 10 Degree Celsius. Decision could be taken to have a cut-off (an all or nothing approach) or a more differentiated approach, according to the respective degree Celsius. Other possibilities include carbon measurement by other international organizations or by non-state actors, such as NGOs. Important here is the legitimacy and trust in that respective institution. Monitoring and verification but also contestability are important tools for this.

[19] UNCTAD, ‘Investment Facilitation: A Review of Policy Practices, Follow-up to UNCTAD's Global Action Menu for Investment Facilitation’ (2017) UNCTAD. Available at: http://mddb.apec.org/Documents/2017/IEG/IEG1/17_ieg1_010.pdf.

[20] Joint Statement on Investment Facilitation for Development, WT/L/1130, 10 December 2021.

[21] J. Suehrer, The Future of FDI: Achieving the Sustainable Development Goals 2030 through Impact Investment (2019) 10 Global Policy 413.

[22] Although streamlining and speeding-up administrative procedures is already one component of the negotiations.

5. Conclusion

Adapting international investment law to climate change goals will not be easy and requires urgent reform initiatives on several fronts. As it stands, investment law and climate change goals are a classical case of fragmentation of international law.[23] But just as investment law and the jurisprudence based on it has partially adapted to more environmental policies and human rights concerns, it can adapt to climate change goals. Law-making would clearly be the best and legally certain way forward.

[23] A. van Aaken, Fragmentation of International Law: The Case of International Investment Protection (2008) XVII Finnish Yearbook of International Law 91.

Submission to the OECD Public Consultation on Investment Treaties and Climate Change

Emma Aisbett[1]

Contents

[1] Author note and disclosure: I am a Fellow at the School of Regulation and Global Governance and Associate Director (Research) of the Zero-Carbon Energy for the Asia-Pacific Grand Challenge at the Australian National University. I write this submission in my academic capacity. I am not involved with any activities connected with Investor-State Dispute Settlement (ISDS) proceedings and do not have an affiliation with any law firm, legal service provider or government.

Summary

This submission proposes a feasible and timely investment treaty reform which could dramatically improve the alignment of the regime with climate change mitigation and adaptation needs. The reform proposal is based on work I have co-authored with Jonathan Bonnitcha.

The submission argues:

1. The current investment treaty (IT) regime is incompatible with climate action goals.
2. Entirely dismantling the IT regime is neither politically feasible in a timely manner, nor necessarily desirable given the scale of investment required to reach climate mitigation and adaptation needs.
3. Our reform proposal supports both the investment and the policy required in the face of climate change.
4. Our reform proposal is feasible to implement in a timely manner.

1. The current investment treaty regime is incompatible with climate action goals

The current investment treaty regime is incompatible with climate action goals both because it diverts investment away from climate-friendly towards climate-risky projects, and because it is antagonistic to the types of policy needed.

1.1 Current ITs pervert investment incentives

The current investment treaty regime it diverts investment away from climate-friendly towards climate-risky projects both because it provides “insurance” against negative impacts from government climate action to climate-risky projects, and because it discourages efficient climate action on behalf of governments. In light of the scientific evidence and political momentum behind climate action, rational investors should be aware that highly greenhouse gas (GHG) emitting investments, such as fossil fuel projects, face a positive probability of being curtailed or entirely shut down before the end of their “normal” lifetime. In the absence of investment treaty (IT) protections, this probability has a dampening effect on investments in climate-unfriendly activities. The current IT regime decreases this dampening effect both by providing the potential for compensation in the event of government action adversely affecting the investment (providing “insurance”) and by deterring government climate policy – hence decreasing the likelihood or severity of negative impacts for investments arising from government actions (Aisbett et al., 2018).

While the empirical evidence regarding the impact of investment treaties on investment flows has been equivocal in the past, there are good reasons to expect this perverse effect on investment decisions to be non-negligible in the case at hand. Firstly, more recent evidence has consistently found effects of ITs on FDI (see e.g. Aisbett et al., 2018; Egger and Pfaffermayr, 2004; Haftel, 2010). Secondly, emissions-intensive investments such as energy extraction and generation have characteristics that make them more likely to respond to IT protections (Colen et al., 2016). Thirdly, the nature and scale of the policy changes required in relation to climate change will by necessity have large and wide-ranging impacts on the profitability of polluting investments.

1.2. Current ITs are antagonistic to climate policy

The current IT regime discourages both policy required to reign in polluting investments and policy required to support clean investments.

1.2.1 Discouraging policy to curtail polluting investments

From the earliest days of ISDS in ITs, there have been concerns that it can discourage efficient public-good regulation. While there has been some debate about the empirical extent of this problem, there are reasons to believe "regulatory chill" is a legitimate concern when it comes to climate policy. Firstly, there is ample evidence of ITs, particularly the Energy Charter Treaty, being used to fight or claim compensation for government actions aimed at GHG mitigation and energy transition (Tienhaara and Downie, 2018). Secondly, there is broad agreement that the current policy settings of governments around the world are insufficient to meet net zero ambitions or to keep global warming under 1.5 C by the end of the century (Masood and Tollefson, 2021). This means that almost all investments in the world today have been made under a policy regime that needs to shift dramatically and rapidly.

There are also theoretical reasons to expect the regulatory chill problem to be greater for climate policy than in other domains. These reasons are essentially the same ones often blamed for the inadequate policy action on climate mitigation in general. The first problem is that emissions mitigation is a public good – and consequently subject to free rider problems. This means that a government faced with bearing the full financial cost of climate mitigation due to compensation requirements for investor losses will not act in a globally efficient (optimal) way because they do not capture the full global benefit of the mitigation action. In other words, IT rules requiring hosts compensate investors for losses due to climate mitigating actions exacerbate the market failure arising from the public good nature of mitigation.

Behavioural economics provides additional reasons to expect climate mitigation actions to be particularly prone to regulatory chill from current IT compensation requirements. The impacts of climate mitigation actions are highly uncertain and possibly far in the future. Yet behavioural economics shows that humans are extremely poor at rationally weighing uncertain costs and benefits, and that they discount future costs and benefits at a rate incompatible with sustainability (Farias et al., 2021). Skovgaard Poulsen and Aisbett, (2013) have demonstrated the former effect also applies to governments with regard to investment treaty participation.

1.2.2 Discouraging policy supporting clean investments

There is widespread agreement that Green Industrial Policy is an essential tool in climate mitigation and adaptation effort.[2] Green Industrial Policy (GIP) is "industrial policies with an environmental goal—or more precisely, as sector-targeted policies that affect the economic production structure with the aim of generating environmental benefits" (Hallegatte et al., 2013). Examples of GIP include the EU's Fit for 55 Package, the Korean New Green Deal, and the hydrogen strategies which have been launched by no less than 20 countries. Another 17 hydrogen strategies are at the initial stage of policy discussion (Uwe Albrecht et al., 2020). GIP helps to overcome market failures that otherwise limit the development, adoption and diffusion of clean technologies. Like other forms of industry policy, GIP involves substantial state involvement and is fertile ground for disputes under existing IT rules.

Response to new information is a central component of GIP. Indeed, some authors characterise the main purpose of GIP as information discovery (Hallegatte et al., 2013; Pegels, 2014; Rodrik, 2014). Rodrik (2014) additionally, identifies systematic learning, democratic accountability and willingness to change or abandon policies that are not (or no longer) performing as essential components of good practice GIP. Current IT rules actively discourage all these elements of good practice.

2. Entirely dismantling the IT regime immediately is neither feasible, nor necessarily desirable given the scale of investment required.

2.1 Political feasibility in a timely manner

The urgency of dramatic action to mitigate GHG emissions has been noted repeatedly in IPCC reports, and acknowledged by governments and businesses around the world, including at last year's Conference of Parties in Glasgow. It seems unlikely that a regime comprising over 2,000 treaties will be entirely dismantled and abandoned in time to pave the way for the climate-friendly policy and investment that is needed.

2.2 Desirability of entirely dismantling the IT regime

It may not be desirable to entirely dismantle the IT regime. Protection from opportunistic host behaviour could help lower the cost and increase the speed of the net zero transition. An unprecedented scale of infrastructure investment will be required to transition economies around the world in the coming decades to low- and zero-net greenhouse emissions. For Australia, Burke et al. (2022) show that replacing current fossil fuel and metal ore imports with renewable-energy based exports would require renewable electricity

[2] These sort of policies are alternatively conceptualised as part of "socio-technical sustainability transitions", "green innovation policy", "green infrastructure policy" or "energy transition policy". Regardless of the term, the importance of policy experimentation, systematic learning and updating of approaches remains accepted in the literature.

production 27 times the current national grid. Infrastructure investments are generally prone to hold-up problems due to high ratio of up front to variable costs; and renewable energy infrastructure has a higher ratio than traditional energy generation – since unlike fossil fuels, sunlight and wind are free. In countries where the domestic legal system is perceived as reliable and independent from the government, fear of expropriation is generally not a meaningful brake on green investment. However, in the case of investment between countries with radically different legal and political traditions, treaty-based investment protection may well have a role to prevent fear of expropriation holding back investment, or leading to higher risk premiums, which raise costs for already stretched state budgets. In other words, there may be a baby worth saving from the investment treaty regime bathwater.

3. Our reform proposal supports both the investment and the policy required in the face of climate change.

In co-authored work with Jonathan Bonnitcha (Aisbett and Bonnitcha, 2021; Bonnitcha and Aisbett, 2021), we propose a liability and compensation rule which solves the hold-up problem arising from time-inconsistency of optimal policy for host governments, without punishing them for changes due to new information. In other words, our combination of economics and law allows our proposal to separate the "under-investment due to fear of opportunistic host actions" baby from the "constraining rational host responses to new information" bathwater. Our proposal is able to achieve this where others have failed because it uses economics to precisely target compensation at the sources of under-investment induced by hold-up problems.

We propose that compensation for breach of an investment treaty should the lesser of the investor's loss and the host state's gain[3] from the host's state not having had the new regulatory arrangements in place when the investment was made. The proposal features two key innovations compared to current rules - under which compensation is ordinarily based on the future income the investor would have earned were it not for changes to regulatory arrangements. Firstly, and most importantly, "hold-up" or "time inconsistency" problems are targeted by changing the counter-factual reference state from the situation in which the host had not taken the action, to the one in which the action had been taken *before* the investment was made. Secondly, we ensure the compensation is no more than that required to prevent under-investment due to time inconsistency by making it the minimum of the amount required to ensure the host's time inconsistency problem is solved (i.e. the host's gain) and the amount required to ensure the investor is not left worse off (the investor's loss).

[3] Both losses and gains are net and for the host include not only financial losses and gains but also environmental or social harms and benefits. These calculations are taken up discussed under heading 4.2 of this submission.

3.1 Supporting climate investment needs

Our proposal supports investments in climate mitigation and adaptation activities by solving time-inconsistency (hold-up) problems. Importantly, the proposal is effective regardless of whether the problem manifests as outright expropriation (such as nationalisation of assets), or as creeping or indirect expropriation (such as decreases in feed-in tariffs, increases in tax rates or stricter regulatory requirements). Our proposal does not rely on arbitrators' opinions about the motives of governments or on the nature of the action taken to determine whether compensation is due. Rather, the mechanism of our rule distinguishes the extent to which a hold-up problem could be manifested and rectifies it. By taking beliefs and biases out the equation, our rule also provides greater certainty for investors and hosts alike, reducing the likely number of disputes that need to go to arbitration.

3.2 Supporting climate policy needs

Importantly, our proposal also supports climate policy by ensuring compensation requirements only target the hold-up problem. This means, for example, that if fossil fuel investments (such as a coal mine or gas plant) are shut-down, there may be little or no compensation required.[4] Similarly, if feed-in tariffs or subsidies for emissions-reducing projects are lowered in response to market developments or policy learnings, the compensation will generally be much lower than under existing ITs, possibly zero. For example, in the Spanish solar cases, the fact that the lowered feed-in tariff was still high enough to ensure efficient operations would return a positive profit means that there was no relevant gain to the state (in terms of cheap electricity) and no compensation would be due.[5]

4. Our reform proposal is feasible to implement in a timely manner

Two key elements of implementation feasibility are worth noting in this short submission: how the reform proposal could be integrated into the IT regime, and how climate damage can be incorporated into assessments of host (net) benefits from an investment.

4.1 Integrating our proposal into the IT regime

Our proposal could be implemented as a relatively minor amendment clarifying the way "damages" are calculated in investor-state disputes. Because our proposal does not affect the institutional architecture or substantive coverage of ITs, it can be applied across a wide range of treaties. As suggested by Jonathan Bonnitcha in his submission to the current consulations, a multilateral instrument that allows states to 'opt in' to specific reforms provides a promising avenue for implementing the proposal. [6]

[4] The submission by Jonathan Bonnitcha explains these situations in more detail. As do our published papers.
[5] For detailed discussion of these cases in Bonnithca & Aisbett, 2021.
[6] *See* U.N. Comm'n on Int'l Trade L., Possible Reform of Investor-State Dispute Settlement (ISDS) Multilateral Instrument on ISDS Reform: Note by the Secretariat, U.N. Doc A/CN.9/WG.III/WP.194, ¶¶ 8–9 (Jan. 16, 2020). For academic discussion, see Wolfgang Alschner, *The OECD Multilateral Tax Instrument: A Model for Reforming The International Investment Regime?*, 45 BROOK. J. INT'L L. 1 (2019); Stephan W. Schill and Geraldo Vidigal, *Designing Investment Dispute Settlement à la Carte: Insights from Comparative Institutional Design Analysis*, 18 L. & PRAC. INT'L CTS. & TRIBUNALS 314 (2019).

4.2 Valuing climate harms and benefits

The general question of calculating net benefit to the host of the purposes of determining compensation is discussed in Bonnitcha and Aisbett (2021). There we argue that the determinations required to establish the compensation value under our rule are generally less onerous and less open to (costly) debate than those required under existing IT norms. In the interest of space, this submission will focus on a specific issue not addressed in the previous publications, one which is very relevant to ITs & climate: how are climate costs and benefits of investments to be calculated? The answer to this question is relevant to any compensation scheme in which environmental costs and benefits play a role (e.g. a Miceli-Segerson rule). It is also relevant to the question of the extent to which states are implicitly subsidizing insurance for polluting firms through their IT participation.

The **minimal set of information that is required to value climate-related harms and benefits** of an investment includes:

- Greenhouse gases (GHGs) are emitted
    - Which gases
    - How much of each gas is emitted
    - Temporal emissions profile of each
- GHGs are removed (sequestered or captured, including via offsets)
    - Which GHGs
    - How much of each gas is removed
    - Temporal removal profile of each

Note that this information set is not the same as the total net carbon equivalent emissions. The disaggregated information is needed because the associated costs differ depending on the type of gas, timing, and direction (emission or removal). This sort of emissions information is increasingly becoming the norm for companies following the recommendations of the Taskforce on Climate-related Financial Disclosures.[7]

A large and rapidly expanding literature considers the question of how to value the cost of GHG emissions. Where those emissions are assumed to be additional, the very complex and contentious task of valuing the climate impacts of marginal emissions arises. The alternative assumption is that the emissions are not additional, rather that emissions reductions commitments are binding and hence any emissions from an investment must be offset elsewhere. Although undoubtedly a conservative approach, this assumption makes the valuation task much more precise (if not more accurate) and less open to debate. In this latter case, the cost of avoiding the equivalent type and magnitude of emissions in the host economy can be used. Importantly, given the climate impacts of avoided emissions are not the same as that of emissions removed, the price of "carbon offsets" should not be used to value the emissions abatement task. Rather, the cost of actually *avoiding* the equivalent emissions elsewhere needs to be estimated.

[7] https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

OECD public consultation on investment treaties and climate change:
Submission by George Anjaparidze, Veritas Global – 14 March 2022

I welcome the initiative of OECD to gather views from a broad range of stakeholders on how government policymakers can respond to the climate crisis through investment treaty policies.

Climate change issues that could potentially be addressed in investment treaties:

1. Issue 1: stranded assets with impact on public finances – If governments borrow or provide guarantees for economically unviable projects, it can create fiscal constraints that prevent the realization of other desired investments. A common set of methods for aligning investment practices is needed across capital providers (OECD and non-OECD). Ideally capital recipients should also have a harmonized way for evaluating which projects merit receiving public sector backing. For external/international capital providers, the building blocks and principles developed by multilateral development banks for aligning with the Paris Agreement could serve as inspiration:

   https://www.adb.org/news/mdbs-announce-joint-framework-combat-climate-change

   In addition, there is a need to develop a harmonized approach for how to handle poor investment decisions of the past (meaning investments that were made in the past and have become or will become stranded). Again, a common framework across all major capital providers (OECD and non-OECD) could be helpful in ensuring an orderly handling of this matter. Crucially, these issues are not unique to climate change but have broader implications, especially in infrastructure investments. As highlighted in a recent media interview, reaching better alignment on investment principals and practice for addressing stranded assets among capital providers is a global imperative but is most urgent in Eastern Europe. Capital can become obsolete or stranded if it is deployed without proper anticipation of the responsibilities and standards that come with closer integration with the EU and meeting of ambitious climate targets. For context, please see media interview question 4:

   https://thegeopost.com/en/interviews/interview-with-the-managing-partner-of-veritas-global-regarding-the-report-high-risk-of-conflict-escalation-in-2022/

2. Issue 2: stranded assets of private sector that are systemically important – If systemically important investments made by the private sector become unviable it could expose countries to macroeconomic shocks and volatility. Therefore, monitoring these risks and having a structured way to address them are important considerations. It may be appropriate to incorporate these elements into existing practices of debt and financial restructuring, such as the frameworks employed by the IMF. However, it may also be appropriate to incorporate climate specific considerations that build on the climate finance principles agreed under the United Nations Framework Convention on Climate Change. Specifically, the principles developed under the framework related to climate finance flows (specifically those related to agreed full costs, agreed full incremental costs, and incremental costs) may also need to be incorporated for addressing stranded assets within existing capital stocks. Section 2 of the brief in the link below provides background information on the concepts and principles that relate to climate finance flows:

   https://www.veritasglobal.ch/post/climate-finance-is-the-key-to-success-for-biden-earth-day-summit-and-cop-26

3. Issue 3: Using investment treaties to promote sectoral standards – commentators have suggested that investment treaties could be used to promote certain environmental standards or increase adherence to environmental agreements within specific sectors. Investment treaties could have a constructive role in accelerating implementation of

multilaterally agreed standards or schemes. For example, investment treaty provisions that accelerate implementation and uptake of the multilaterally agreed scheme targeting CO_2 emissions from international aviation may be desirable. The scheme caps the growth in CO_2 emissions while addressing the special circumstances and respective capabilities of developing countries and avoids creating competitive distortions through uniform treatment of aircraft operators. Crucially, the scheme leaves room for more ambitious action, which could be reinforced and supported through relevant investment treaty provisions. The brief below explains the design of the Carbon Offset and Reduction Scheme for International Aviation:

https://www.belfercenter.org/publication/extraordinary-climate-agreement-international-aviation-airline-industry-perspective

However, using investment treaty provisions to promote sectoral schemes developed bilaterally or with limited representation of industry, risks having adverse effects. The section of the brief below, “sectoral initiatives targeting steel and aluminum need better representation” explains the shortcomings of non-multilateral approaches:

https://www.veritasglobal.ch/post/implication-of-cop-26-for-wto-negotiations

Governance and Process

4. The OECD has an outstanding reputation, and its staff have excellent technical skills. However, other organizations may be better placed to serve as forums for finding solution on the nexus of investment and climate change, not least because they are better placed to tap into the perspectives of developing countries (capital providers and recipients) and have direct insights to the challenges they face.

5. For the list of issues identified, the IMF offers the best institution for where international solutions would be agreed. The IMF has technical expertise of comparable caliber to the OECD, with the added benefit of being able to relate to the challenges facing developing countries. More broadly, the institution has a high degree of trust across governments and through its representation covers all groupings of countries. Ensuring that all country groupings are represented, even if some individual countries might not always be part of the process, allows for solutions to be developed that will have broad acceptance. In addition, through various existing practices and levers (e.g. surveillance under Article 4, lending) the solutions developed under the IMF umbrella would have a better chance of having real policy impact and relevance.

6. Having raised the points above, the OECD can play an important role in the ideation phase, and I welcome opportunities to contribute to this effort.

I would like to again thank the OECD for the opportunity to contribute to this online public consultation and welcome future occasions to exchange views.

George Anjaparidze

Managing Partner – Veritas Global
Geneva 1203 – Switzerland
www.veritasglobal.ch

ADB

OECD Public consultation on investment treaties and climate change

Expression of interest
Asian Development Bank (ADB)

Investment Treaties in Asia

1. International investment agreements (IIAs) are an important policy tool to attract FDI by safeguarding the economic interests of both the recipient economies and international investors. Investment treaties govern a set of circumstances that includes the scope of investment, treatment received by foreign investors, and dispute settlement and compensation mechanisms. They can signal a stable and predictable environment for investment and promote governance standards by encouraging institutional and judicial reforms.

2. As of 2021, nearly a thousand investment agreements involved Asian economies. While some elements are common, investment agreements across the region differ in scope and nature. There is considerably heterogeneity in the structure of agreements, with some provisions (*i.e.,* definition of investment, expropriation and exception clause), generally more favorable to grant extensive rights to investors. Investment provisions in intra-Asian agreements also contrast with those from agreements between Asia and the rest of the world.

3. ADB's Economic Research and Cooperation Department monitors information on investment agreements in the Asia Pacific region, providing granular information on investment provisions. This work aims to provide ADB members and practitioners a tool to develop metrics and compare different areas of treaty design. It also aims at offering information on some areas of new-generation treaties, such as public interest obligations and noneconomic standards, which are still nascent in many investment agreements in the region.

4. ADB remains committed to ongoing multilateral efforts to reform the investment treaty agenda through knowledge sharing and institutional support. These initiatives strive for a more balanced approach granting protection to investors while supporting national development goals of host states. These efforts will support policies to encourage a better investment climate and improve the quality of FDI into the region.

Trade, Investment and Climate Change in Asia Pacific

5. ADB produces the Asian Economic Integration Report (AEIR), an annual flagship publication that monitors the progress of regional economic integration in the Asia region. As part of its next flagship, to be published in February 2023, ADB aims to explore the linkages and issues surrounding the nexus of climate change, trade and investment.

6. Asia and the Pacific is in the frontline of climate change, with many people working and living in low-lying coastal cities. Asia is currently experiencing the highest temperatures in the last 30 years, with average temperatures 1.39 °C above the 1981-2010 average and it is the warmest year on record since 1900. The region is responsible for over 50 percent of global greenhouse gas emissions. It is crucial that countries in Asia address the challenges and capture the opportunities that emerge from climate change.

7. Trade and investment play an outsized role in the economic development story in the region. Many countries in the region, from Japan, South Korea, and Singapore to India, Viet Nam and Malaysia have relied on exports and foreign direct investments as engines of economic growth. The region accounts for 35 percent of the world's trade in 2020 and a third of global foreign direct investments (FDI) in 2019. Indeed, decades of export-oriented development strategies and inward FDI have brought about the emergence of "factory Asia" – a dense production network in Asia that is the world's factory.

8. While trade and investment has been critical to Asia's development story, they also come with environmental costs. Traded products embody carbon content in its production, which are often produced in developing countries where environmental regulations are lax, or energy sources are more carbon intensive and shipped over long distances. Foreign investors may also choose investment locations to produce precisely to circumvent the stricter environmental regulations in their home country. Many of these investments are also vertical FDI that is a node in the supply chain and will import intermediate inputs and exports final products (or intermediate inputs). This will exacerbate the carbon emissions from transportation.

9. Yet, trade and investment can be channels for countries to enhance climate change mitigation and adaptation. Green and environment-related goods can support developing countries efforts towards generating clean and renewable energy. Foreign investments bring cleaner technology and production processes that can reduce the emission intensity of production, which can also spillover to other domestic firms. These foreign investments can also originate from countries with higher environmental standards and regulations that will apply the same regulations in the destination countries.

The role of International Investment Agreements in Asia's Climate Mitigation Policies

10. An area of particular interest for ADB's agenda is how trade and investment agreements in the Asia Pacific region can support climate mitigation efforts. Investment agreements can support sustainable development by fostering sustainable investment and maintaining market access in green technologies to support climate adaptation. Looking forward, agreements should also ensure investor compliance, reduce the risk of investor-State arbitration and be consistent with other regional agreements.

11. Current discussions on the Future of Investment Treaties led by the OECD are an important space to examine the existing approaches and options for governments to make progress in this agenda. ADB would be like to express its interest to participate in the OECD Investment Treaty Conference and other relevant discussions within the framework of consultations with external partners and

organizations. They will certainly contribute to shape ADB's work in investment policy for climate change and inform the current discussions with Asia's developing member countries in this area. We look forward to providing further information on our current work and exchanging further in this area.

Contact information

Rolando Avendano
Economist
Economic Research and Cooperation Department
Asian Development Bank
Email: ravendano@adb.org

Shawn Tan
Senior Economist
Economic Research and Cooperation Department
Asian Development Bank
Email: swtan@adb.org

AEP's contribution to the OECD Public Consultation on Investment Treaties and Climate Change

1. Background and Mission of AEP:

1.1. [AEP - Portuguese Business Association](#) (from now on simply referred to as "AEP") is a multisectoral and nation-wide Chamber of Commerce and Industry based in Porto (Portugal), where it was founded in 1849.

1.2. AEP's mission is to promote and defend business and associative activities in Portugal, standing up for the interests of companies and offering services to make them more competitive.

2. AEP´s proposals for both current and future Investment Treaties (ITs) **upon agreement** of the parties:

2.1. Explicitly insert **climate investments in the scope of ITs**.

2.2. Still regarding scope, we propose the **specific inclusion of ESG** (Environmental, social, and corporate governance) **financial instruments**. This will be beneficial both in terms of clarity (avoiding future arbitrage problems) and investment purposes, where the environmental side is also included.

2.3. Consider a new "**Most Beneficial Approach to Climate Investment" subclause of the** traditional **'Most Favored Nation"** (non-discriminating) **clause** in ITs, which should be **transformed into a more generic "Non-discriminating clause"**.

The new subclause seeks to adopt in all signatory parties the most beneficial conditions for climate investment found in the country (or countries) with the best practice(s). This most beneficial approach will apply not only to foreign investors from the other signatory countries, but to national investors as well (to avoid distortions), which justifies the insertion as a subclause of the MFN clause following an analogue non-discriminating logic, in this case applied to national investors.

To improve clarity, we propose the traditional MFN clause transformation into a more generic "Non-discriminating clause", which ensures the best equal treatment between national investors and foreign investors from signatory countries considering all possibilities with the proposed subclause.

The new subclause elevates the overall potential and ambition for climate investment and mitigates possible carbon leakage effects between signatory countries.

2.4. In the case any of the 2.1 to 2.3 proposals above are inserted into an IT, to better align incentives, we suggest a complementary **Carbon Neutrality Improvement Clause**, where the signatory countries compromise to an improvement in their carbon neutrality trajectories (taking as reference the UN 2050 goal) if climate investment progresses because of the treaty.

This clause, which will exclude countries not committed to the carbon neutrality goal, will help to further mitigate possible carbon leakage effects between signatory countries.

2.5. Finally, it is also important to consider (namely in 2.4) the different **degrees of industry development in different countries**. More significant support is needed for countries whose industry is still at an early stage of the climate transition, **to ensure that there is no loss of competitiveness**.

Submission to the OECD Public Consultation on Investment Treaties and Climate Change

Dafina Atanasova[1]

Executive summary

- There are the inherent limitations in examining international investment agreements (IIAs) when assessing their impact on climate change and other broader societal goals. The coexistence of several IIAs in parallel between the same parties, i.e. "spaghetti bowling", is widespread, and ignoring it distorts any impact analysis or reform efforts.
- This situation is compounded by the prevalence of non-derogation clauses in IIAs. Under these clauses, investors are guaranteed the benefit of the more favourable provision among those applicable to them under coexisting IIAs, undermining the effectiveness of reform efforts.
- As a result, for analytical purposes, coexisting IIAs and their inter-relationships must be factored into impact assessment of the IIA regime on states' regulatory space. In addition, as part of reform efforts, as much in future IIAs as in the existing stock of IIAs, non-derogation clauses must be terminated.
- Throughout the submission, I use the initiative to modernize the Energy Charter Treaty (ECT) aimed at facilitating energy transition away from fossil fuels to illustrate the problems that arise because of the combined effects of spaghetti bowling and non-derogation clauses. At each step I also highlight how the same question arises beyond the ECT.

A. Coexisting IIAs among the same states is highly relevant for assessing the impact of the investment regime on climate change

1. When multiple IIAs that coexist between that same state parties (spaghetti bowling), which is a widespread phenomenon in the investment treaty universe, this leads to a lack of predictability as to their respective scope of application and requires the assessment of their cumulative impact on states' ability to pursue climate change mitigation measures. Yet it is currently often overlooked.
2. Having multiple IIAs coexist among the same states introduces unpredictability as to the standard of liability that will apply to the respondent state in case of divergent formulations under these IIAs. This position has two complementary negative effects.[2] First, it creates the risk that among several different provisions, the one that creates the strictest liability for the state may be applied to it, undermining possible reform efforts if those do not apply to all parallel IIAs. This is especially the case, as investors have the power to initiate proceedings and choose the instrument to do so. Second and, irrespective of the outcome of proceedings, the

[1] **Dafina Atanasova** is a lecturer at the Master in International Dispute Settlement (MIDS) and resident researcher at the Geneva Center for International Dispute Settlement (CIDS), a joint Research Center of the University of Geneva and the Graduate Institute (IHEID), Geneva.
[2] UNCTAD, *World Investment Report 2017 – Investment and the Digital Economy* (United Nations 2017) pp. 128-130.

complexity of the legal regime and lack of clarity as to the respective scope of application of each IIA can lead to both higher costs for an administration to manage its IIA portfolio and to higher litigation costs in case of an investment dispute, due to the added dispute on the legal standard to apply. In addition, contrary to trade disciplines, the coexistence of IIAs does not create any offsetting advantage comparable to additional tariff reductions, for example.

3. Spaghetti bowling is widespread in the investment treaty universe. State parties commonly maintain more than one IIA in force between themselves. As UNCTAD reports, 141 out of 167 broad economic treaties with investment provisions (TIPs) coexist with at least one other IIA.[3] Analysing the Asia-Pacific region, Wolfgang Alschner similarly shows that ASEAN countries commonly have three or more IIAs in force in parallel among themselves.[4] By way of example, CPTPP currently coexists with close to 40 parallel IIAs among various of its Contracting Parties. The African Continental Free Trade Area, unless it breaks the current common practice, will also coexist with over 50 IIAs in force among African Union Member States and another over 100 IIAs signed among them, awaiting ratification.

4. The ECT provides a telling illustration of this phenomenon and the consequences of its absence from the public debate. Currently there are 463 IIAs in force among two or more of the ECT Contracting Parties in parallel to the ECT. The modernization or termination of the ECT has been in the spotlight for over a year. Yet, these IIAs have remained outside of the discussion, even though they coexist with the ECT.

5. These IIAs, mostly bilateral investment treaties (BITs), protect investments in general, including in the energy sector. They contain similar protection standards to those under the current ECT, as well as provide for investor-state arbitration. They are mostly older generation treaties. Over 60 percent of them were signed before 2000 and, of those signed more recently, only 29 IIAs were signed in 2010 or later. Over 100 of these IIAs are of ECT Contracting Parties that are among the 15 most common home states of investors.[5] By way of example, the Netherlands has 14 IIAs coexisting with the ECT, the United Kingdom - 25, Germany - 18, Spain - 12, France - 15, Belgium/Luxembourg - 19, Switzerland - 30, Austria – 18, etc.[6] The European Union and Ireland are the only Contracting Parties that do not have IIAs coexisting with the ECT. (See Annex 1 for the number of coexisting IIAs for each ECT Party.)

6. Maintaining the focus on the ECT alone in the circumstances significantly reduces the accuracy of the impact assessment that the investment regime can have on the regulatory activity of the Contracting Parties to it. As shown above, even if the ECT is terminated or successfully reformed, there are 463 IIAs that would continue to provide substantially similar protection to investors in its absence.

[3] UNCTAD, *World Investment Report 2017 – Investment and the Digital Economy* (United Nations 2017) pp. 128-130.
[4] Wolfgang Alschner 'Regionalism and Overlap in Investment Treaty Law: Towards Consolidation or Contradiction?' 17 Journal of International Economic Law 271.
[5] Based on the number of 1104 known investor-state arbitration cases based on IIAs as per UNCTAD's ISDS Navigator. See here: https://investmentpolicy.unctad.org/investment-dispute-settlement.
[6] For EU Member States these numbers exclude intra-EU BITs, in view of their progressive phasing out, even certain of them may still be in force. Source of raw data: UNCTAD, IIA Navigator, https://investmentpolicy.unctad.org/international-investment-agreements.

B. Non-derogation clauses in one IIA maintain and give prevalence to more favourable conditions for investors under any coexisting IIA

7. In addition to the parallel standards of liability under coexisting IIAs, the most common provisions regulating the inter-relationship among coexisting IIAs in the investment treaty universe, non-derogation clauses and clauses having similar effects, also undermine reforms undertaken through more balanced formulations in recent treaties. These clauses and, more broadly, the way in which recent IIAs regulate their coexistence with earlier treaties must also form part of the way in which one assesses IIAs' impact on states' ability to implement climate change mitigation measures. Yet, non-derogation clauses have been largely absent from reform efforts too.

8. Non-derogation clauses are very common in the IIA universe. These clauses are the most common way in which IIAs regulate their relations with other international agreements. UNCTAD's Mapping of IIA Content shows that non-derogation clauses are present in 1912 out of 2574 IIAs.[7] Based on my own prior work on conflict clauses, I found that 56% of over 1000 examined IIAs included a non-derogation clause that refers specifically to international norms.[8]

9. The ECT contains a particularly clear example of such a non-derogation clause. Article 16 reads as follows:

> *Where two or more Contracting Parties have entered into a prior international agreement, or enter into a subsequent international agreement, whose terms in either case concern the subject matter of Part III [investment] … of this Treaty,*
>
> *a. nothing in Part III … shall be construed to derogate from any provision of such terms of the other agreement or from any right to dispute resolution with respect thereto under that agreement; and*
>
> *b. nothing in such terms of the other agreement shall be construed to derogate from any provision of Part III … or from any right to dispute resolution with respect thereto under this Treaty,*
>
> *where any such provision is more favourable to the Investor or Investment.*

10. Non-derogation clauses are problematic in the context of reform efforts because they guarantee to investors the benefit of the more favourable among two potentially applicable provisions. For example, among two formulations of the FET standard, or of indirect expropriation, the investor is guaranteed the one more advantageous of them. Even if the exact bounds of the effect of the non-derogation clause are subject to controversy, investment tribunals ruling on the basis of the ECT have generally construed the provision broadly.[9] Indeed, non-derogation

[7] Both UNCTAD Mapping IIA Content (https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping) and EDIT (https://edit.wti.org/document/ttt/search) databases do not distinguish between non-derogation clauses that apply to both international and domestic norms of the host state and those that only apply to domestic ones.

[8] Dafina Atanasova, 'Non-economic disciplines still take the back seat: The tale of conflict clauses in investment treaties' 34(1) *Leiden Journal of International Law* (2021) 155, Section 4.2.2.

[9] A series of investment tribunals have recently ruled on the effects of Article 16 in the context of the relationship between the ECT and EU law. For example Mathias Kruck et al. v. Kingdom of Spain (ICSID Case No. ARB/15/23), Decision on Jurisdiction and Admissibility, ¶¶ 293 (19 April 2021); SolEs Badajoz GmbH v. Kingdom of Spain (ICSID Case No. ARB/15/38), Award, ¶¶ 247-250 (31 July 2019); RREEF Infrastructure (G.P.) Ltd. et al. v. Kingdom of Spain (ICSID Case No. ARB/13/30), Decision on Responsibility and on the Principles of Quantum, ¶¶ 208-209 (30 November 2018); Vattenfall AB et al. v. Federal Republic of Germany (ICSID Case No. ARB/12/12), Decision on the Achmea Issue, ¶¶ 202, 229 (31 August 2018); Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain (ICSID Case No. ARB/14/1), Award, ¶ 332 (16 May 2018). The scope of application that the tribunals assign to Article 16 may be questioned. The salient point for present purposes is that even a more

clauses are interpreted to ensure that a particular treaty is seen as a minimum requirement and does not affect more favourable treatment in place elsewhere. As a result, the clause has the effect of reversing the usual rules that regulate normative conflict in international law, such as Art 30 of the Vienna Convention on the Law of Treaties that would give priority to the later treaty over an earlier one.

11. The effect of non-derogation clauses as described above, coupled with the fact that investors choose under which IIA to commence proceedings, favours investors' continued reliance on non-reformed over reformed IIAs. In the early days of IIAs, the goal of these provisions was in line with the understanding that IIAs were setting a minimum standard of treatment that should not impede higher protection available elsewhere. However, maintaining non-derogation provisions is problematic in the midst of reform efforts which aim to offer "clearer and more precise investment protection standards …removing ambiguities that made these standards open to abuses or excessive interpretations ".[10] This self-stated goal of IIA reform almost by definition leads to formulations less favourable to investors, rendering the maintenance of non-derogation provisions harmful to reform efforts. As a result, non-derogation clauses constitute a hurdle to the reform of the IIA regime.

12. The above suggests that countries should be aware of non-derogation clauses when conducting the impact assessment of their IIA portfolios and in their efforts to reform them. This is particularly relevant for countries that have more than one IIA with capital exporting countries. Yet, in a concerning trend, the potential effect of non-derogation clauses is currently overlooked.

13. Non-derogation clauses have been maintained or continue to be inserted in recent IIAs. To give the ECT as prominent example once more, under Article 16 of the ECT, reformed ECT provisions and unreformed coexisting IIA provisions are explicitly maintained in parallel. Yet, currently, no proposal to modify Article 16 is on the table as part of the under ECT modernization.[11] As a result, paradoxically several years of modernization efforts could result a text that investors can circumvent at will.

14. Similarly, the Comprehensive and Progressive Transpacific Partnership (CPTPP), sometimes referred to as a new golden standard on investment protection, contains Article 1.2, footnote 1 which has the similar effects. It reads:

> *For the purposes of application of this Agreement, the Parties agree that the fact that an agreement provides more favourable treatment of goods, services, investments or persons than that provided for under this Agreement does not mean that there is an inconsistency within the meaning of paragraph 2.*[12]

moderate reading, in line with comparative and historical data on the meaning of non-derogation clauses, would still entitle investors to select the most favourable IIA among those potentially applicable to them.

[10] European Commission, *Investment Provisions in the EU-Canada free trade agreement (CETA)*, 1. https://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf The same goal underlies the EU's participation in the negotiations for the modernization of the ECT. According to the European Commission "The EU's objective is to ensure that the ECT reflects modern investment standards, such as the ones pursued through the EU's reformed approach on investment protection…" https://ec.europa.eu/trade/policy/accessing-markets/investment/.

[11] European Commission, *EU text proposal for the modernisation of the Energy Charter Treaty (ECT)*, 27 May 2020. https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf.

[12] Article 1.2, para. 2 requires Parties to consult in order to reach a mutually-agreed solution.

15. Despite the difference in formulation, the effect of this provision is likely to also disapply the otherwise applicable conflict resolution procedure, thus allowing investors to choose the most favourable among the IIAs in force in parallel between the relevant CPTPP Contracting Parties.

16. The continued inclusion of such provisions in IIAs and their maintenance in the existing stock of IIAs undermines reform efforts by explicitly guaranteeing to investors and their investments the benefit of the more favourable to them provision among those potentially applicable. This situation suggests that:

  i. The assessment of the impact of IIAs must factor in all coexisting IIAs and the provisions that regulate the inter-relationships among them in order to offer an accurate description of states' available regulatory space;

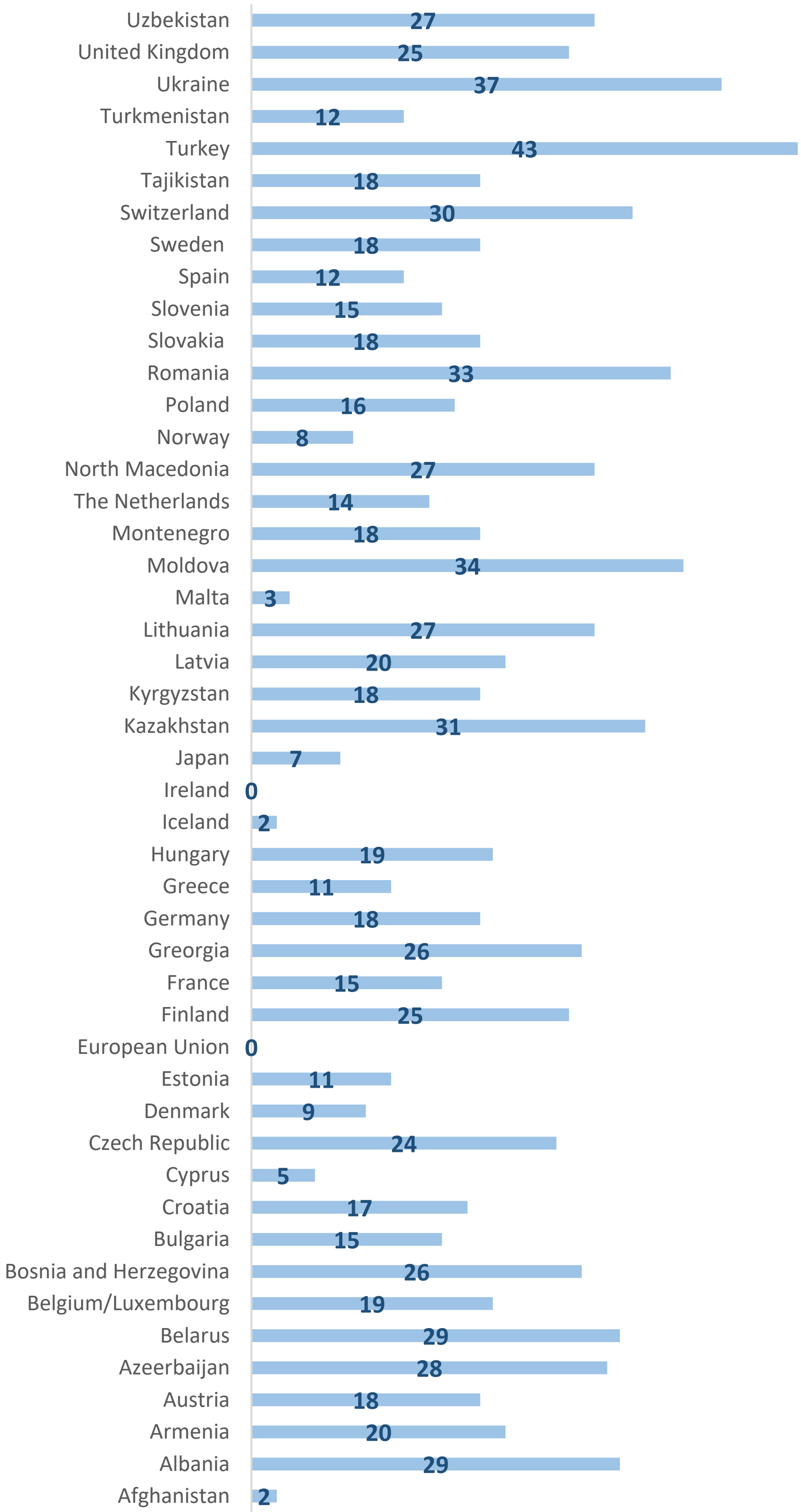
  ii. "Reformed" IIAs should not include non-derogation provisions and should, instead, either terminate earlier IIAs coexisting among their parties or, if earlier IIAs are maintained, provide an explicit conflict clause for the "reformed" IIA's prevalence over such earlier IIAs;[13]

  iii. If a multilateral instrument is negotiated for the reform of the existing stock of IIAs, non-derogation clauses that refer to international norms should be terminated as part of that instrument.

[13] In view of the restrictive definition of normative conflict adopted by tribunals, this conflict clause should ideally be triggered by the overlap of scope of the IIAs, without the need to find a conflict.

Annex 1[14]

Number of IIAs coexisting with the ECT by Contracting Party



[14] Source of rough the data: UNCTAD IIA Navigator: https://investmentpolicy.unctad.org/international-investment-agreements/treaties/tips/3118/the-energy-charter-treaty-1994-.

Submission to the OECD Public Consultation on Investment Treaties and Climate Change

Jonathan Bonnitcha[1]

Executive Summary:

1. Investment treaties are an obstacle to effective action to avert catastrophic climate change. This is because the treaties, in their current form, shift the risk that fossil fuel sector assets will be 'stranded' as economies decarbonise from private investors to taxpayers. This discourages the change in government policy, as well as the private sector divestment, that the global energy transition requires.

2. The problems with existing treaties are well-known, but the practical challenges of amending or terminating treaties mean that little progress has been made in addressing them. Given the urgency of reform, states should consider targeted changes to the principles governing compensation under investment treaties. The amount of compensation available under investment treaties shapes the distribution of risks associated with decarbonisation between private investors and taxpayers. Under existing approaches, foreign investors are entitled to compensation for the income they would have earned were it not for changes to regulatory arrangements.

3. Drawing on co-authored research with Dr Emma Aisbett, I propose specific treaty language to reform compensation under investment treaties. Under our approach, compensation is the lesser of the investor's loss and the host state's gain from the host state not having had the new regulatory framework in place when the investment was made. This approach to compensation gives host states flexibility to shift their policy priorities over time – for example, to adopt accelerated timetables for the decommissioning of coal-fired power stations – while ensuring that foreign investors remain protected from asset seizure and other forms of opportunistic state conduct.

4. Our proposal could be adopted in a relatively straightforward way through an 'opt in' multilateral instrument. A practical benefit of our proposal is that it does not foreclose wider, and more contested, discussions about reform of the investment treaty regime to better align the regime with the goal of averting catastrophic climate change.

[1] Author note and disclosure: I am a Senior Lecturer in the Faculty of Law and Justice at the University of New South Wales. I write this submission in my academic capacity. In addition to my full-time academic role, I am affiliated with the International Institute for Sustainable Development as a Senior Associate (consultant). In that capacity I contribute to the research and drafting of policy reports and, occasionally, provide ad hoc policy advice to developing countries on investment governance. I am not involved with any activities connected with Investor-State Dispute Settlement (ISDS) proceedings and do not have an affiliation with any law firm or legal service provider. I have previously worked for the Australian Government's Office of International Law on Australia's defence of the *Philip Morris Asia v Australia* arbitration. I am no longer affiliated with the Australian Government.

Investment treaties are an obstacle to effective action on climate change

5. Investment treaties are an obstacle to effective action to avert catastrophic climate change. This is because the treaties, in their current form, shift the risk that fossil fuel sector assets will be 'stranded' as economies decarbonise from private investors to taxpayers. This possibility is illustrated by ISDS proceedings brought under the Energy Charter Treaty by Uniper and RWE, claiming a right to compensation for the Netherlands' decision to phase-out coal power generation by 2030.

6. Among other claims, the owners of the coal power plants argue that the phase-out of coal power is inconsistent with their 'legitimate expectations',[2] notwithstanding that the risks of progressive tightening of the regulatory framework governing the burning of fossil fuels should have been obvious to any prospective investor since at least the 1990s. If the investors are successful in their claims, they will be entitled to compensation for their losses, which tribunals ordinarily calculate by reference to the future income investors would have earned 'but for' the change in the regulatory framework.[3]

7. Even in the absence of successful ISDS claims, the existence of investment treaties can affect the distribution of costs and risks under negotiated transitional arrangements between private investors and governments. For example, in 2020 Germany agreed to provide the operators of coal power plants with €4.35 billion in compensation as part of its plan to phase out coal power generation by 2038.[4] Given Germany's well-documented experience with ISDS claims relating to the accelerated phase-out of nuclear power under the Energy Charter Treaty, it is likely that the terms of this compensation package were influenced by an awareness of the possibility of ISDS claims.

8. Although the examples in the foregoing paragraphs relate to the phase-out of coal power, investment treaties have the potential to impede a much broader set of policies relating to the energy transition. For example:

    a. Claims arising from decisions to terminate subsidies to polluting industries. [5]
    b. Claims arising from changes to pricing in regulated markets in ways that aim to better reflect the environmental externalities associated with production.[6]

[2] Stan Putter, 'The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations' (2021) http://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/

[3] Jonathan Bonnitcha, Malcolm Langford, José Manuel Álvarez Zárate and Daniel Behn, 'Damages and ISDS Reform: Between Procedure and Substance' (2022) *Journal of International Dispute Settlement*.

[4] European Commission. 'State aid: Commission opens in-depth investigation into compensation for early closure of lignite-fired power plants in Germany' (2021) https://ec.europa.eu/commission/presscorner/detail/en/ip_21_972

[5] Termination of subsidies led to the successful claim in *Micula v Romania,* see https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/180/micula-v-romania-i-

[6] Changes to the tariff regime governing electricity generated from solar energy led to a series of successful claims against Spain, although it is important to note that these changes made the tariffs *less* favourable to the solar generators. See, for example, *Novenergia v Spain* https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/782/novenergia-v-spain

c. Claims relating to changes to the regulatory framework governing site remediation and liability for environmental impacts.[7]

The climate ministers of New Zealand and Denmark have reportedly identified investment treaties as a barrier to more ambitious action to limit climate change in their respective countries.[8] The fact that states have often been surprised by the broad and unexpected implications of their treaty obligations in the past, points to the potential for other unexpected interactions between investment treaties and action to avert climate change.[9]

9. The *extent* to which investment treaties shift the risks associated with action to avert climate change from private investors to taxpayers raises a complex set of questions that depend on the range of investments covered by the treaties, the drafting and interpretations of the treaties' substantive provisions and the principles governing the quantification of compensation. The *direction* of the shift, however, is clear; investment treaties shift risks of foreseeable regulatory change to prevent climate change from private investors to taxpayers.

10. As well as discouraging change in government policy, shifting the risks associated with policy change from private investors to taxpayers encourages ongoing investment in polluting industries and slows the divestment necessary for the energy transition. This is because investment treaties act as a form of insurance for investors in polluting industries against the possibility that environment regulation will become more restrictive over time.[10]

Reform of *existing* treaties should be a priority

11. The problems that existing treaties pose for action to avert catastrophic climate change are well-known, but the practical challenges of amending or terminating treaties mean that little progress has been made in addressing these concerns. Over 2,000 'old style' investment treaties remain in force and these treaties continue to be source of the vast majority of ISDS claims.[11]

[7] Changes to the legal framework governing site remediation where the basis for the unsuccessful claims in *Glamis Gold v United States of America*, see https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/100/glamis-gold-v-usa

[8] Elizabeth Meager, 'Cop26 targets pushed back under threat of being sued' (2022) https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/

[9] For discussion of other examples, see Lukas Schaugg and Greg Muttit, 'How the Energy Charter Treaty risks undermining the outcomes of COP 26' (2022) https://www.iisd.org/itn/en/2022/03/01/how-the-energy-charter-treaty-risks-undermining-the-outcomes-of-cop-26/

[10] Emma Aisbett, Larry Karp and Carol McAusland, 'Police Powers, Regulatory Takings and the Efficient Compensation of Domestic and Foreign Investors', 86 (2010) Economic Record 274

[11] Of the 68 cases brought in 2020 that are listed on the UNCTAD ISDS Navigator website, 42 were brought under pre-2000 treaties with a further 22 brought under treaties signed between 2000 and 2009. Only 4 were brought under treaties signed since 2010.

12. Given the urgency of action to avert climate change, we cannot wait for 'old style' treaties to be replaced gradually. Concerted action needs to be taken now to amend or terminate these treaties.

Rethinking compensation is a promising way to address concerns about investment treaties' implications for action to address climate change

13. There are several options for better aligning investment treaties with the need for action to avert climate change. Many of these options can be pursued in ways that are complementary and mutually reinforcing. However, before turning to the question of compensation, it useful to briefly review some of the challenges associated with other reform options.

14. In the stalled negotiations for the reform of the Energy Charter Treaty, the European Union has proposed to gradually limit that treaty's coverage of fossil fuel investments. Under the EU proposal, future fossil fuel investments would not be entitled to the protection of the treaty, while the protection of existing fossil fuel investments would be gradually withdrawn ten years after the proposed EU amendment enters into force.[12] The EU proposal is inadequate, in that much of the risk of policy action to avert climate change over the coming decades will continue to be shifted on to taxpayers. The fact that there is, as yet, no consensus around this modest proposal points to the challenges of negotiating changes that place different categories of investment completely outside the scope of treaties' protection.

15. A different strategy is to include general exception provisions in investment treaties that reaffirm states' right to implement non-discriminatory measures for environmental purposes. While promising, this strategy has been less effective in practice than one might expect. In *Eco Oro v Colombia* a majority of the Tribunal reached the surprising conclusion that states remained liable to pay compensation for legitimate, non-discriminatory measures falling within the scope of the treaty's general environmental exception.[13]

16. In this wider context, it is useful to consider reform of principles governing compensation as a central component of any wider strategy to better align investment treaties with action to prevent climate change. The principles governing compensation are of central importance to the functioning of the investment treaty regime. It is the possibility of concrete outcomes from ISDS proceedings – i.e. the pay-out of compensation to foreign investors – that shapes the behaviour of states and investors. Recent discussion in UNCITRAL Working Group III highlight states' concerns relating to the existing approach to compensation under investment treaties.

Our concrete proposal to reform compensation under investment treaty.

[12] 'European Union text proposal for the modernisation of the Energy Charter Treaty' (2020) https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159436.pdf
[13] For discussion, Ben Heath, 'Eco Oro and the Twilight of Policy Exceptionalism' (2021) https://www.iisd.org/itn/en/2021/12/20/eco-oro-and-the-twilight-of-policy-exceptionalism/

17. In two papers co-authored with Dr Emma Aisbett, we develop a proposal for a new approach to compensation.[14]

18. We begin from the observation that investment treaties currently address two conceptually distinct problems.

    a. Time inconsistency of the host state's optimal policy toward the investment – theoretically, a host state has an incentive to offer attractive conditions to new foreign investment and then renege on the bargain once the investment has been made. An example is a state that allows a foreign investor to build a power station and then seizes possession of the power station once construction is complete.

    b. The broader phenomenon of policy change throughout the life cycle of an investment, including policy change in response to new information or changes in a state's policy preferences. An example is a state that shuts down a power station on account of its negative environmental impacts.

    We argue that investment treaties should be narrowly targeted to solving problems of opportunism driven by time inconsistency. This is because only treaties that are narrowly targeted at addressing opportunism generate mutual benefits for both home and host states. It is also because wider constraints on policy change are inconsistent with basic democratic principles and the 'polluter pays' principle of environmental governance.

19. Principles governing compensation play a central role in the way that investment treaties allocate the risk of future policy change between states and investors. In our papers we show that a well-designed compensation rule can distinguish between these two drivers of policy change – opportunism and changing policy priorities – without any need for arbitral tribunals to inquire into the motives for government conduct. Perhaps more importantly, our proposal cleanly addresses complex cases of mixed motives of the sort that regularly arise in ISDS claims in practice.

20. We propose that compensation for breach of an investment treaty should be the lesser of the investor's loss and the host state's gain from the host's state not having had the new regulatory arrangements in place when the investment was made. This differs from the existing approach, where compensation is ordinarily based on the future income the investor would have earned were it not for changes to regulatory arrangements.

21. The basic intuition behind our proposal is as follows.

    a. In situations where the host state has not gained anything from allowing the investment to go ahead and then subsequently changing the regulatory framework there is no opportunism and no compensation is required. An example is the case

[14] Emma Aisbett and Jonathan Bonnitcha, 'A Pareto-Improving Compensation Rule for Investment Treaties' 24 (2021) Journal of International Economic Law 181; Jonathan Bonnitcha Emma Aisbett 'Against Balancing: Revisiting the Use/Regulation Distinction To Reform Liability and Compensation Under Investment Treaties' 42 (2021) Michigan Journal of International Law 231.

in which an investor constructs a gas pipeline and the host state then refuses to issue the permits necessary for the pipeline to going into operation. Absent some additional factor, such as payments by the investor to the state or the construction of dual-use infrastructure that is subsequently repurposed by the state, a state gains nothing by allowing and then cancelling this investment. This is a 'pure' case of policy change.

b. In other situations, however, there will be a relevant gain to the host state. An example is the situation in which a host state unilaterally alters the financial terms of a project-specific offtake agreement to such an extent that it makes a power plant uneconomic from the investor's perspective. In this case, the host state gains from the supply of below market-cost electricity from a power station that would not otherwise have been built. In such situations, requiring payment of compensation equal to the hosts state's gain compared to the situation that would have existed if the new regulatory arrangements had been in place from the outset neutralises the state's incentive to engage in opportunistic conduct. This protection against opportunistic conduct is important to encourage investments in clean energy. Such investments – for example, wind and solar power generation, and batteries and other energy storage infrastructure – are characterised by a high ratio of up-front costs to operating costs and, therefore, vulnerable to opportunism.

c. Gain-based compensation is only necessary up to the threshold of the loss suffered by the investor as compared to the situation that would have existed if it had the new regulatory arrangements in place from the outset. Normally, this loss will equal the investor's sunk costs less any net income earned from the operation of the investment. If an investor is protected from the possibility that opportunistic conduct leave will leave it worse off than if it had not gone ahead with the investment, then the risk of opportunism will not discourage investors from going ahead with prospective investment projects.

22. The effect of our proposal is to prevent states from having to pay compensation for policy changes designed to prevent climate change, while retaining a degree of protection for investors from opportunistic state conduct.

23. An application of our proposal to the disputes between the Netherlands and the owners of coal-fired power stations may help clarify how our proposal works in practice:

    a. Assuming that a tribunal found that the Netherlands had breached the Energy Charter Treaty, the next step would be to determine the loss suffered by the investors compared to the situation that would have existed if the 2030 phase-out date had been in place from the outset.
    b. This loss is equal to the up-front cost of constructing the power plant adjusted to include the cost of capital over the operating life cycle of the project, minus the operating income that the investment would generate up to 2030. It may be that the return on investment up to 2030 fully amortises the up-front cost, in which case no compensation is due.

c. If the investor has suffered some relevant loss, the next step would be to determine whether a gain has accrued to the host state compared to the situation that would have existed if the 2030 phase-out date had been in place from the outset.
d. Conceptually, there may be a gain to the state if it allowed the investor to build the coal power plant and then introduced the 2030 phase-out date. The value of that gain is the value of the electricity obtained from the investment, less the amount actually paid for that electricity, and also less the value of the environmental damage caused by the investment's operation to the host state with all three figures calculated over the operating life cycle of the investment up to the point where it is shut down. These first two amounts can be quantified by reference to market prices. The question of how to value the environmental damage is a matter of legal and policy debate across many domains, and is a question taken up in more detail in Emma Aisbett's submission to this consultation. However, explicit or implicit carbon prices in the host economy can be used to calculate a lower bound on this value. As a practical matter, the negative environmental impact of coal power generation makes it highly unlikely that there is relevant gain to the state, but this assessment needs to be made at the project level. In the unlikely event that there is a compensable gain, the amount of compensation will be far less than is case under existing approaches to compensation.
e. At the most, the state pays compensation equal to what it gained from allowing a specific investment to go ahead, the wider risk of policy change is borne by the investor.

Implementing our proposal in practice

24. UNCITRAL Working Group III has discussed the practicalities of amending existing treaties. The most promising option is a multilateral instrument that allows states to 'opt in' to specific reforms.[15] If two states 'opt in' to the same reform, the effect would be to amend any bilateral investment treaty between those states to incorporate the reform in question and also to amend the operation of any multilateral instrument as it applies between them.

25. Our proposal is well-suited to adoption via such an instrument, as a new approach to compensation can be applied across diverse treaties, regardless of their jurisdictional scope and the substantive protections contained therein.

26. Because our proposal is designed to ensure investment treaties generate mutual benefits for both home and host states, including in the context of policy change associate with the energy transition, it is more likely to achieve broad support among states with different economic and political systems. At the same time, our proposal does not foreclose wider,

[15] *See* U.N. Comm'n on Int'l Trade L., Possible Reform of Investor-State Dispute Settlement (ISDS) Multilateral Instrument on ISDS Reform: Note by the Secretariat, U.N. Doc A/CN.9/WG.III/WP.194, paras 8–9 (Jan. 16, 2020). For academic discussion, see Wolfgang Alschner, *The OECD Multilateral Tax Instrument: A Model for Reforming The International Investment Regime?*, 45 BROOK. J. INT'L L. 1 (2019); Stephan W. Schill and Geraldo Vidigal, *Designing Investment Dispute Settlement à la Carte: Insights from Comparative Institutional Design Analysis*, 18 L. & PRAC. INT'L CTS. & TRIBUNALS 314 (2019).

and more contested, discussions about reform of the investment treaty regime to better align the regime with the goal of averting catastrophic climate change.

Appendix: Suggested model treaty language

(1) To determine the amount of compensation due for expropriation or for any other measure(s) that breach(es) this treaty, the tribunal shall first determine whether, if the measure(s) had been in place immediately prior to the time at which the investor made its investment, the investor would, nevertheless, have made the investment:

a. To determine whether the investor would have made the investment, the tribunal shall consider objective rather than subjective factors. In particular, the tribunal shall base its decision on whether, if the measure(s) had been in place immediately prior to the time at which the investor made its investment (but if the situation in all other respects, including information about the likelihood of future contingencies, was the same as that facing the investor immediately prior to making its investment), the investment would, nevertheless, have been expected to generate a positive net return.

b. In the case of measure(s) amounting to expropriation of an investment, a tribunal shall conclude that the investor would not have made the investment if the measure(s) had been in place immediately prior to the time at which the investor made its investment, unless the host state proves otherwise.

(2) If the tribunal determines that the investor would have made the investment, then no compensation is due to the investor.

(3) If the tribunal determines that the investor would not have made the investment, then the tribunal shall award the lesser of the following amounts as compensation to the investor:

a. The value of the loss the investor has suffered, as compared to the situation the investor would have been in if it had not made the investment; and

b. The value of the gain the host state has obtained, as compared to the situation the host state would have been in if the investor had not made the investment.

i. In assessing the value of 3(b) the tribunal shall take into account any payment the investor has made to the host state to acquire the investment, any physical assets owned by the investor that have been transferred into state ownership and any genuinely additive economic contribution of the investment to the host state's economy – for example, through the payment of wages to employees in the host state at a higher rate than the wages those employees would have earned if the investment had not been made. In assessing the value of 3(b) the tribunal shall deduct the value of any damage caused by the investment's operation to the host state.

By implication of the above, when either amount 3(a) or 3(b) is zero, compensation shall be zero.

Reforming IIAs to Combat Climate Change: Lessons from Latin America[1]
Submission to the OECD public consultation on investment treaties and climate change

Dr. Julia Calvert, Lecturer in International Political Economy
School of Social and Political Science, University of Edinburgh

Overview

1.1. IIAs create strong incentives for governments to maintain the status quo in natural resource and energy policy. Combatting climate change and promoting sustainable development requires modifying existing regulations and law to achieve a better balance between corporate interests and environmental protection.

1.2. IIAs with investor-state dispute settlement (ISDS) provisions will generate the most costs for countries that are willing to experiment with forward-thinking policy alternatives aimed at combatting climate change and replenishing our ecosystems.

1.3. The OECD can play a role in promoting the reform of international investment agreements (IIAs) to better protect the environment by: calling for the termination and / or renegotiation of first generation (pre-2012) IIAs; promoting the integration of investor obligations into investment treaty models; encouraging greater capacity building programmes that foster sustainable partnerships between foreign investors and host-governments, especially in natural resource sectors; and by encouraging the use of alternative dispute settlement mechanisms in lieu of ISDS.

International Investment Agreements and the Environment

2. **Contributing to sustainable development by encouraging sustainable investment and preserving policy space is needed, but government policy space is already constrained by IIAs.** Researchers have noted the potential negative impact of IIAs on government efforts to transition economies toward renewable energy sources and reduce reliance on fossil fuels (see Tienhaara and Cotula 2020). IIAs may also reduce the ability and willingness of governments to promote sustainable natural resource governance and to introduce and enforce policies that minimise the impacts of mining and oil extraction on the environment.

2.1. Foreign investors have resorted to ISDS to pressure governments into delaying or forgoing the introduction or modification of natural resource regulations and environmental policy that affect their profit expectations. For instance, in Ecuador, the government of Rafael Correa largely failed to implement new mining legislation introduced in 2009 that would have banned large foreign-owned mining companies from operating in environmentally sensitive areas after ISDS claims by mining companies.[2] This ban had been widely championed by indigenous and environmental activists as an essential means to protect the Amazon rainforest.

2.2. IIAs have been used by foreign investors to dissuade government officials from enforcing environmental standards in Peru. For instance, Peru was targeted by an ISDS

[1] This brief is based on a forthcoming book: Calvert, Julia. (forthcoming). The Politics of Investment Treaties in Latin America. Oxford University Press. Please contact the author for a pre-release copy.
[2] See Copper Mesa Mining Corporation v. Republic of Ecuador (PCA Case No. 2012-2) and RSM Production Company v. Republic of Ecuador.

claim under the 2001 Peru-Chile IIA after the municipal government of Lima rescinded the operating license of Lucchetti Perú, which owned a food production factory. The factory had been built in an ecologically protected zone after the investor obtained permission by the National Institute of Natural Resources (NINR) through corruption.[3]

2.3. Peru lost an ISDS case with US-based mining company Renco after the government provided multiple extensions on the company's environmental remediation commitments. Renco's subsidiary, Doe Run Peru, operated a metallurgical complex in the city of La Oroya. The complex leached lead into surrounding waterways and polluted the air. Renco committed to bringing facilities into compliance with environmental standards, but fell behind repeatedly on its commitments. Tests conducted by local NGOs found that the level of lead in the blood of local residents far exceeded the maximum acceptable standards set out by the World Health Organisation (Scurrah et al. 2009, 166; Pérez-Rocha et al. 2011, 10). Growing demands from local community members and clearer information about the project's impact on public health contributed to the government's unwillingness to grant further extensions. Renco responded with an ISDS claim, which is currently in arbitration.[4]

2.4. These cases may seem anecdotal, but one ISDS claim can promote regulatory chill as governments fear that introducing or enforcing legislation will prompt costly litigation. Academic studies suggest that governments learn from ISDS cases brought against other countries and factor the risk of ISDS claims into their decisions (not) to adopt legislation targeted by ISDS cases in other countries (see Moehlecke 2020; Thakur 2021; Calvert forthcoming).

2.5. Introducing stronger environmental policy and enforcement mechanisms and modifying natural resource legislation to reduce damage from mining on the environment is needed in Latin America and in other resource-rich countries. Mining and mineral extraction is set to increase as the demand for Lithium and other metals and minerals used in the production of green and clean technologies grows. Without stronger policies and enforcement, much of the potential gains from transitioning toward a greener global economy will not be realised, especially in countries where these mineral and metal deposits are abundant and commercially viable.

2.6. First generation IIAs, defined by the United Nations Conference on Trade and Development as those signed before 2012, present the greatest threat of regulatory chill because of the ambiguous wording and scope of key investment protections. These treaties must be terminated and / or renegotiated as a matter of urgency so that governments do not delay action on climate change. In interviews with policymakers, Calvert (forthcoming) found that while many policy leaders wanted to renegotiate IIAs, they feared that doing so would contribute to capital flight or lead to denouncements from their economic partners. Normalising the renegotiation of IIAs to promote strong environmental standards would alleviate this pressure and encourage more governments to renegotiate their treaties.

[3] Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) v. Republic of Peru (ICSID Case No. ARB/03/4), Final Award, 7 February 2005. ICSID arbitrators ultimately declined the case on the basis that the dispute began before the IIA's 2001 entry into force

[4] The Renco Group Inc. v. Republic of Peru I (ICSID Case No. UNCT/13/1), Final Award, 9 November 2016. In July 2016, an ICSID tribunal dismissed the case on jurisdictional grounds after it was found that Renco violated the PUSTA's waiver claims. The claim was reintroduced by the company in 2018.

3. **Encouraging sustainable development also requires strengthening the ability of governments to hold foreign investors responsible for sustainable business practices. Foreign investors have used ISDS to seek compensation for disruptions to investment projects that stem from their own environmental mismanagement.**
   3.1. Renco's repeated failure to meet its own environmental commitments underpinned the dispute which led to its 2016 ISDS case against Peru. Peru lost an ISDS case against Canadian mining company Bear Creek after a dispute between that company and local communities over the mine's impact on the environment. Bear Creek failed to conduct adequate consultations with local community members before the mine's development, which led to violent clashes between protestors and national police forces that were protecting the project. The conflict prompted Peru to revoke the company's operating permit, which ICSID arbitrators ruled as arbitrary treatment.[5]
   3.2. IIAs provide very few grounds on which governments can bring a legal claim against an investor. Governments must instead rely on their investment contracts to introduce counter claims. Ecuador has used counter claims to hold foreign investors accountable for environmental damage and to reduce the overall compensation owed to foreign-owned oil companies in ISDS cases.[6] Peru has also used counterclaims to dissuade frivolous ISDS claims.[7] Rebalancing investment treaty law requires eliminating the single-party liability principle whereby foreign investors have the capacity to hold states accountable for harms done but governments cannot sue foreign investors.

4. **More flexible and balanced implementation mechanisms are needed to increase the capacity of governments to meet their IIA obligations and to develop constructive and sustainable relationships with foreign investors.** Sattorova (2018) finds that IIAs do not contribute to strengthening the rule of law in countries that signed onto them because ISDS is a weak enforcement mechanism and provides few incentives for institutional improvements.
   4.1. In an analysis of the primary drivers of IIA infringement and noncompliance in Latin America, Calvert (forthcoming) finds that governments most often infringed unintentionally on their agreements due to institutional weakness and a lack of knowledge about their IIA commitments. Unintentional infringement means that governments use significant public funds to compensate foreign investors because they are unable to control the conditions that lead to IIA infringement. In the future, these funds will be needed to promote the transition toward green economies.
   4.2. Calvert (forthcoming) also finds that ISDS was a weak predictor of IIA compliance in Latin American countries. Even in countries where support for IIA compliance is strongest, ISDS made it easier for governments to reassure investors of their property rights without disrupting clientelistic networks or dedicating the resources needed to

[5] Bear Creek Mining Corporation v. Republic of Peru (ICSID Case No. ARB/14/21), Award, 30 November 2017

[6] Ecuador brought counterclaims against two foreign-owned oil companies, Perenco Ecuador and Burlington Resources, under their respective contracts over soil and groundwater pollution which allegedly had been caused by the companies' failure to maintain appropriate infrastructure to mitigate the damage. The Perenco tribunal awarded Ecuador USD$ 54,439,517 for the costs of restoring the environment as well as USD$ 6,325,782.76 towards its legal fees. Burlington was ordered to pay Ecuador $41, 776492.77. See Perenco Ecuador Limited v. Republic of Ecuador (ICSID Case No. ARB/08/6), Final Award, 27 September 2019.

[7] See for example: Caraveli Cotaruse Transmisora de Energía (CCTE) v. Republic of Peru (ICSID Case No. ARB/11/9).

tackle institutional gaps that contribute to infringement (see also Gaukrodger and Gordon 2012).

4.3. Preventing disputes requires massive investments in strengthening domestic institutions responsible for the planning, management and servicing of foreign investment. Ensuring sustainable and effective partnerships between governments and foreign investors is therefore not solely a matter of enforcing the rule of law.

4.4. Dispute prevention and the sustainable governance of foreign investment will ensure that public funds required to promote environmental protection and a green energy transition are not redirected toward ISDS awards.

5. **Improving or maintaining market access for green and health technologies may run counter to the effort of promoting sustainable investment if market access obligations are too broad.** Governments must preserve their ability to vet investment projects according to sustainability criteria and should therefore avoid granting pre-establishment rights which limit this ability.

6. **Recommendations**

6.1. The OECD has the opportunity to act as a global leader in IIA reform by helping to construct a norm around the termination and / or revision of first-generation treaties. To this end, the OECD should call – in the clearest terms possible – for the renegotiation of first-generation treaties.

6.2. IIAs must incorporate clearer and more precise language on investment protection standards and dispute settlement procedures. However, governments also require effective monitoring and compliance mechanisms that generate awareness of IIA obligations across all levels of government; that strengthen domestic institutions needed to manage and service investment projects; and, that enhance community involvement in the development and governance of investment projects. Establishing these mechanisms requires funding and knowledge, which OECD members can supply through foreign aid and capacity building programmes.

6.3. The ISDS system should be replaced by dispute settlement mechanisms (e.g. an ombudsperson) that can encourage accountability on behalf of both parties (i.e. foreign investors and host governments). ISDS does not strengthen domestic institutional quality and does not necessarily lead to the fairer and more predictable treatment of foreign investors.

6.4. IIAs should incorporate investor obligations that strengthen the ability of governments to hold foreign investors accountable for poor environmental practices. These obligations may encourage the adoption of corporate social responsibility and decrease the occurrence of investment disputes, particularly in the natural resource sectors where social conflicts between host communities and foreign investors are most common.

6.5. The OECD should work with other international organisations, including the United Nations Conference on Trade and Development, the United Nations Commission on International Trade Law, the International Centre for the Settlement of Investment Disputes, to ensure that reform processes are inclusive of all member state interests and civil society concerns. Transparency and inclusiveness are necessary to ensure that IIAs meet growing demands for strong environmental standards. Inter-organisational cooperation will also help ensure that reform processes and outcomes are not competing, but complementary.

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OECD Public Consultation on Investment Treaties and Climate Change

Response paper

Cambridge Research Group on Foreign Investment and the Environment

J. H. Do, F. S. Eichberger, S. Ropia, A. Singh, A. H. Singh, P. Vakharia, J. E. Viñuales*

The purpose of this response paper is to identify and provide an initial discussion of ten key issues that should be taken into account in the stock-taking exercise supporting the OECD work on investment treaties and climate change. Each of them is only briefly noted and their interconnections are fleshed out when relevant.

The basic idea of this submission is that investment treaties could be used (pre-establishment) to facilitate market access of genuinely green investment but they must at the same time be drafted, amended and interpreted in such a way as to provide (post-establishment) more leeway to States to adopt and manage green transformation policies. By contrast, using investment treaties (pre-establishment) to facilitate market access of any type of investment or (post-establishment) to constrain the legal space for States to transform their economies would not support the effort to combat climate change.

(1) The 'green investment' equation

As noted in the introduction, a very important overarching issue that has so far gone unnoticed is the tension between granting more legal protection to foreign investment in order to attract more 'green investment' and granting more regulatory margin of manoeuvre to States to conduct green transformation policies.

The two terms of the equation are relatively simple to understand. On the one hand, bilateral investment treaties (BITs) or investment chapters in trade agreements (FTAs) can be used (i) to provide or facilitate market access to foreign investors and (ii) to provide enhanced

* The views expressed in this response paper are personal and strictly in our academic capacity. This paper may be cited as follows: Cambridge Research Group on Foreign Investment and the Environment, *OECD Public Consultation on Investment Treaties and Climate Change. Response paper* (March 2022)

investment protection post-establishment. This, it is sometimes argued, would pave the way for more green investment. On the other hand, such protection would also have the implication that State regulatory power is tightly constrained at a time when not just incremental but transformational policy change is required to pursue the low-carbon transition. What term of the equation should be given priority?

This response paper advances the thesis that enhanced market access or investment facilitation should be provided only for genuinely green investment, not for other forms of foreign investment. Then, post-establishment, BITs/FTAs should be drafted in such a way as to provide much more space for green transformational policies. Genuinely green investment would also benefit from such enhanced legal space for green transformational policies post-establishment. Although the regulatory change inherent to the low-carbon transition may affect aspects of the profitability of green investment, it would not affect its overall viability or even commercial interest. In much of the renewable energy investment claims brough against countries such as Spain, Italy or the Czech Republic, what is at stake is not the viability but the level of profitability (higher or lower, but positive overall), as affected by policy adjustments made by States to steer the transition.

This balance between market access/facilitation for genuinely green investment and enhanced regulatory space for green transformation policies is, in our view, the most viable approach to address the 'green investment equation', understood as how to use BITs/FTAs to support investment in the low-carbon transition. Different aspects relating to this framing are discussed in the following points.

(2) Defining what is 'green investment'

The insufficiency of public investment in combating climate change and the consequent reliance on private investment to achieve this is a well-known issue in climate finance discussions.[1] Governments' endorsement can go a long way in mobilizing private investment for green growth. One possibly way of incentivizing green investment flows in countries is through BITs/FTAs, provided that an operational definition of 'green investment' can be agreed. BITs and FTAs can be used to increase openness to investors by providing market access to green investments.[2] Even if countries wish to retain legal control on whether to grant market access or not, they may also facilitate green investments through other means, such as investment facilitation.[3] But, again, an initial hurdle in doing this is confronting the

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1 *Enabling Private Investment in Climate Adaptation & Resilience*, World Bank Group; *The Green Investment Report: The Ways and Means to Unlock Private Finance for Green Growth*, World Economic Forum.

2 David Gaukrodger, *The Future of Investment Treaties-possible directions*, OECD Working Papers on International Investment (2021).

3 See WTO (2022), Investment facilitation negotiators take steps to assess needs of developing countries, available at: https://www.wto.org/english/news_e/news22_e/infac_23feb22_e.htm. Axel Berger, Manjiao Chi, Bernard Hoekman,

lack of a commonly-accepted definition of a green investment. A range of potential different definitions exist for green investment and it is useful for countries to draw upon them in order to cull out certain core characteristics of green investments for BITs/FTAs.

Some countries and regional organizations have adopted taxonomy regulations which identify economic activities that are considered to be environmentally-sustainable. The European Union (EU) Taxonomy Regulation has enumerated a list of objectives that economic activities must further in order to be considered environmentally-sustainable, including climate change mitigation and adaptation.[4] A similar approach to defining sustainable economic activities has been or is being planned to be followed in green taxonomies in Malaysia,[5] Bangladesh,[6] Singapore,[7] Mongolia,[8] South Africa,[9] Chile,[10] Colombia,[11] Indonesia,[12] Association of Southeast Asian Nations (ASEAN),[13] EU-China Common Ground Taxonomy,[14] Russia,[15] the Climate Bonds Initiative[16] and the International Finance Corporation.[17] These taxonomies are not fully aligned, but a meta-analysis of core intersections, recurrent exclusions and grey areas could be developed to guide a partial

Makane Moïse Mbengue, Karl P. Sauvant, Matthew Stephenson, Facilitating Sustainable Investment To Build Back Better, *Journal of World Trade*, 55 (6), 2021, pp. 8.

4 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

5 *Climate Change and Principle-based Taxonomy*, Bank Negara Malaysia (2021), https://www.bnm.gov.my/documents/20124/938039/Climate+Change+and+Principle-based+Taxonomy.pdf.

6 *Sustainable Finance Policy for Banks and FIs*, Bangladesh Bank Sustainable Finance Department, https://www.bb.org.bd/aboutus/draftguinotification/guideline/draft_sfpolicy_bankfi.pdf.

7 *Green Finance Industry Taskforce: Identifying a Green Taxonomy and Relevant Standards for Singapore and ASEAN* (2021) https://abs.org.sg/docs/library/gfit-taxonomy-consultation-paper.

8 *Mongolian Green Taxonomy*, Financial Stability Commission of Mongolia, https://www.ifc.org/wps/wcm/connect/0c296cd3-be1e-4e2f-a6cb-f507ad7bdfe9/Mongolia+Green+Taxanomy+ENG+PDF+for+publishing.pdf?MOD=AJPERES&CVID=nikyhIh

9 *Draft Green Finance Taxonomy* (2021), https://sustainablefinanceinitiative.org.za/wp-content/uploads/2021/06/Draft-Green-Finance-Taxonomy.pdf.

10 *Taxonomy Roadmap for Chile*, Climate Bonds Initiative (2021), https://www.climatebonds.net/2021/05/taxonomy-roadmap-chile.

11 *La Taxonomía Verde de Colombia* (2021), https://www.minhacienda.gov.co/webcenter/portal/TaxonomiaVerdeColombia/pages_taxonomiavercolombia.

12 *Indonesia Green Taxonomy*, Indonesia Financial Services Authority (2022), https://www.ojk.go.id/keuanganberkelanjutan/Uploads/Content/Regulasi/Regulasi_22012011321251.pdf.

13 *ASEAN Taxonomy for Sustainable Finance*, ASEAN Taxonomy Board (2021), https://asean.org/wp-content/uploads/2021/11/ASEAN-Taxonomy.pdf.

14 *Common Ground Taxonomy-Climate Change Mitigation* (Instruction Report), International Platform on Sustainable Finance (2021), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf.

15 *Russia Green Taxonomy*, VEB.RF (2021), https://www.climatebonds.net/files/releases/joint-media-release-russian-green-taxonomy-20211109-final.pdf.

16 *Climate Bonds Taxonomy,* Climate Bonds Initiative (2021), https://www.climatebonds.net/standard/taxonomy.

17 *IFC's Definitions and Metrics for Climate-Related Activities*, IFC Climate Business Department (2017), https://www.ifc.org/wps/wcm/connect/8ebdc507-a9f1-4b00-94687b4465806ecd/IFC+Climate+Definitions+v3.1+.pdf?MOD=AJPERES&CVID=lQuLLhw.

standardization process. Such process would in turn be useful to BIT/FTA negotiations on core green investment market access and/or facilitation.

Both the World Bank[18] and Organisation of Economic Co-operation and Development[19] (OECD) have prepared guides for countries on developing green taxonomies which provide useful insights into what green investment might look like for the purposes of BITs. Countries may choose to define green investments according to their national needs such as those which reduce or remove greenhouse gas or as those which help build "adaptive capacity and resilience" for climate change.[20] Furthermore, many countries have green growth strategies and green deals in place which may inform the definition of green investments in BITs/FTAs.[21]

More specific definitions of green investment also exist. The Asset Management Association of China has defined green investment as the act of adopting systematic green investment strategies in enterprises or projects which can produce environmental benefits, lower environmental costs, develop green industry and reduce environmental risk.[22] It goes on to define green investments as those that relate to enhancement of energy efficiency, emissions reduction, clean and renewable energies . . . with a focus on environmental protection, low-carbon development and recycling, etc.

Some BITs/FTAs already reflect the need to encourage green investments. The draft EU-China Comprehensive Agreement on Investment (CAI) has a Section IV dedicated to 'Investment and Sustainable Development'. Article 6 (Section IV, Sub-Section 2) of the CAI requires parties to "promote and facilitate investment . . . for climate change mitigation and adaptation . . . including investment concerning climate friendly goods and services, such as renewable energy, low-carbon technologies and energy efficient products and services." Similarly, Article 275(4) of the EU-Colombia-Peru FTA states that the parties "will promote trade and investment measures that promote and facilitate access, dissemination and use of best available technologies for clean energy production and use, and for mitigation of and adaptation to climate change." Article 286(e) of the same agreement also provides that the parties will cooperate for trade and investment activities that contribute to the achievement of the objectives of the United Nations Framework Convention on Climate Change (UNFCCC). Further, the proposed modernised Energy Charter Treaty (ECT) would require

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18 *Developing a National Green Taxonomy: A World Bank Guide*, World Bank (2020).

19 *Developing Sustainable Finance Definitions and Taxonomies, Green Finance and Investment*, OECD (2020).

20 Stephen S. Golub, C. Kauffmann and P. Yeres (2011), *Defining and Measuring Green FDI: An Exploratory Review of Existing Work and Evidence*, OECD Working Papers on International Investment (2011).

21 *What we have learned from attempts to introduce green-growth policies*, OECD Green Growth Papers (2013).

22 *Green Investment Guidelines (For Trial Implementation)*, Asset Management Association of China (2018), https://www.amac.org.cn/industrydynamics/guoNeiJiaoLiuDongTai/jjhywhjs/esg/202001/P020200120447423886721.pdf.

contracting parties to promote and facilitate investment of relevance to climate change mitigation and adaptation.[23]

Lastly, the draft Pan-African Investment Code encourages investors to provide adequate financial resources to member States of the African Union in meeting costs for climate change mitigation and adaptation.[24]

(3) Regulatory competition among investment promotion agencies

One important dimension of green investment promotion, whether through enhanced market access, investment facilitation or other routes, concerns the role of Investment Promotion Agencies (IPAs). The role of IPAs can be two pronged, first, to attract investment in green sectors, and second, to promote environment-friendly investment in all sectors. However, IPAs may also face competing goals of attracting more investment (irrespective of its impact on the environment) and promoting green investment in all sectors. As a general matter, IPAs tend to focus their efforts on the volume of Foreign Direct Investment (FDI) they attract.[25] The integration of an environmental sustainability dimension into these efforts may raise intricate issues, including regulatory competition with other IPAs, definitional challenges and also environmental integrity issues (avoiding greenwashing). The evidence on trends is not clear-cut. A survey conducted in 2010 suggested that IPAs were generally targeting the attraction of 'sustainable' investment, but out of the three pillars of sustainable development (economic development, social development and environmental protection), the understanding of sustainability clearly emphasised economic development over environmental considerations.[26]

The role that the IPAs may play in this regard is visible in the programmes that they run or the policies that they incorporate to attract green investment. The results of an early survey of investment promotion practices conducted in 2001 by the United Nations Conference on Trade and Development (UNCTAD), suggested that almost 75 percent of the IPAs in

[23] EU Text Proposal for the Modernisation of the Energy Charter Treaty (ECT), https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf.

[24] Draft Pan-African Investment Code (2016) art 30(2).

[25] VCC and WAIPA (2020), Investment Promotion Agencies and Sustainable FDI: Moving toward the fourth generation of investment promotion, Report of the findings of the Survey on Foreign Direct Investment and Sustainable Development undertaken by the Vale Columbia Center on Sustainable International Investment (VCC) and the World Association of Investment Promotion Agencies (WAIPA) June 25, 2010, pp. 4, available at: https://waipa.org/waipa-content/uploads/WAIPA-VALE-Columbia-Center.-2010.-IPAs-and-Sustainable-FDI.pdf.

[26] VCC and WAIPA (2020), Investment Promotion Agencies and Sustainable FDI: Moving toward the fourth generation of investment promotion, Report of the findings of the Survey on Foreign Direct Investment and Sustainable Development undertaken by the Vale Columbia Center on Sustainable International Investment (VCC) and the World Association of Investment Promotion Agencies (WAIPA) June 25, 2010, pp. 4, available at: https://waipa.org/waipa-content/uploads/WAIPA-VALE-Columbia-Center.-2010.-IPAs-and-Sustainable-FDI.pdf.

developing countries tried to attract environment-friendly technology projects.[27] Most pertinent are the IPAs in countries with the high rates of carbon emissions, including China, the US, India, Japan, South Korea, Germany or South Africa.[28] The evidence is difficult to gather and analyse but some cases illustrate how green investment may be promoted or facilitated.

South Africa's IPA, InvestSA, facilitated a recycling project with a paper and plastics packaging business in South Africa.[29] It also developed an effective partnership with Wesgro, the IPA of the Western Cape, and with other key stakeholders in promoting the Western Cape as a green investment destination. It facilitated the first FDI project in renewable energy sector in the region and its initiatives have resulted in the development of new investment opportunities in water, energy efficiency, and sustainable agriculture.[30] Germany's IPA (GTAI) offers free support services for companies planning to make green investment.[31] It emphasises the web-based promotion of green FDI with well-documented coverage of green sectors and industry-specific information on green investment facilitation.[32] Japan's IPA, JETRO, has launched an initiative in collaboration with GTAI to promote practical solutions for global matters such as global warming and Sustainable Development Goals (SDGs).[33] The Portland Development Commission (PDC), a subnational US IPA in Oregon, works actively to attract investment for the expansion of local clean-tech clusters.[34] India's IPA, Invest India, creates awareness about social issues and impact through its Social Impact Initiative called SAHYOG which connects investors interested in boosting their Corporate Social Responsibility (CSR) through investment to viable projects, such as, paper recycling for rural school's stationary. Further, it partners with the Office of the Principal Scientific Advisor to the Government of India in its 'waste to wealth' initiative which covers various

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27 UNCTAD (2001), The World Of Investment Promotion At A Glance A Survey of Investment Promotion Practices, ASIT Advisory Studies No. 17, UNCTAD/ITE/IPC/3, pp. 21, available at: https://unctad.org/system/files/official-document/poiteipcd3.en.pdf.

28 World Bank (2018), The World Bank Data on CO2 emissions (kt), available at: https://data.worldbank.org/indicator/EN.ATM.CO2E.KT?most_recent_year_desc=true.

29 UNCTAD (2018), Promoting Investment In The Sustainable Development Goals, Investment Advisory Series A number 8, UNCTAD/DIAE/PCB/2018/4 ISSN 1995-6088, pp. 40, available at: https://unctad.org/system/files/official-document/diaepcb2018d4_en.pdf.

30 UNCTAD (2016), Investment promotion agencies honoured at UNCTAD14, available at: https://unctad.org/news/investment-promotion-agencies-honoured-unctad14.

31 Germany Trade & Invest (GTAI), Climate Change & The Environment, available at: https://www.gtai.de/en/invest/industries/environmental-technologies/climate-change-the-environment-68370.

32 GTAI (2015), GTAI receives UN award for green investment promotion, available at: https://www.gtai.de/en/meta/press/gtai-receives-un-award-for-green-investment-promotion-63002.

33 Japan External Trade Organisation (JETRO)(2016), JETRO and Germany Trade and Investment (GTAI) agree to launch "Japanese-German/Germany-Japan Innovation Initiative 160" to promote practical solutions for current global matters, available at: https://www.jetro.go.jp/en/news/releases/2021/3fd0d0bc087b9d31.html.

34 UNCTAD (2016), Promoting Green FDI: Practices and Lessons from the Field, The IPA Observer No. 5 - 2016, pp. 2, available at: https://unctad.org/system/files/official-document/webdiaepcb2015d6_en.pdf.

SDGs including climate action. It has created a sustainability framework which deploys tools and enablers to embed SDG orientation in the investment ecosystem.[35]

Countries also try to attract green investment through other initiatives. For example, Republic of Korea has established Ulsan Eco-Industrial Park (EIP) Centre under its EIP initiative which coordinates the collaboration of companies in the Ulsan EIP giving rise to opportunities to reduce waste and environmental impact while cutting costs.

The IPAs will have greater role in influencing governments to adopt sustainable FDI-attracting policies as their policy advocacy function grows with time. For the specific purpose of the OECD, the key point is the need to develop and systematise the evidence on the IPAs role in promoting climate change-related foreign investment, including good practices and policies. IPAs should be closely engaged in any process that involves the enhanced used of BITs/FTAs to attract and protect genuinely green FDI. This is particularly important in light of the greater need for private investment supporting the low-carbon transition, as discussed next.

(4) The role of the private sector in climate finance

Over the previous decade, total climate funding has increased, reaching USD 632 billion on average in 2019/2020, but flows have stagnated in recent years. Annual climate funding flows increased by just 10% between 2017/2018 and 2019/2020, compared to previous growth of more than 24%.[36] The flatter rate of increase is only partly explained by the need to divert funds for COVID-19 rescue and recovery policies, as three of the four years considered for the calculation were not affected by the pandemic.

There has been a gradual shift towards private-sourced climate finance. Private climate investments took up 49% of the overall climate funding (to USD 310 billion), up by 13% from 2017/2018. Corporations accounted for most private climate funding (40%), but commercial financial institutions' spending increased speedily, rising from 18% to 39% (USD 122 billion)[37]. Public climate finance remained steady at 51% (USD 321 billion) of overall funding.

[35] Invest India, Facilitating Investments into Sustainable Development Goals, available at: https://www.investindia.gov.in/invest-india-sustainability-framework.

[36] *Global Landscape of Climate Finance 2021*, Climate Policy Initiative (CPI), p. 2, available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf

[37] *Global Landscape of Climate Finance 2021*, Climate Policy Initiative (CPI), p. 2, available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf, p. 3

Development Finance Institutions (DFIs) are still the main source of public finance, accounting for 68% (USD 219 billion)[38]. Importantly, three quarters of all climate finance in 2019-2020 (USD 479 billion) flowed domestically and, out of all international flows (USD 153 billion), East Asia & Pacific, Western Europe, and North America received three-quarters of global climate investments. East Asia & Pacific stood out as the destination for most of the funds, almost half of the total (USD 292 billion) of 2019/2020 tracked global climate investments, among which China accounted for almost 81%[39]. Meanwhile, little investment flowed to African and Central American countries, while they are most vulnerable to climate change. Mozambique, Zimbabwe, and the Bahamas were the top three countries most affected by the impacts of extreme weather events in 2019[40]. Between 2000 and 2019, it was Puerto Rico, Myanmar, and Haiti[41]. However, only less than a quarter of global investments total went to these regions[42]. The lack of funding flowing moving to these areas is concerning and shall not be ignored.

These figures are important to keep in mind because BITs/FTAs, by themselves, are highly unlikely to change the direction of the flows. This, in turn, emphasises the continued need for public finance for climate vulnerable countries. Private investment flows will certainly play an important role and BITs/FTAs would be useful in this context, but the suggestion that improved market access through such treaties would change the fortunes of climate vulnerable countries remains unproven. Thus, discussions regarding the interface between climate change and investment agreements must neither detract from the need to increase public finance to the most climate vulnerable countries nor serve as a basis to argue for blanket market access (irrespective of the green credentials of the investment potentially attracted). States and the OECD should keep these considerations in mind.

(5) Private finance in climate change negotiations

At COP 26, a large group of financial actors made a commitment to climate finance and sustainability with the launch of the Glasgow Financial Alliance for Net Zero (GFANZ). GFANZ is a global coalition of over 450 finance firms across 45 countries, jointly managing

[38] *Global Landscape of Climate Finance 2021*, Climate Policy Initiative (CPI), p. 2, available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf, pp. 10-11

[39] *Global Landscape of Climate Finance 2021*, Climate Policy Initiative (CPI), p. 2, available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf, pp. 4, 29-30

[40] *Global Climate Risk Index 2021* (GCRI 2021), Eckstein, D., Künzel, V., & Schäfer, L. (2021), pp. 8-9, available at: https://www.germanwatch.org/en/19777

[41] *Global Climate Risk Index 2021* (GCRI 2021), Eckstein, D., Künzel, V., & Schäfer, L. (2021), pp. 8-9, available at: https://www.germanwatch.org/en/19777, p. 5

[42] *Global Landscape of Climate Finance 2021*, Climate Policy Initiative (CPI), p. 2, available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf, pp. 29-30

$130 trillion, to align their financing activities to achieve net-zero emissions by 2050[43]. Several public-private partnerships and multilateral funding mechanisms, spearheaded by investment banks, were also announced at COP 26, such as Climate Investment Funds' Capital Market Mechanism[44], the MCPP One Planet platform[45], IFC-Amundi Bond Strategy[46], and the Asian Development Bank's Energy Transition Mechanism[47].

Outside COP 26, globally, 217 companies have joined the Climate Pledge, founded by Amazon with a commitment to net zero carbon by 2040, 10 years ahead of the Paris Agreement. The Pledge also kickstarted the Climate Pledge Fund in 2019, a dedicated investment program with an initial $2 billion in funding for companies innovating for the transition to a low-carbon economy[48]. Private environmental finance is expanding and diversifying at an unprecedented scale, and nations must capture this opportunity.

Although from a conceptual (or statistical) perspective, these initiatives include a range of private investment forms, some BITs/FTAs have been interpreted expansively to consider a broad range of financial transactions as 'investments'. As a result, these initiatives are also relevant from the perspective of topic under consultation. Their potential relevance for BITs/FTAs concerns matters such as the specific definition of what is a protected investment and, more generally, questions such as investor diligence (genuine abidance by their climate commitments).

(6) Preparing NDCs as investment plans to encourage foreign investment

An important route to attract green investment in low-carbon sectors is provided by Nationally Determined Contributions (NDCs) under the Paris Agreement. Developing both NDC-oriented investment frameworks and investment-oriented NDCs (business plan-like NDCs) may be an effective way to incorporate the liquidity of private finance post-COP-26.

This approach would be relevant for BITs/FTAs, for example, because investment consistent with an NDC could be specifically recognised as 'green investment' and thereby granted some advantages, e.g. in relation to market access or at least facilitation. Six sectors of

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43 The Glasgow Financial Alliance for Net Zero (GFANZ) https://www.gfanzero.com/about/

44 *BlackRock raises $673mln for climate-focused infrastructure fund*, Jessop, S., & Kerber, R. (2021), available at: https://www.reuters.com/business/sustainable-business/exclusive-blackrock-raises-673-mln-climate-focused-infrastructure-fund-2021-11-02/

45 *IFC and Institutional Investors Embark on New Multi-Billion Climate Finance Initiative*, International Financial Corporation (IFC) (2021), available at: https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=26689

46 *Amundi Launch $2B Bond Strategy to Support Green, Resilient, Inclusive Recovery*, International Financial Corporation (IFC) (2021), available at: https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=26688

47 *ADB, Indonesia, the Philippines Launch Partnership to Set Up Energy Transition Mechanism*, Asian Development Bank (ADB) (2021), available at: https://www.adb.org/news/adb-indonesia-philippines-launch-partnership-set-energy-transition-mechanism

48 The Climate Pledge https://www.theclimatepledge.com/us/en/the-pledge/the-climate-pledge-fund

particular relevance for cities are: green buildings, public transport infrastructure, electric vehicles, improved management of water resources, renewable energy, and better handling of waste, worth around $29.4 trillion by 2030[49].

(7) Market access provisions in BITs/FTAs and their relevance for climate change/sustainability

In the trade context, market access refers to concessions contained in the country's schedules with respect to bindings and reductions of tariffs and to other minimum import commitments. This is typically granted to goods under multilateral and bilateral trade agreements. However, the granting of market access to investments in BITs/FTAs is the exception rather than the rule. States prefer to keep control on the admission of investors and investments in their territories. Once admitted, BITs/FTAs impose certain standards of treatment to which States commit. Granting market access or facilitating such access for green investment (rather than for any investment) could be a way of promoting such investment. Yet, the practice on this point remains limited, even in BITs/FTAs concluded after the Paris Agreement.

For example, the 2016 Canada-EU Trade and Investment Agreement lays down the goal of parties to remove obstacles to investment in goods and services of particular relevance for climate change mitigation.[50] The Pan-African Investment Code of 2016 of the African Union, a model agreement for the African continent, goes further when it ‘encourages’ investors to provide adequate financial resources and transfer of technology with a particular view to Member States that are vulnerable to the adverse effects of climate change.[51]

A larger number of BITs/FTAs, pre- or post-Paris, contain clauses addressing access in an indirect manner, which consists not of facilitating green investment but of discouraging a race-to-the-bottom. They state indeed that it is inappropriate to encourage investment by relaxing existing environmental standards. Recent examples include the following: Art. 2(7) of Hungary – Kyrgyztan BIT (2020), Art. 22.2 of Brazil – India BIT (2020), Art. 12 of Hong Kong China – Mexico BIT (2020), Art. 20 of Cote d’Ivoire – Japan BIT (2020), Art. 19 of Japan – Morocco BIT (2020) and Art. 20 Japan – Jordan BIT (2018).

In some FTAs, there are specific clauses pertaining to market access, however they do not specifically address the topic of climate change or sustainable development in this specific regard. In the UK – Australia FTA (2021), Art. 13.4 talks about market access through the

49 *Climate Investment Opportunities in Cities: An IFC Analysis*, International Financial Corporation (IFC) (2018), pp. 12-13, available at: https://www.ifc.org/wps/wcm/connect/875afb8f-de49-460e-a66a-dd2664452840/201811-CIOC-IFC-Analysis.pdf?MOD=AJPERES&CVID=mthPzYg

50 Comprehensive and Economic Trade Agreement between Canada and the European Union (signed 30 October 2016) (https://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf) (accessed: 5 March 2022) Article 24.9.

51 Pan-African Investment Code (31 December 2016) (https://au.int/en/documents/20161231/pan-african-investment-code-paic) (accessed: 5 March 2022) Article 30(2).

establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of any investment and lays out the limitations on enterprises with respect to a range of factors. However, none of these factors specifically mention climate change or sustainable development. This can be read with Art. 13.7 which mentions that "nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental objectives". Additionally, Art. 13.18 of the FTA recognises that it is inappropriate to waive or derogate from environmental law to encourage investment and encourages investment in environmental goods and services. Art. 13.18 also specifically addresses a positive obligation towards supporting the transition to low carbon and climate resilient economies. In the China – Mauritius FTA (2019), there is no provision addressing market access with regards to climate change or sustainability. However, Art. 8.2(3) provides that measures adopted with regards to the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures.

Overall, there has been an increase in the incorporation of environmental provisions in BITs/FTAs but rarely at the level of market access.

(8) The relevance of legality clauses in BITs/FTAs

Most BITs contain legality clauses which require investments to be made in accordance with the domestic law of the host State in order to benefit from the protections under the treaty. The OECD has noted that around 185 jurisdictions have submitted climate action policies following the 2015 Paris Agreement.[52] The adoption of climate change laws may have a bearing on the question of legality of investments and their compliance with the domestic environmental laws of the host states.

Governments have already begun incorporating environmental considerations in their BITs in a direct manner which may help tribunals avoid the complex issues surrounding the interpretation of 'applicable laws' of the host state in deciding the legality of investments. Article 7 of the Dutch Model BIT requires investors and their investments to comply with laws and regulations on environmental protection. Further, similar to the Dutch BIT, the Morocco-Nigeria BIT requires investors to comply with environmental assessment screening and assessment processes prior to the investment.[53] The Model BIT of Belgium and

[52] David Gaukrodger, *The Future of Investment Treaties-possible directions*, OECD Working Papers on International Investment (2021).

[53] Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria (2016) art 14

Luxembourg makes a specific reference to pursuing the objectives of the UNFCCC in Article 17 and further obligates investors to comply with domestic law.[54] The Draft Pan-African Investment Code has a similar provision.[55] These treaties, which express the obligation in mandatory terms (using the word 'shall') can be contrasted with the BITs between Brazil-India,[56] Brazil-Malawi[57] and Brazil-Ethiopia[58] which exhort the investor to comply with voluntary principles for responsible business conduct consistent with laws adopted by the host State, one of which includes a contribution to environmental progress. Mandatory provisions to comply with domestic environmental laws in BITs such as those which have been discussed above may become relevant at the jurisdictional and admissibility stages. Tribunals may be less inclined to entertain claims by investors whose investments have not been in made in compliance with domestic environmental law.

Another potential development is the application of international climate change law by tribunals as part of the applicable law of a host State. There is a growing practice of courts applying international climate change law in domestic litigation.[59] In a recent judgment, the Netherlands Dutch Court used international law extensively to require a private company to mitigate climate change.[60] Furthermore, in recent years, climate change litigants against governments have also invoked international law in 21 of 93 cases between 2015-2021.[61]

This practice has significant implications for investment treaty arbitration, particularly as regards the interpretation of key investment law concepts such as legality clauses but also many others (e.g. the police powers doctrine, the margin of appreciation doctrine, legitimate expectations as part of fair and equitable treatment clauses, like-circumstances in non-discrimination clauses, etc). With respect to legality clauses, tribunals would have good reason to reject arguments that only a very narrow core of principles (e.g. anti-corruption or

54 Agreement between the Belgium-Luxembourg Economic Union on the Reciprocal Promotion and Protection of Investments (2019) art 18.

55 Draft Pan-African Investment Code (2016) art 22(1).

56 Investment Cooperation and Facilitation Treaty between the Federative Republic of Brazil and the Republic of India (2020) art 12.

57 Investment Cooperation and Facilitation Agreement between the Federative Republic of Brazil and the Republic of Malawi (2015) art 9.

58 Agreement between the Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation (2018) art 14.

59 Anna-Julia Saiger, *Domestic Courts and the Paris Agreement's Climate Goals: The Need for a Comparative Approach, 9 Transnational Environmental Law* 37 (2019); D. Estrin, *Limiting Dangerous Climate Change: The Critical Role of Citizen Suits and Domestic Courts – Despite the Paris Agreement*, CIGI Papers, No. 101, May 2016. Domestic courts also routinely apply international environmental law directly in domestic cases, see Part IX ('International Environmental Law in National/Regional Courts') in *The Oxford Handbook of International Environmental Law* (Lavanya Rajamani and Jacqueline Peel eds. 2nd ed. 2021).

60 *Milieudefensie et al. v. Royal Dutch Shell plc.* (2021).

61 Joana Setzer and Catherine Higham, *Global Trends in climate change litigation*, (Policy Report, 2021), https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2021/07/Global-trends-in-climate-change-litigation_2021-snapshot.pdf.

international public policy) is relevant to make an investment unlawful *ab initio* and hence unprotected. To avoid ambiguities, States could include in their BITs/FTAs language stating clearly that investors have to comply with domestic environmental laws, undertake environmental impact assessments or align with the objectives of the UNFCCC and the Paris Agreement.

(9) 'Climate clauses' and other environmental/sustainability clauses

Historically, climate change mitigation played no prominent role in the investment law. Climate concerns were rarely considered by arbitration tribunals and seldom expressly addressed in investment treaties. The latter, however, is changing. Recently, climate change considerations that affect the treatment of investors have been gaining in importance under investment agreements. Yet, the integration of climate concerns is not uniform. Rather, several possibilities can be identified, which differ in terms of their addressees (investor or State) as well as their substance ('softer' incentives or 'harder' exceptions and obligations).

Occasionally, climate considerations have been included by way of investment incentives or encouragements to facilitate climate-friendly investments (see point 7 above). Yet, as a rule, climate change features implicitly in investment treaties as an 'environmental' concern. The extent to which the protection of the environment plays a role under investment agreements varies widely, but the current trend indicates a shift towards more robust protections. For example, the 2016 Morocco-Nigeria BIT or the 2019 Dutch Model BIT require investors to conduct environmental impact assessments.[62] This is particularly noteworthy, as 'classic' investment treaties focused almost exclusively on States' obligations. An interesting variation of such investors' duties can be found in the 2019 Morocco Model BIT that expressly lays down the obligation of investors to comply with climate change mitigation goals.[63]

Many investment agreements also contain clauses that reserve the right of States to take measures that serve to protect the environment. In modern agreements, such provisions are frequently accompanied by a clause emphasizing States' 'right to regulate'. The interpretation of these kinds of general clauses allowing for the protection of the environment may be guided by goals of climate change mitigation. The 2016 Azerbaijan Model BIT, for example, includes a reference to the goal of 'combating climate change' in its preamble.[64]

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[62] Morocco-Nigeria Bilateral Investment Treaty (signed 3 December 2016) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5409/download) (accessed: 5 March 2022) Article 14; 2019 Dutch Model BIT (22 March 2019) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5832/download) (accessed: 5 March 2022) Article 7(3).

[63] 2019 Morocco Model BIT Article 20.4 (June 2019) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5895/download) (accessed: 5 March 2022).

[64] 2016 Azerbaijan Model BIT (April 2016) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4787/download) (accessed: 5 March 2022).

Even more expressly, the 2021 Canada Model BIT emphasizes the parties' right to regulate with an aim to 'addressing climate change'.[65] This approach has also been adopted by the EU in its proposal to reform the Energy Charter Treaty.[66]

Similarly, a number of recent treaties refer to multilateral agreements on climate change. The 2019 Belgium-Luxembourg Economic Union Model BIT expressly reaffirms the parties' commitments under the UNFCCC.[67] Generally, such references may affect the interpretation of other provisions, such as those reserving environmental regulatory space or non-precluded measures. The EU-Japan FTA may permit parties to go further by giving implementation measures of multilateral agreements, like the UNFCCC and the Paris Agreement, the same weight as non-precluded measures.[68] However, this provision remains the exception.

In sum, clauses incorporating climate change concerns are on the rise in new investment agreements. At the same time, they still constitute a recent phenomenon and their impact in practice will only become clear in the years to come.

(10) Sustainability transitions in investment arbitration

The growing emergence of 'green' investments has been prompted by several drivers such as the dwindling costs and consequences of non-renewable resources, the proliferation of renewable energy promotion policies, and a rapidly shifting public response.[69] This sustainability transition[70] is not without its challenges in the investment arbitration landscape. Core concepts of investment law, which historically developed to protect investment in fossil fuels and other so-called 'brown' sectors, is now widely used by the 'green' sectors, particularly in renewable energy companies.

The energy transition has found expression in international and domestic litigation. Examples include the cases arising from Germany's *Energiewende*, which has led to claims under investment treaties[71] and domestic constitutional law.[72] Investors in fossil fuels have

65 2021 Canada Model BIT (May 2021) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6341/download) (accessed: 5 March 2022) Article 3.
66 EU Text Proposal for the Modernisation of the Energy Charter Treaty (27 May 2020) (https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf) (accessed 5 March 2022) 4.
67 Belgium-Luxembourg Economic Union Model BIT (1 June 2019) (https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5854/download) (accessed: 5 March 2022) Article 17(2).
68 EU-Japan Economic Partnership Agreement (signed 17 July 2018, entered into force 1 February 2019) (https://trade.ec.europa.eu/doclib/docs/2018/august/tradoc_157228.pdf) (accessed: 5 March 2022) Article 16.4-5.
69 Global Commission on the Geopolitics of the Energy Transformation, *A New World: The Geopolitics of the Energy Transformation* (IRENA, 2019), at 18-23.
70 J. E. Viñuales, The International Law of Energy, (CUP, 2022) *forthcoming,* chapter 8.
71 *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12, pending
72 Order of the Federal Constitutional Court (29 September 2020), 1 BvR 1550/19.

also brought claims specifically framed as investments suffering regulatory change driven by the low-carbon transition.[73]

Aside from the specific bodies of claims relating to renewable energy schemes, the German energy transition or fossil fuel sectors affected by the transition, there is a substantial body of investment cases with environmental components. In most cases, such components have been managed by means of classic concepts of investment law, such as legality clauses, the police powers doctrine, the margin of appreciation doctrine, legitimate expectations as part of fair and equitable treatment clauses, like-circumstances in non-discrimination clauses, quantum adjustment, etc. This practice is by now well documented.[74]

However, there is also a growing practice relating to the use of environmental clauses in BITs/FTAs, particularly annexes to expropriation clauses carving-out environmental regulations or interpreting them presumptively consistent with investment obligations. The operation of such clauses is currently at a jurisprudential cross-roads, in that they could potentially perform a wide range of functions, from excluding jurisdiction (much like a tax carve-out) to creating a presumption of conformity with the agreement to merely serving as interpretive guidance or even as a restrictive exception.[75] The jury is still out. The operation of a clause will of course depend on its wording and context, but, in practice, it is also affected by the relative narrow understanding that counsel and tribunals have tended to assume, which in turn has left many options untested.

[73] *Westmoreland Coal Company v. Government of Canada*, UNCITRAL Rules (NAFTA Dispute), Notice of Arbitration and Statement of Claim, 19 November 2018, paras. 4-6.

[74] See J. E. Viñuales, *Foreign Investment and the Environment in International Law* (CUP, 2012); J. E. Viñuales, 'Foreign Investment and the Environment in International Law: Current Trends', in K. Miles (ed.), Research Handbook on Environment and Investment Law (Edward Elgar, 2019), pp. 12-37.

[75] *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award, para 368; *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, para 473; *Infinito Gold Ltd. v. Costa Rica*, ICSID Case No. ARB/14/5, Award, paras. 772-773; *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, paras. 629, 699. See J. E. Viñuales, 'Defence Arguments in Investment Arbitration', in J. E. Viñuales, M. Waibel (eds.), *ICSID Reports*, vol. 18 (CUP, 2019), preliminary study.

COMMENTARY

Submission to the Organisation for Economic Co-operation and Development on Investment Agreements and Climate Change

Contributed by the Center for International Environmental Law (CIEL), ClientEarth, and the International Institute for Sustainable Development (IISD)[1]

March 2022

I. Introduction

1. On December 12, 2015, 196 parties to the United Nations Framework Convention on Climate Change (UNFCCC) adopted the Paris Agreement, recognizing the need to take urgent and significant action to address the climate emergency. Under this agreement, parties promised to take swift climate action to limit global temperature increase to 1.5°C,[2] consistent with the ultimate objective of the UNFCCC to "prevent dangerous anthropogenic interference with the climate system."[3] In its latest report, the Intergovernmental Panel on Climate Change (IPCC) issued stark new findings on how current global warming of 1.1°C is already causing severe and permanent loss and damage to natural and human systems, and surpassing 1.5°C warming would unleash further irreversible harm.[4] With every additional fraction of a degree of warming, the report found, risks accelerate and our ability to respond declines.

[1] A description of the contributing organizations and their work on investor–state dispute settlement is provided on the last page of this document.

[2] Art. 2(1)(a) of the Paris Agreement, signed February 12, 2015, entered into force November 4, 2016 (Paris Agreement).

[3] Art. 2 of the United Nations Framework Convention on Climate Change, signed June 4, 1992, entered into force March 21, 1994 (UNFCCC). https://unfccc.int/files/essential_background/background_publications_htmlpdf/application/pdf/conveng.pdf.

[4] See Intergovernmental Panel on Climate Change (IPCC) Working Group II (2022). *Climate change 2022: Impacts, adaptation and vulnerability: Summary for policymakers. Contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change.* https://report.ipcc.ch/ar6wg2/pdf/IPCC_AR6_WGII_SummaryForPolicymakers.pdf. See also, CIEL & Heinrich Böll Stiftung. (2022). *Beyond the limits: New IPCC Working Group II report highlights how gambling on overshoot is pushing the planet past a point of no return.* https://www.ciel.org/wp-content/uploads/2022/02/CIEL_HBF_IPCC-WGII-Key-Messages-28Feb2022.pdf.

2. This is a wake-up call that governments must take immediate action to meet the Paris Agreement's objectives and to avoid the catastrophic consequences of climate change. The burning of fossil fuels is the most significant source of greenhouse gases, and a rapid phase-out of coal, oil, and gas should be governments' highest priority (noting that in 2021 the "[i]ncreased use of coal was the main factor driving up global energy-related CO_2 emissions by over 2 billion tonnes, [which was the] largest ever annual rise in absolute terms").[5] By 2030, states must reduce global greenhouse gas emissions collectively by 45% and reach net-zero by mid-century.[6] This means business as usual is simply no longer an option, particularly for the fossil fuel industry. In line with this, since the Paris Agreement, the European Union (EU), and other countries have adopted emissions targets for 2030.[7]

3. Known fossil fuel reserves as well as associated infrastructure (e.g., pipelines, power plants) and other assets are increasingly at risk of becoming "stranded."[8] Globally, the value of stranded assets could be as high as USD 1.8 trillion for the power sector alone, and the estimated value of stranded assets in the upstream oil and gas industry amounts

[5] See International Energy Agency (IEA) (2022, March 8). *Global CO_2 emissions rebounded to their highest level in history in 2021* [Press release]. https://www.iea.org/news/global-co2-emissions-rebounded-to-their-highest-level-in-history-in-2021.

[6] The IPCC already issued a stark warning in its 2018 Special Report: "the world's governments have less than twelve years to take action to completely transform energy systems in order to avert catastrophic climate change," as cited in ClientEarth. (n.d.). *Potential solutions for Phase 3: Aligning the objectives of UNCITRAL Working Group III with states' international obligations to combat climate change.* https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/wgiii_clientearth.pdf. To meet the goals of the Paris Agreement, according to a report by the IEA, fossil fuels need to decline from accounting for nearly 4/5 of total energy supply today to just over 1/5 in 2050. Under a 1.5°C-aligned pathway, no new oil and gas investments, coal mines, or mine expansions should be approved. See IEA. (2021). *Net zero by 2050: A roadmap for the global energy sector.* https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-AroadmapfortheGlobalEnergySector_CORR.pdf.

[7] The EU, for instance, has raised its climate targets and committed to reducing its net emissions by at least 55% by 2030—see the Communication from the Commission. (2019, December 11). *The European Green Deal.* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2019%3A640%3AFIN: "Fossil-fuel subsidies should end" (para. 2.1.5-3); "The guidelines [...] will facilitate the phasing out of fossil fuels, in particular those that are most polluting" (para. 2.2.2). Denmark and Costa Rica (joined by France, Greenland, Ireland, Quebec, Sweden, and Wales) also jointly launched the Beyond Oil & Gas Alliance (BOGA), an international alliance of governments and stakeholders working together to facilitate the phase-out of oil and gas production. Key members of BOGA commit to: (i) ending new concessions, licensing or leasing rounds for oil and gas production and exploration; and (ii) setting a Paris-aligned date for ending oil and gas production and exploration in the territory over which they have jurisdiction. For more information: https://beyondoilandgasalliance.com/.

[8] This risk is created as a result of government regulation (e.g., emissions reduction limits, carbon prices, coal phase-out, removal of fossil fuel subsidies), technological innovation (e.g., alternative sources of energy), changes in societal norms and consumer behaviour (e.g., increased use of electric vehicles), increased scrutiny and pressure from investors, as well as litigation (e.g., legal challenges resulting in court orders preventing pipeline construction in Indigenous territory). See Caldecott, B., Howarth, N., & McSharry, P. (2013). *Stranded assets in agriculture: Protecting value from environment-related risks.* Smith School of Enterprise and the Environment & University of Oxford. https://www.smithschool.ox.ac.uk/publications/reports/stranded-assets-agriculture-report-final.pdf; Caldecott, B. (2017). Introduction to Special Issue: Stranded assets and the environment. *Journal of Sustainable Finance & Investment, 7*(1), 1–13.

to at least USD 3 trillion[9]—with some estimates placing that figure as high as USD 7 trillion–17 trillion.[10]

4. This stranded asset risk is a financial risk that companies should be expected to consider when deciding to invest. However, companies have started to shift this risk onto taxpayers, using investor–state dispute settlement (ISDS) mechanisms in international investment treaties to enforce investment protection standards. Research increasingly indicates that foreign investors may also resort to ISDS as a strategic tool to challenge and delay emissions-reduction policies.[11]

II. ISDS and Climate Change

5. International investment law has become one of the fastest-growing areas of international law, with the signing of thousands of international investment agreements (IIAs). International investment law primarily aims to protect foreign investment and liberalize global investment flows.[12]

1. Unproven Benefits of ISDS and IIAs

6. Traditionally, experts have argued that ISDS is a valuable tool to facilitate inward direct investment.[13] However, more recent research demonstrates that the expected benefits

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[9] International Renewable Energy Agency. (2017). *Stranded assets and renewables: How the energy transition affects the value of energy reserves, buildings and capital stock.* https://www.irena.org/publications/2017/Jul/Stranded-Assets-and-Renewables, as cited in Tienhaara, K. & Cotula, L. (2020). *Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuel assets* (p. 11). https://pubs.iied.org/sites/default/files/pdfs/migrate/17660IIED.pdf.

[10] See Hansen, T. A. (2022). Stranded assets and reduced profits: Analyzing the economic underpinnings of the fossil fuel industry's resistance to climate stabilization. *Renewable and Sustainable Energy Reviews, 158.* https://www.sciencedirect.com/science/article/pii/S1364032122000727, which reviews the literature and estimates the magnitude and distribution of wealth losses from stranded assets for the upstream fossil fuel industry at between USD 13 trillion and USD 17 trillion. See also Mercure, J-F. et al. (2021). Reframing incentives for climate policy action, Nature Energy, 6, 1133–1143. https://www.nature.com/articles/s41560-021-00934-2.pdf, which estimates stranded fossil fuel assets at between USD 7 trillion and USD 11 trillion.

[11] See K. Tienhaara, & L. Cotula (2020), supra n. 9; Gaukrodger, D. (2017). *The balance between investor protection and the right to regulate in investment treaties: A scoping paper* (OECD Working Papers on International Investment). https://www.oecd-ilibrary.org/finance-and-investment/the-balance-between-investor-protection-and-the-right-to-regulate-in-investment-treaties_82786801-en; Pelc, K. (2016). *Does the international investment regime induce frivolous litigation?* https://ssrn.com/abstract=2778056; Brown, J. G. (2013). International Investment Agreements: Regulatory chill in the face of litigious heat. *Western Journal of Legal Studies, 3*(1). https://ir.lib.uwo.ca/uwojls/vol3/iss1/3; Tienhaara, K. (2010). Regulatory chill and the threat of arbitration: A view from political science. In C. Brown & K. Miles, (Eds.), *Evolution in investment treaty law and arbitration.* Cambridge University Press. https://ssrn.com/abstract=2065706; Van Harten, G. (2008). *Investment treaty arbitration and public law.* Oxford.

[12] Sornarajah, M. (2020). Disintegration and change in the international law on foreign investment. *Journal of International Economic Law, 23*(2), 414; Montanaro, F. & Violi, F. (2020). The remains of the day: The international economic order in the era of disintegration. *Journal of International Economic Law, 23*(2), 299.

[13] See Mirabile, M., Marchal, V., & Baron, R. (2017). *Technical note on estimates of infrastructure investment needs – Background note to the report Investing in Climate, Investing in Growth* (OECD Background Note) (p. 1). https://www.oecd.org/env/cc/g20-climate/Technical-note-estimates-of-infrastructure-investment-needs.pdf; OECD. (2017). *Investing in climate, investing in growth.* https://www.oecd.org/environment/cc/g20-climate/synthesis-investing-in-climate-investing-in-growth.pdf.

of IIAs and ISDS have not materialized, while the costs have been unexpectedly high (see point (2) below). In particular, there is a lack of evidence that: (i) treaty protections benefiting investors and investments are causing an increase of investment flows; (ii) increased flows allegedly due to the investment agreements (inward or outward) are indeed beneficial to the host country; and (iii) the treaties' benefits outweigh the costs. It is, therefore, difficult for states to justify the continuation of their investment agreements (in particular, those that include ISDS provisions), as well as the conclusion of any new similar agreements.[14]

7. This is equally true in the context of climate change, where arbitration practitioners have argued that investment agreements—and in particular the Energy Charter Treaty (ECT)—are necessary to protect and promote renewable energy investments.[15] This is, however, misleading at best, as there is no evidence of a link between the existence of IIAs, including the ECT, and an increase in foreign direct investment in the renewable energy sector among contracting states.[16] Additionally, there is significant evidence that global investment in renewable energy is mostly domestic rather than foreign,[17] and factors other than the existence of an IIA are far more decisive when companies make the decision to invest.

2. Demonstrated Costs of ISDS and Investment Agreements

8. The costs of IIAs and ISDS, on the other hand, are very clear for host states. By providing a mechanism for investors to directly challenge good faith domestic law and regulation before private arbitral tribunals, ISDS encroaches on governments' sovereignty and policy space, including in crucial areas such as the environment and public health.[18]

9. The investment protection standards typically included in IIAs are so broad and indeterminate that arbitrators can interpret them extensively. For instance, arbitral tribunals have construed compensation for expropriation at "fair market value" to include

[14] Johnson, L., Sachs, L., Güven, B., & Coleman, J. (2018). *Costs and benefits of investment treaties: Practical considerations for states* (Policy paper) (p. 15). https://ccsi.columbia.edu/sites/default/files/content/docs/publications/07-Columbia-IIA-investor-policy-briefing-ENG-mr.pdf.

[15] This conclusion is frequently based on statistics that demonstrate the continuous growth of ECT-based ISDS claims brought by investors of the renewable energy sector. The ECT Secretariat, for instance, regularly highlights that a large percentage of ECT-based ISDS claims—approximately 60%—concern renewable energy investments; see Energy Charter. (2020, October 12). *Even more renewable energy investors rely on treaty protection: Updated statistics of investment arbitration cases under the Energy Charter Treaty.* https://www.energycharter.org/media/news/article/even-more-renewable-energy-investors-rely-on-treaty-protection-updated-statistics-of-investment-arb/; Vail, T. (2021). *The Energy Charter Treaty supports investment in renewables.* https://www.euractiv.com/section/energy/opinion/the-energy-charter-treaty-supports-investment-in-renewables/.

[16] Di Salvatore, L., Bernasconi-Osterwalder, N., & Schaugg, L. (2021). Despite consensus on the ECT's incompatibility with the global climate agenda, claims that it is well-suited for the clean energy transition persist. *Investment Treaty News 3*(12) (p. 19). https://www.iisd.org/system/files/2021-10/iisd-itn-october-2021-english.pdf.

[17] In the period from 2013 to 2018, an average of 75% of global investment in renewable energy was domestic rather than foreign (Ibid.).

[18] This has been the case, for example, in the context of *Philip Morris v. Uruguay,* where the states sought to mitigate the health risks and investors challenged the state action, see *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay,* ICSID Case No. ARB/10/7.

potential future losses over long and entirely hypothetical operating cycles.[19] Arbitral tribunals are also not bound by precedent, giving rise to inconsistent interpretation and application of standards.[20] It is, therefore, very difficult, if not impossible, to predict whether a claim will be successful and, if so, what amount of compensation an arbitral tribunal will award (often hundreds of millions or billions of EUR), which will ultimately be paid by taxpayers.

10. Moreover, international environmental law is still considered an "outsider" element in investment law. Arbitral tribunals have treated environmental measures taken by states as protectionist and have expressed skepticism regarding their basis in international or regional law. For this reason, arbitrators have decided that foreign investment protection prevails over international and domestic environmental obligations[21] and have either disregarded environmental safeguards included in recent investment agreements or considered them insufficient to alter their prioritization.[22]

11. The prevailing arbitral jurisprudence will therefore encourage states to revoke or dilute existing environmental regulations and discourage them from introducing new rules. Due to methodological challenges and data accessibility issues, it is impossible to quantify how many regulations have been affected by actual claims or the threat thereof. However, there is a growing body of evidence demonstrating this "regulatory chill" effect of ISDS on public interest measures.[23]

12. As recognized in the report from the UN Working Group on the issue of human rights and transnational corporations and other business enterprises presented to the UN General Assembly in July 2021:

> [S]ome tribunals have interpreted the "fair and equitable treatment" clause in such agreements very broadly, which in turn may undermine States' ability to pursue legitimate public policy goals. [...] As far as the effect of arbitration claims on States' right to regulate is concerned, reference may be made to the fossil fuel companies relying on the Energy Charter Treaty to challenge government measures aimed at

[19] Bonnitcha, J. & Brewin, S. (2021). *Compensation under investment treaties: What are the problems and what can be done?* International Institute for Sustainable Development. https://www.iisd.org/publications/compensation-under-investment-treaties.

[20] Mamidoil Jetoil Greek Petroleum Products Societe S.A. v. Republic of Albania, ICSID Case No. ARB/11/24, February 9, 2022, para. 603: "International arbitral tribunals are under no obligation to rely on precedents, but also by the lack of a jurisprudence constante."

[21] Viñuales, J. (2012). *The "dormant environment clause": Assessing the impact of multilateral environmental agreements on foreign investment disputes* (Centre for International Environmental Studies Research paper 9) (p. 3). https://repository.graduateinstitute.ch/record/12752?_ga=2.13384823.1777731916.1647630227-1984829490.1647630227

[22] See Eco Oro Minerals Corp. v. Republic of Colombia, ICSID Case No ARB/16/41, August 9, 2009, Decision on jurisdiction, liability and directions on quantum; attached to the decision is a partial dissenting opinion by arbitrator Horacio A. Grigera Naón and a partial dissent by arbitrator Philippe Sands.

[23] See Van Harten, G., & Nadine Scott, D. (2016). *Investment treaties and the internal vetting of regulatory proposals: A case study from Canada Osgoode Legal Studies Research Paper Series,* 12(6); Kelsey, J. (2017). Regulatory chill: Learnings from New Zealand's plain packaging tobacco law. *QUT Law Review, 17(2);* Tienhaara, K. (2018). Regulatory chill in a warming world: The threat to climate policy posed by investor-state dispute settlement. *Transnational Environmental Law,* 7(2).

> mitigating climate change.[...] Even if the States concerned had been able to justify their measures in the end, the process entailed spending unnecessary time and resources in defending claims that should not have existed in the first place. Such claims also tend to create a regulatory chill not only in States involved in such claims but also in bystander States.[24]

13. It is also undeniable that the ISDS system has given rise to an alarming number of claims against environmental measures.[25] In the context of climate change, the range of measures that will affect energy and extractive activities is wide and growing. They include, for instance, denial or revocation of permits for the exploration, development, transport, or use of coal, gas, or petroleum resources; planned phase-outs of certain energy sources; removal of fossil fuel subsidies; the introduction of carbon taxes; stricter emissions standards; and electric vehicle mandates.[26] The arbitration industry has already recognized this as an area for future growth in legal practice.[27]

14. Additionally, according to a recent report, the fossil fuel industry is the most litigious industry in the ISDS system by number of cases, accounting for almost 20% of the total known ISDS cases across all sectors. Recent cases have illustrated that investors in the

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[24] United Nations (2021). *Human rights-compatible international investment agreements* (A/76/238). https://documents-dds-ny.un.org/doc/UNDOC/GEN/N21/208/09/PDF/N2120809.pdf?OpenElement. The impact of arbitration on regulatory change has not only been explicitly acknowledged by policy-makers but also by arbitrators themselves. For example, Professor Philippe Sands stated recently in a dissenting opinion on the application for amicus curiae submission in *Odyssey v. Mexico:* "It is now well-recognised that investment treaty arbitration can have a significant impact on domestic regulatory regimes, even where compensation is the only remedy awarded. It is therefore entirely possible that a finding that the Respondent has breached the treaty could lead to regulatory changes, which directly affect the interests of the Cooperativa, either immediately or in the future. The Majority's decision fails to recognise or take account of the broader impacts of investment treaty arbitration." Odyssey Marine Exploration, Inc. (USA) v. United Mexican States, ICSID Case No UNCT/20/1, Procedural Order No. 6, Professor Sands' Dissenting Opinion, para. 2. http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C8573/DS17216_En.pdf.

[25] For example, a quarter of all ISDS claims brought by Canadian investors abroad involved environmental policy. See Mertins-Kirkwood, H. (2019, May 14). Canadian investors need to stop suing foreign governments over environmental-friendly policies. *Globe and Mail.* https://www.theglobeandmail.com/business/commentary/article-canadian-investors-need-to-stop-suing-foreign-governments-over/; Public Citizen. (2021). *Table of foreign investor-state cases and claims under NAFTA and other U.S. "Trade" deals.* https://www.citizen.org/wp-content/uploads/2021.01.08-Investor-State-Chart-Jan-2021.pdf. In practice, investors have challenged environmental measures such as environmental restrictions on a coal-fired power plant (see Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No ARB/09/06), a moratorium on fracking (see Lone Pine Resources Inc. v. The Government of Canada, ICSID Case No UNCT/15/2), a ban on offshore oil drilling (Rockhopper Exploration Plc, Rockhopper Italia S.p.A. and Rockhopper Mediterranean Ltd v. Italian Republic, ICSID Case No ARB/17/14), nuclear power phase-out (see Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No ARB/12/12), and a refusal of permits relating to a cyanide-based open pit gold-mine (see Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania, ICSID Case No ARB/15/31).

[26] Güven, B. , & Johnson, L. (2016). *International investment agreements: Impact on climate change policies in India, China, and beyond.* In K. Gallagher (Ed.), *Trade in the balance: Reconciling trade and climate policy: Report of the Working Group on Trade*. The Frederick S. Pardee Center for the Study of the Longer-Range Future. https://ccsi.columbia.edu/sites/default/files/content/docs/Trade-in-the-Balance-International-Investment-Agreements-Impacts-on-Climate-Change-Policies-in-India-China-and-Beyond-Nov-2016.pdf.

[27] Neil, A. (2019). *Heating up: Climate change and investor-state arbitration*. https://riskandcompliance.freshfields.com/post/102fh51/heating-up-climate-change-and-investor-state-arbitration.

fossil fuel industry may seek to use ISDS to discourage or halt climate-friendly policies or to secure payouts as governments strive to move to a low-carbon economy.

15. For instance, in Europe, *RWE v The Netherlands and Uniper v. The Netherlands* are the most emblematic recent cases. German energy companies Uniper and RWE initiated arbitration proceedings against the Netherlands,[28] alleging that the government's plan to phase out coal by 2030 violated the ECT due to alleged de facto expropriations without adequate compensation.[29] The Dutch parliament adopted legislation in 2019 introducing a phased ban on the use of coal to generate electricity[30] in order to reduce greenhouse gas emissions by 49% from 1990s levels before 2030 and to meet targets under the Paris Agreement on climate change.[31] Both companies filed their claim despite recent rulings by the Court of Justice of the European Union that such arbitration proceedings between European investors and EU member states are illegal under EU law.[32]

16. In 2017, the Canadian oil and gas company Vermilion allegedly threatened to sue France under ISDS if it pushed ahead with a law to phase out fossil fuel extraction in all French territories drafted by the French Environment Minister.[33] In North America, a Canadian company (TransCanada) sued the United States over the Obama administration's rejection of a proposal to build the controversial Keystone XL pipeline to transport oil produced from Alberta's tar sands to various refineries on the Gulf Coast.[34] The decision to reject the pipeline is alleged to have been influenced by a significant grassroots campaign and a desire by the administration to demonstrate climate leadership in the run-up to the Paris conference in 2015. The case was discontinued following President Trump's executive order allowing construction of the pipeline project to move ahead, but

[28] See Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands, ICSID Case No ARB/21/22; RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands, ICSID Case No ARB/21/4.

[29] As demonstrated in a legal opinion by ClientEarth, this type of claim is ill-founded and Uniper and RWE should not be entitled to compensation under the ECT. See ClientEarth. (2019). *Legal opinion on Uniper's legally misconceived ISDS threat to Dutch coal phase-out* [Annex]. https://www.clientearth.org/latest/documents/clientearth-letter-and-analysis-regarding-uniper-isds-threat/.

[30] *Wet van 11 december 2019, houdende Regels voor het produceren van elektriciteit met behulp van kolen* ("Act prohibiting coal in electricity production"). https://www.eerstekamer.nl/9370000/1/j9vvkfvj6b325az/vl4kf9h8kewd/f=y.pdf.

[31] *Wet van 2 juli 2019, houdende een kader voor het ontwikkelen van beleid gericht op onomkeerbaar en stapsgewijs terugdringen van de Nederlandse emissies van broeikasgassen teneinde wereldwijde opwarming van de aarde en de verandering van het klimaat te beperken* ("Dutch Climate Act"), https://wetten.overheid.nl/BWBR0042394/2020-01-01

[32] CJEU, Judgment of the Court (Grand Chamber), Case C-741/19, Republic of Moldova v. Komstroy, September 2, 2021, https://curia.europa.eu/juris/document/document.jsf?docid=245528&doclang=EN; CJEU, Judgment of the Court (Grand Chamber), Case C-284/16, Slovak Republic v. Achmea, March 6, 2018, https://curia.europa.eu/juris/document/document.jsf?docid=199968&doclang=EN.

[33] The law was subsequently gutted, although it is not possible to determine the role that ISDS played in influencing the minister on the basis of available evidence. See Corporate Europe Observatory, the Transnational Institute, & Friends of the Earth Europe/International. (2019). *Red carpet courts: 10 stories of how the rich and powerful hijacked justice,* www.10isdsstories.org.

[34] TransCanada Corporation and TransCanada PipeLines Limited v. The United States of America, ICSID Case No ARB/16/21 (discontinued).

later in 2021, following President Biden's cancellation of the permit, two new cases on the same pipeline began.[35]

17. Any requirement for governments to pay compensation to aggrieved investors protected by international treaties will significantly increase the cost of the energy transition by diverting huge amounts of public money and resources that could instead support a clean energy transition. Even in the case of a state victory, the cost of participating in an ISDS case can be very high and risk delaying urgently needed climate action in the host state as well as in other countries.[36]

III. Barriers to Change in the Investment Treaty Regime

1. Increased Awareness but With Limited and Uncoordinated Reforms

18. Awareness about the negative impacts of investment law on public policies, including in relation to climate change, has been growing over recent years, and states are now firmly engaged in several initiatives to reform international investment policy at the international, regional, bilateral, and national levels.

19. Despite growing consensus that reform is necessary, divergent views persist as to the scope (e.g., qualifying substantive provisions by adding exceptions vs. termination) and the nature of reform. While awareness about the inherent risks of investment agreements is growing among technical experts in national governments, the reform efforts do not yet feature prominently on the agenda of high-level political decision-makers, rendering multilateral reform efforts more difficult. That said, states have increasingly addressed outdated investment agreements by way of termination, suspension, amendment, renegotiation, or joint interpretative statements in recent years.[37] In the last 3 years, the number of treaty terminations entering into force has exceeded the number of newly concluded IIAs, and in 2021 at least 78 IIAs were terminated.[38]

[35] TC Energy Corporation and TransCanada Pipelines Limited v. United States of America, ICSID Case No ARB/21/63; Alberta Petroleum Marketing Commission v. United States of America, Notice of Intent submitted February 9, 2022.

[36] For example, in the ISDS case brought by tobacco giant Philip Morris against an Australian health policy, the government's legal fees and arbitration costs amounted to almost AUD 24 million. Although Australia won the case, Philip Morris was only required to pay 50% of these costs. Uruguay fought a similar ISDS case against the same company (and also won) but was only able to do so because it had received financial support from a philanthropic organization to cover some of its costs. See further Ranald, P. (2019, April 2). The cost of defeating Philip Morris over cigarette plain packaging. *Sydney Morning Herald*. https://www.smh.com.au/national/the-cost-of-defeating-philip-morris-over-cigarette-plain-packaging-20190327-p5182i.html; New Zealand also delayed the introduction of rules about cigarette packaging until the ISDS brought against Australia by Philip Morris was decided.

[37] See UNCTAD. (2019). Taking stock of IIA reform: Recent developments. *IIA Issues Note, 3,* 4–7. https://unctad.org/system/files/official-document/diaepcbinf2019d5_en.pdf.

[38] See UNCTAD. (2021). Recent developments in the IIA regime: Accelerating IIA reform. *IIA Issues Note, 3,* 1. https://unctad.org/system/files/official-document/diaepcbinf2021d6_en.pdf; for terminations in 2021, see UNCTAD's International Investment Agreements Navigator: https://investmentpolicy.unctad.org/international-investment-agreements.

20. The vast majority of old-generation[39] investment agreements nevertheless remain in force. Fair and equitable treatment (FET) is the treaty provision that has been invoked most frequently to challenge legitimate regulatory measures.[40] Almost all old-generation treaties contain broad, unqualified FET provisions, giving arbitral tribunals broad interpretive discretion.[41] In addition, more than 95% of all IIAs in force today contain a sunset clause, which in the vast majority of cases guarantees survival periods of 10 years or more.[42] In case of a termination of or withdrawal from the treaty, existing investments may continue to be protected for extensive periods, thereby further limiting states' agency for reform (see point (2) below). In the absence of the required systemic change, foreign investors will therefore continue to rely on the investment provisions in these treaties for decades to come.

21. Furthermore, the number of institutions engaging in the reform of investment policy is multiplying. Currently, efforts to reform aspects of investment policy and law are underway under the auspices of the United Nations Conference on Trade and Development (UNCTAD) (reform of IIAs), United Nations Commission on International Trade Law (UNCITRAL) Working Group III (ISDS reforms), the World Trade Organization (Joint Statement Initiative on investment facilitation), the UN Office of the High Commissioner for Human Rights, and now the Organisation for Economic Co-operation and Development (OECD). At the regional level, states renegotiate investment agreements, for instance as part of the ECT modernization or the negotiation of the African Continental Free Trade Area Investment Protocol. The multiplicity of forums poses severe challenges for streamlined and resource-efficient reform. Varying mandates and nuances in the reform focus among these forums further complicate the coordination that is required for integrated reform. For instance, the type of enforcement will determine the practical impact of substantive treaty provisions. The outcome of the reform of ISDS at UNCITRAL Working Group III therefore has significant implications for the reform of investment agreements in other forums. A lack of progress in the former therefore blocks, or at least complicates, progress in the latter.

[39] Recent scholarly research differentiates first-generation IIAs that did not contain ISDS provisions—and that were aimed at facilitating negotiated settlements between investors and host states—from more recent IIAs, mostly signed since the 1980s, that did include ISDS; see Skovgaard Poulsen, L. (2020). Beyond credible commitments: (Investment) treaties as focal points. *International Studies Quarterly, 64*(1), 26–34. For the purpose of this text, we refer to old-generation IIAs broadly to designate those treaties that were mostly signed 1980 and include ISDS but none of the reform-oriented provisions developed in more recent years.

[40] Recent developments recorded on the UNCTAD International Investment Agreements Database paint a clear picture of the status of investment treaty reform. While the recent years have seen unprecedented and growing numbers of treaty terminations, more than one third of all IIAs currently in force (2,574) were signed and entered into force before the year 2000. 95% of all IIAs in force contain FET provisions, and in more than 75% of all IIAs, these clauses are unqualified, i.e., they contain "no express reference to international law and no list of the elements of the FET obligation" (UNCTAD. [n.d.]. *IIA Mapping Project* (p. 10), https://investmentpolicy.unctad.org/uploaded-files/document/Mapping%20Project%20Description%20and%20Methodology.pdf). According to UNCTAD, despite ongoing reform efforts, "the stock of old-generation treaties is 10 times larger than the number of new, reform-oriented treaties"; see the UNCTAD Investment Agreement Navigator (as of February 17, 2022), https://investmentpolicy.unctad.org/international-investment-agreements

[41] Ibid., p. 5.

[42] UNCTAD Investment Agreement Navigator (as of February 17, 2022), https://investmentpolicy.unctad.org/international-investment-agreements.

2. Economic and Legal Barriers to Reform

22. Besides a certain persistent lack of awareness, economic competition remains one of the most significant obstacles to more widespread IIA reform. Increasingly intense competition between states in recent years, particularly among developing countries, to attract foreign investment, has sparked a global race to the bottom. This incentivizes governments to maintain a low level of investment regulation[43]—to refrain from implementing reinforced investment screening and enforcing investors' obligations—and to avoid reforming their stock of old-generation treaties, even if those treaties threaten their regulatory space. This development is diametrically opposed to urgent requirements for swift and significant regulatory measures to address the climate crisis, as enshrined in agreements at the multilateral[44] and regional levels.[45]

23. On top of those economic barriers, the legal requirements for the reform of bilateral and multilateral IIAs create several additional obstacles. Some bilateral investment treaties contain tacit renewal clauses requiring a decision to terminate the treaty occur within a certain, possibly short, period of time.[46] Not only must states be aware of temporal conditions applicable to termination, but they may also have to reach a negotiated agreement to terminate by consent where the clause so requires. Time constraints linked to termination clauses may also negatively impact the prospect of negotiating a new IIA to replace the previous treaty. Moreover, sunset clauses, which are contained in the vast majority of all IIAs, further complicate decisions to terminate. Even if the rules of public international law or the treaty itself usually allow for a neutralization of the sunset clause,[47] whether such a neutralization will indeed occur in practice often depends on a successful negotiation between the treaty parties. In cases of unilateral termination, it is less likely that treaty partners will consent to a neutralization of the sunset clause. Additionally, even if states have agreed to replace old-generation treaties, they may not

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[43] See Gaukrodger, D. (2021). *The future of investment treaties - possible directions.* (OECD Working Papers on International Investment 2021/3) (p. 8). https://doi.org/10.1787/946c3970-en.

[44] For instance, the Paris Agreement set a temperature goal and committed states to efforts to limit global warming to 1.5°C above pre-industrial levels (Art. 2a); an increasing number of nationally determined contributions and long-term low greenhouse gas development strategies address the issue of fossil fuel production, and several countries have developed policies and/or pathways for a decline in fossil fuel production; see Stockholm Environment Institute, International Institute for Sustainable Development, Overseas Development Institute, E3G, and UN Environment Programme. (2021). *The production gap.* http://productiongap.org/2021report.

[45] The EU, for instance, has raised its climate targets and committed to reducing its net emissions by at least 55% by 2030; see the Communication from the Commission, 2019, supra note 11: "Fossil-fuel subsidies should end" (para. 2.1.5-3) and "The guidelines [...] will facilitate the phasing out of fossil fuels, in particular those that are most polluting" (para. 2.2.2). Denmark and Costa Rica (joined by France, Greenland, Ireland, Quebec, Sweden and Wales) also jointly launched the Beyond Oil & Gas Alliance (BOGA), an international alliance of governments and stakeholders working together to facilitate the phase-out of oil and gas production. Key members of BOGA commit to: (i) ending new concessions, licensing or leasing rounds for oil and gas production and exploration; and (ii) setting a Paris-aligned date for ending oil and gas production and exploration in the territory over which they have jurisdiction. For more information: https://beyondoilandgasalliance.com

[46] See e.g., Article 26.2 of the 2019 Dutch Model BIT.

[47] See Bernasconi-Osterwalder, N., Schaugg, L., & Van den Berghe, A. (2021). *Energy Charter Treaty reform: Why withdrawal is an option.* International Institute for Sustainable Development. https://www.iisd.org/itn/en/2021/06/24/energy-charter-treaty-reform-why-withdrawal-is-an-option/.

have included sufficiently clear transitional provisions—or the transition periods provided may be overly long, thereby effectively locking in the status quo. Treaty replacements or amendments are also usually subject to ratification, approval, or acceptance procedures at the national level, further adding to the duration of systemic reform.

24. Legal barriers also exist at the intersection of bilateral and multilateral levels, where new regional and mega-regional treaties are added to a plethora of existing bilateral agreements without fully replacing or consolidating them. For instance, 37 IIAs that predate the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) remain in force among CPTPP member countries. The Regional Comprehensive Economic Partnership (Art. 20.2) even expressly affirmed the coexistence of existing treaties among its parties. Similarly, the ECT overlaps with several other bilateral investment treaties. Neither the ECT nor CPTPP includes sufficiently potent conflict clauses to clarify situations of overlap.

25. Regional and multilateral investment agreements often involve legal barriers to reform that are distinct from the bilateral context. Consensus and ratification by unanimity or a majority of all contracting states of an agreement are usually required to amend regional or multilateral agreements. This allows a small number of states that are opposing reform to block amendment processes. For instance, in the current modernization of the ECT, the European Union has been unable to rally the required support for its proposal on limiting the coverage of fossil fuel investments in a modernized ECT,[48] due to the resistance of a small number of non-EU states.[49]

26. While a uni- or plurilateral withdrawal will normally trigger the sunset clauses these treaties typically contain, a neutralization of this sunset clause is not as straightforward as in the bilateral context. A group of states may modify the treaty to extinguish the sunset clause *inter se*,[50] but this neutralization will not affect their relationships with other treaty parties.

3. Increased Negotiation Complexity Requires Governments to Adopt Sophisticated Strategies

27. In addition to economic and legal barriers, treaty negotiations today are significantly more complex than they were at the time of the conclusion of "first-generation" IIAs. Negotiations increasingly involve a risk of trade-offs between investment and other policy areas and quid pro quos. Recent treaties also interact significantly more with other regimes of international law, such as laws relating to climate change and biodiversity, labour law and corporate social responsibility, trade and intellectual property law, and

[48] EU. (2020). *EU text proposal for the modernisation of the Energy Charter Treaty.* https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158754.pdf.

[49] Especially state parties that are heavily reliant on fossil fuel exports; see Taylor, K. (2021). *Leaked diplomatic cables show 'limited progress' in Energy Charter Treaty reform talks.* https://www.euractiv.com/section/energy/news/leaked-diplomatic-cables-show-limited-progress-in-energy-charter-treaty-reform-talks.

[50] Johnson, L., Sachs, L. Coleman, J., & Güven, B. (2018). *Clearing the path: Withdrawal of consent and termination as next steps for reforming international investment law* (p. 6.) (CCSI Policy paper). https://ccsi.columbia.edu/sites/default/files/content/docs/publications/IIA-CCSI-Policy-Paper-FINAL-April-2018.pdf

tax regulations, all of which need consideration in treaty renegotiations.[51] In contrast, the increasing fragmentation and specialization of international law render an integration of climate and investment policies at the treaty level more complex. Negotiations are therefore increasingly time consuming and costly and require significant human resources and specialized know-how, thereby raising additional challenges for countries—especially those in the Global South. While this new situation requires integrated negotiation strategies that take into account interdisciplinary and cross-cutting issues, such strategies presuppose a high level of interagency coordination that must first be developed.

28. The rising complexity of investment treaty-making and reform is further exacerbated by significant asymmetries in negotiating power between developing and developed countries.[52]

IV. Policy Recommendations

29. If the OECD decides to work on reform of investment agreements, it should consider the following:

1. Take a multistakeholder approach and coordinate with other ongoing reform efforts

30. Systemic changes to existing frameworks mean moving away from a strict investment protection and investment liberalization perspective toward the creation of a sustainable investment governance framework. However, this is unlikely to happen if reform and negotiations processes are led only by states' trade and investment representatives and investment arbitration experts. Redesigning investment agreements has an important prerequisite: it requires the adoption of a multistakeholder approach, allowing the effective balance of non-economic interests during the negotiations. It particularly requires relying on (i) scientific evidence, independent and multidisciplinary impact assessments, and costs and benefits analysis; (ii) involvement of relevant experts on environmental, climate, and other non-economic issues; and (iii) transparency and appropriate participation of stakeholders, in particular civil society.

31. Furthermore, the multiplicity of ongoing reform processes—at UNCTAD, UNCITRAL, the International Centre for Settlement of Investment Disputes (ICSID), WTO, regional bodies, and in the bilateral context—require far greater coordination and strategic planning to avoid inefficiency. Only by coordinating and integrating efforts will the

[51] See Bernasconi-Osterwalder et al., 2021, supra n. 47, p. 10; see Owens, J., & Zhan, J. (2018). Trade, investment and taxation: Policy linkages. *Transnational Corporations, 25*(2), 1–8, https://www.un-ilibrary.org/content/journals/2076099x/25/2/1; See also UNCTAD. (2021). Recent developments in the IIA regime: Accelerating IIA reform. *IIA Issues Note, 3,* 11. https://unctad.org/system/files/official-document/diaepcbinf2021d6_en.pdf.

[52] States are often parties to numerous IIAs and if "a given State wants to amend its agreements to resolve an issue of scope, or reach an interpretive agreement with its treaty partners to clarify the substantive meaning of standards, it may have to do so on an individual treaty-by-treaty basis. That exercise is not only time consuming but, as anecdotal evidence indicates, often unsuccessful, due to asymmetries in power between the treaty parties or other misaligned interests" (Johnson et al., 2018, supra n. 50, p. 6.

international community be able to foster the rapid change required to give states the regulatory space they need. This could also involve coordination with the World Investment for Development Alliance[53] hosted by UNCTAD with the participation of the OECD. Such coordination would also reduce negotiation costs and time and would ensure greater certainty, transparency, and accountability.

2. Explore a wide range of alternative options

32. In order to respond to climate change in investment agreements and remove barriers to climate action, a number of creative and credible alternative options deserve to be further discussed and examined. They may be implemented individually or in parallel:

a. Multilateral termination or withdrawal of consent to ISDS

33. Any reform effort should involve consideration of the development of a multilateral "exit" agreement that allows for the coordinated termination of investment agreements and the invalidation of "sunset" or "survival" clauses.[54] As stated above, these clauses extend the life of treaties up to 20 years beyond termination, thwarting government action to keep warming well below 2°C. An exit agreement would address these concerns swiftly and systemically and would avoid a multiplication of negotiations at bilateral levels.

34. Such an option would allow states to easily move away from traditional investment agreements and develop sustainable investment governance frameworks.[55]

35. As an alternative to termination, the OECD could support the development of a multilateral instrument for states to withdraw consent to ISDS under existing investment agreements, leaving them bound by their substantive obligations and accountable by way of state-to-state dispute settlement.[56] Preferably, this would be coupled with a requirement for investors to first exhaust local remedies.

[53] See website of the World Investment Forum (UNCTAD). (2021, October 18). *Towards the establishment of the world investment for development alliance (in partnership with the World Economic Forum)*. https://worldinvestmentforum.unctad.org/session/launching-a-global-alliance-for-sustainable-investment/.

[54] See the *Agreement for the Termination of Bilateral Investment Treaties Between the Member States of the European Union* (2020), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22020A0529(01); Bernasconi-Osterwalder, N., Brewer, S., Brauch, M. D., & Nikièma, S. (2020). *Terminating a bilateral investment treaty.* IISD Best Practices Series. International Institute for Sustainable Development. https://www.iisd.org/system/files/publications/terminating-treaty-best-practices-en.pdf; Columbia Center on Sustainable Development, IIED, & International Institute for Sustainable Development. (2019). *Draft treaty language: Withdrawal of consent to arbitrate and termination of International Investment Agreements.* Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform. https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/wgiii_withdrawalconsent_0.pdf; Johnson et al., 2018, *supra* n. 50.

[55] See Brauch et al. (2018). *Treaty on sustainable investment for climate change mitigation and adaptation.* IISD Submission to the Stockholm Treaty Lab. https://www.iisd.org/publications/treaty-sustainable-investment-climate-change-mitigation-adaptation

[56] See Bernasconi-Osterwalder, N. (2014, October). *State-state dispute settlement in investment treaties.* IISD Best Practice Series. International Institute for Sustainable Development. https://www.iisd.org/system/files/publications/best-practices-state-state-dispute-settlement-investment-treaties.pdf.

36. From a climate perspective, the option of relying on state–state dispute settlement would reduce the litigation risk, increase home state involvement, and emphasize the shared responsibility of home and host states to take climate action. Investors would also be less likely to (successfully) challenge measures needed to achieve the goals of the Paris Agreement.

37. Whether states choose to terminate IIAs or withdraw consent to ISDS, investors would still be able to challenge the validity of climate measures at the domestic level.

b. Removal of investment treaty protections for fossil fuel investments

38. Continuing to provide generous risk insurance policies and rewarding investments that urgently need to be discouraged if the world is to avoid climate catastrophe simply does not make sense. Another option for the OECD would be to develop a multilateral instrument whereby countries would agree on a list of carbon-intensive investments (in particular, fossil fuel investments such as extraction, transport, and refining of coal, oil, and gas) that would be excluded from the scope of investment agreements' application.[57]

39. The EU has recently proposed such an approach in the context of the modernization of the ECT. According to the EU's proposal on the application of Part III of the ECT (investment protection and ISDS), existing fossil fuel investments would remain protected for another 10 years after the proposed amendment entered into force. Future investments in fossil fuels would be excluded from the scope of the ECT's investment protections, except for investments in certain gas infrastructures and power plants that could continue to be protected until 2030 (and 2040 for certain gas pipelines). Such a proposal is a step in the right direction, but the 10-year period for phasing out existing investments and the exemptions afforded to certain future gas investment risk creates a major stumbling block to achieving climate objectives. In order to align with Paris Agreement goals and avert the irreversible damage that would ensue if temperature rise surpasses 1.5°, even temporarily, the protection of all fossil fuel investments should be phased out as soon as possible.

40. This option would ensure coherency and consistency of investment agreements with the Paris Agreement. It would also substantially reduce litigation risk since the fossil fuel industry is the primary user of arbitration systems.

c. Carve-out for climate-related measures

41. Based on evidence showing that a large number of ISDS cases have been brought in relation to environmental regulations, and considering the specific threat posed by fossil fuel industries challenging efforts to address climate change,[58] it is of paramount importance to clarify that regulatory changes required to respond to the climate emergency cannot be interpreted as a breach of an investment treaty. Because of the

[57] The approach taken in the EU taxonomy for sustainable activities could inspire and inform states in determining the best approach to define what can be considered low-carbon energy investments that will benefit from treaty-based protection under a modernized ECT.

[58] See Di Salvatore, L. (2021). *Investor-state disputes in the fossil fuel industry*. International Institute for Sustainable Development. https://www.iisd.org/publications/investor-state-disputes-fossil-fuel-industry.

longstanding scientific consensus around the causes of anthropogenic climate change (fossil fuels chief among them) and its impacts, as well as international action on it (1992 UNFCCC, 1997 Kyoto Protocol, and 2015 Paris Agreement), investors can only have expected progressively more stringent national regulation in this area.

42. The OECD could also encourage its members to reach a legal agreement on how to navigate frictions between climate policies and investment law. This could first consist of the **establishment of a preliminary reference procedure and a panel of climate experts**, as developed by Ankersmit and Lawrence in 2019: "One way of preventing arbitrators from glossing over or misunderstanding obligations that result from the UNFCCC would be to involve climate experts early in the dispute settlement process. We recommend putting climate experts in the driver's seat in the application of the UNFCCC regime in the context of trade and investment agreements."[59] Such a preliminary climate reference mechanism would oblige arbitration tribunals to refer on their own motion any questions relating to the interpretation or application of the Paris Agreement (or other climate instruments) to a climate expert panel, including instances where a party invokes compliance with a UNFCCC agreement such as the Paris Agreement to justify a challenged act or measure.

43. Secondly, similar to the mechanism proposed in respect of the dismissal of frivolous claims,[60] OECD members could facilitate the conclusion of a multilateral **agreement to carve out climate measures** from the scope of ISDS. This type of agreement would demonstrate that OECD member states think that claims challenging climate measures should be dismissed. In turn, if tribunals do not dismiss such claims, the OECD or its members could commit to submitting amicus briefs to encourage the dismissal of those claims.[61]

44. The carve-out would apply to any measure linked to the objective and principles of, or commitment to, the UNFCCC. Relying on the language of UNFCCC would allow the climate carve-out to apply to a wide range of state measures relating to climate change mitigation and adaptation. In particular, this provision should clearly mention that IIA protection and ISDS would not be permitted in the context of a denial or revocation of permits for exploration and the development of fossil fuels; the planned phase-out of certain energy sources such as coal, oil, and gas; and the removal of fossil fuel subsidies. Investors would still be able to challenge the validity of these measures at the domestic level. By ruling out the possibility of ISDS cases on climate change measures, the carve-out would significantly reduce the risk of regulatory chill, including any cross-border chilling effect.

[59] Lawrence, J., & Ankersmit, L. (2019). *Making EU FTAs 'Paris Safe': Three studies with concrete proposals.* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3407949; See, for example, *S.D. Myers, Inc. v. Government of Canada,* UNCITRAL and Eco Oro Minerals Corp. v. Republic of Colombia, ICSID Case No ARB/16/41.

[60] Secretariat of UNCITRAL Working Group III. (2018). *Possible reform of investor-state dispute settlement (ISDS): Note by the Secretariat* (A/CN.9WG.III/WP.149) (para. 15). https://undocs.org/en/A/CN.9/WG.III/WP.149.

[61] As an example, the European Commission has recently adopted an active and ambitious role as amicus curiae petitioner seeking annulment of intra-EU arbitration awards and uniform application of EU law. See for example, Eiser Infrastructure Limited and Energía Solar Luxembourg S.à.r.l. v. Spain, ICSID Case No. ARB/13/36.

d. Reining in excessive awards of compensation

45. In recent years, the amounts of compensation awarded by arbitral tribunals in ISDS have been increasingly large, reaching hundreds of millions and even billions of U.S. dollars. Tribunals frequently award compensation for loss of future income across the life of a project, calculated based on a series of complex and interlocking assumptions about the future. Large awards pose serious challenges for states and have systemic implications that directly affect climate policy and exacerbate regulatory chill. Nevertheless, the issue of compensation has not received the same attention from policy-makers as other aspects of international investment law. As such, it largely remains unregulated by states' treaty practice, affording a great deal of discretion to arbitrators on this critical topic. Arbitral jurisprudence is not only inconsistent from case to case within the ISDS regime, it also increasingly departs from previously accepted principles of international law and practice in other international courts, as well as the approaches to compensation in domestic courts.[62]

46. To address this issue, states could explore ways to implement a balancing approach to the award of compensation that would oblige tribunals to take into account a range of contextual factors and public interest objectives, including climate change mitigation and adaptation. States could also decide to cap compensation at the amount actually invested by the investor, to prevent large awards based on a speculative scenario of future income streams. A third option would be to integrate into compensation principles questions of whether the host state has obtained any benefit from allowing the investment to proceed. Lastly, states could also consider requiring arbitral tribunals to follow the law of the host state when determining compensation or referring questions of quantum (the amount of compensation owing) to the domestic courts once the tribunal has found the state to be in breach of the investment treaty.[63]

e. Additional short-term options besides reform

47. Besides these options for long- and medium-term reform, states should also explore short-term options to address legal risks. With regard to ongoing cases, home states could undertake to more systematically intervene as non-disputing parties in ISDS proceedings to emphasize a treaty interpretation in line with original state intent and international climate commitments.

48. More generally, states could rein in increasingly broad arbitral treaty interpretation by issuing joint interpretive statements. Those interpretative statements should also cover the interpretation of environmental provisions, exception provisions, legality provisions, carve-outs, or other types of safeguard provisions. Such clauses could limit potential ISDS claims and secure space for domestic policy-making. Those interpretative statements shall affirm their understanding that IIAs have to be interpreted in light of/in conformity with international climate change obligations.

[62] An example would be the fundamentally different valuation techniques used in the cases of Copper Company Pty Limited v. Islamic Republic of Pakistan, ICSID Case No. ARB/12/1, Award, para. 278 and Bear Creek Mining Corporation v. Republic of Peru, ICSID Case No. ARB/14/21, Award, para. 596.

[63] See Bonnitcha & Brewin, 2020, supra n. 19.

49. Lastly, home states could explore the possibility of granting extraterritorial civil jurisdiction to claimants that have suffered damages from the adverse environmental and climate impact of foreign investors, thereby increasing investor accountability.[64]

[64] See Ullauri, P. (2020). Reconciling the rights of multinational companies under IIAs with the tort liability caused by their subsidiaries. *Investment Treaty News, 4*(11), 6 https://www.iisd.org/system/files/2020-12/iisd-itn-december-2020-english.pdf.

THE CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW (CIEL)

CIEL is an independent, nonprofit organization with offices in Washington DC, United States, and Geneva, Switzerland. Since 1989, CIEL has used the power of law to protect the environment, promote human rights, and ensure a just and sustainable society. In the context of investor–state dispute settlement (ISDS), CIEL focuses on how investment law and arbitration affect human rights and the environment, and the role of international environmental and human rights law in the resolution of investment disputes. CIEL has participated as amicus curiae in multiple investment arbitration cases, has published extensively on investment and trade law, and has worked on ISDS reform and free trade agreement negotiations.

CLIENTEARTH

ClientEarth is an independent, non-profit organization providing dedicated public interest legal capacity for the environment since 2007. ClientEarth's goal is to use the power of the law to bring about systemic change that protects the Earth for—and with—its inhabitants. We come up with practical solutions to the world's toughest environmental challenges and work with people, campaigners, governments, and industry to make those solutions a reality. ClientEarth has legal expertise in the application and enforcement of environmental law, as well as relevant knowledge and experience in supporting non-governmental organizations and communities in various legal forums, including in supporting groups submitting amicus briefs in arbitration proceedings. ClientEarth has extensively published on and actively participated in negotiations of investment and ISDS reforms.

INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (IISD)

IISD is an award-winning independent think tank working to create a world where people and the planet thrive. IISD works with governments and civil society to develop and improve legal and policy tools focusing on the critical linkage between investment and sustainable development. IISD actively participates in the ISDS reform process at UNCITRAL Working Group III, the UN talks on a binding treaty on business and human rights, and the negotiations of several regional investment instruments in the Global South. As an integral component of its investment work, IISD is also the host and convener of the Annual Forum of Developing Country Investment Negotiators, an event that brings together officials from across world regions to discuss the latest trends in these areas, exchange experiences, design innovative approaches, and assess possible next steps.

Climate Action Needs Investment Governance, Not Investment Protection and Arbitration

Response by the Columbia Center on Sustainable Investment to the OECD Public Consultation on Investment Treaties and Climate Change

March 25, 2022

The Columbia Center on Sustainable Investment (CCSI)—a joint research center of Columbia Law School and the Earth Institute at Columbia University—explores elements of the international investment legal framework, including the impact of investment treaties, investor–state dispute settlement, and home and host government policies governing inward and outward investment, among many other issues.

1 **Existing investment treaties do not and cannot advance climate goals. There is a fundamental misalignment between the existing international investment regime—including its centerpiece: investor–state arbitration—and the actions needed to meet the objectives of the international climate regime and avoid catastrophic climate change. For international investment law to support climate goals, we need a wholly new regime for investment governance, not investment protection and arbitration.**[1]

2 Investment is crucial to achieving climate mitigation and adaptation goals. We need substantially more investment in zero-carbon sectors, such as renewable power generation (solar, wind, hydropower, and geothermal), batteries and other energy storage technologies, green hydrogen, electric transportation, and energy efficiency, while phasing out investment in fossil fuels and other high-emission economic activities. The 2022 Intergovernmental Panel on Climate Change (IPCC) report on Impacts, Adaptation and Vulnerability also stresses that investments in mitigation must be coupled with investment in adaptation and climate-resilient infrastructure to help billions in areas of growing climate risk.[2]

3 International investment law should accelerate climate-friendly, sustainable investment and the phase-out of climate-unfriendly investment. Existing investment treaties and investor–state dispute settlement (ISDS) fail to do either. They were not designed to advance those goals, but to protect economic interests of foreign investors and their investments, regardless of their climate friendliness.

[1] This submission is based on Martin Dietrich Brauch, "Climate Action Needs Investment Governance, Not Investment Protection and Arbitration," *Columbia Center on Sustainable Investment [CCSI]* (blog), March 15, 2022, https://ccsi.columbia.edu/news/climate-action-needs-investment-governance-not-investment-protection-isds.

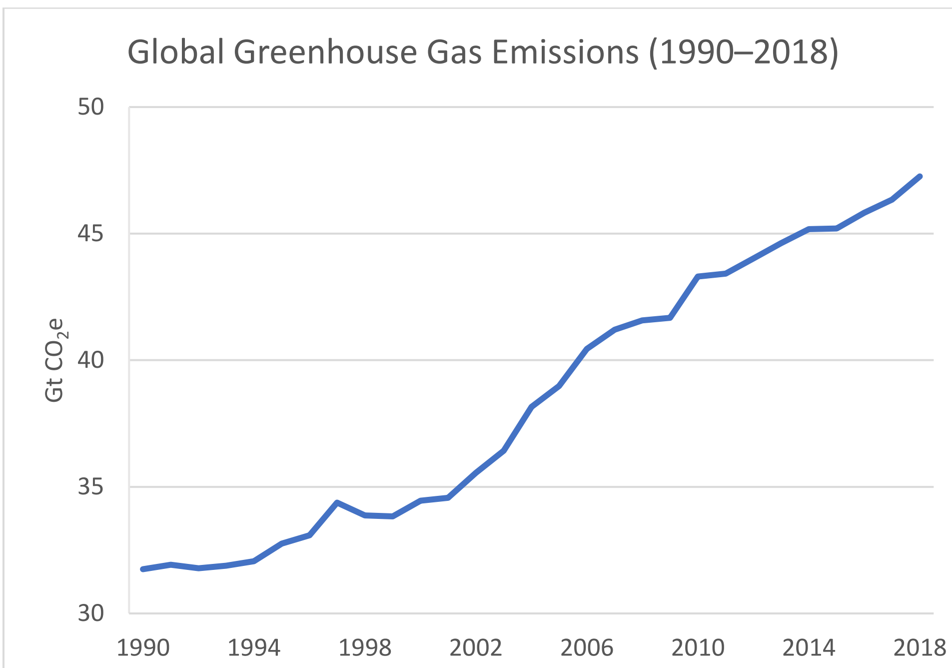
[2] Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2022: Impacts, Adaptation, and Vulnerability. Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* [H.-O. Pörtner, D.C. Roberts, M. Tignor, E.S. Poloczanska, K. Mintenbeck, A. Alegría, M. Craig, S. Langsdorf, S. Löschke, V. Möller, A. Okem, B. Rama (eds.)] (City: Cambridge University Press, 2022), https://report.ipcc.ch/ar6wg2/pdf/IPCC_AR6_WGII_FinalDraft_FullReport.pdf.

The Clashing Climate Change and Investment Regimes: Back to the 1990s

4 The 2015 Paris Agreement's umbrella treaty, the United Nations Framework Convention on Climate Change (UNFCCC), was adopted in 1992 and entered into force in 1994—a landmark moment that emphasized the need for long-term planning for a climate-friendly future. Its ultimate objective is to stabilize greenhouse gas concentrations in the atmosphere "at a level that would prevent dangerous anthropogenic interference with the climate system."[3]

5 In a 1994 report—months before the first Conference of the Parties (COP) to the UNFCCC—the IPCC indicated that "the main anthropogenic sources of [carbon dioxide] are the burning of fossil fuels [among others]." The same report also estimated a carbon budget, which indicated the amount of greenhouse gases we could, starting in 1994, still emit while stabilizing concentrations at safe levels. The report stressed that "stabilization [of greenhouse gas concentrations] is only possible if emissions are [...] reduced well below 1990 levels."[4]

6 The international community—including states as well as investors—has been on notice since the 1990s: to prevent disastrous anthropogenic interference with the climate system, greenhouse gas concentrations in the atmosphere must be stabilized. To do that, emissions must be reduced well below 1990 levels, which requires transitioning away from fossil energy. Yet emissions have since increased substantially as states and investors have been too slow in adjusting course.



Source: Prepared by the author based on data from ClimateWatch.

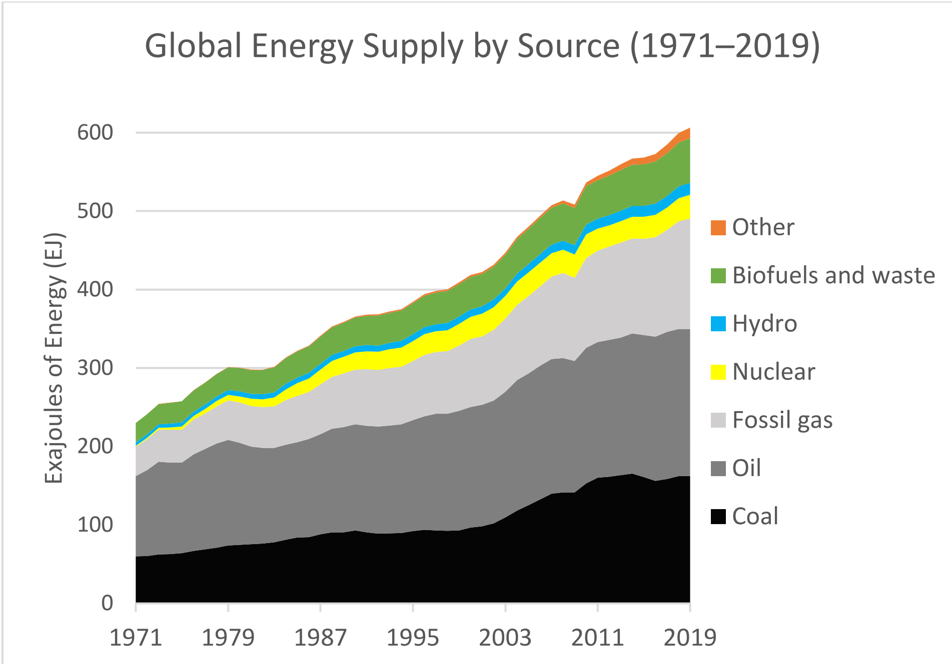
7 If fossil energy companies have any "legitimate expectation" since the 1990s, it is that states would take steps to phase out their sector. In the International Energy Agency's (IEA) pathway to net-zero by 2050,[5] "there is no need for investment in new fossil fuel supply": "Beyond projects already committed as of 2021, there are no

[3] United Nations Framework Convention on Climate Change, opened for signature May 9, 1992, entered into force March 21, 1994 (UNFCCC), Art. 2, https://unfccc.int/resource/docs/convkp/conveng.pdf.

[4] IPCC, *Climate Change 1994*, [J.T. Houghton, L.G. Meira Filho, J. Bruce, Hoesung Lee, B.A. Callander, E. Haites, N. Harris and K. Maskell (Eds.)] (Cambridge: Cambridge University Press, 1994), 339, https://archive.ipcc.ch/pdf/special-reports/cc1994/climate_change_1994.pdf.

[5] International Energy Agency (IEA), *Net Zero by 2050* (Paris: IEA, 2021), https://www.iea.org/reports/net-zero-by-2050.

new oil and gas fields approved for development in our pathway, and no new coal mines or mine extensions are required." In the next three decades, trillions of dollars in fossil fuel assets need to be stranded to achieve climate goals, including reserves and projects that fossil and infrastructure companies have continued recklessly to develop.



Source: Prepared by the author based on data from the [International Energy Agency (IEA)](#).

8 States need to push more forcefully for the transition away from fossil energy in both the climate and investment regimes. It took 26 COPs for the 2021 Glasgow Climate Pact[6] to call upon states, for the first time, to "[accelerate] efforts towards the phasedown of unabated coal power and phase-out of inefficient fossil fuel subsidies."[7] The climate regime still needs to toughen up language on the need to accelerate the phase-out of all fossil fuel development.

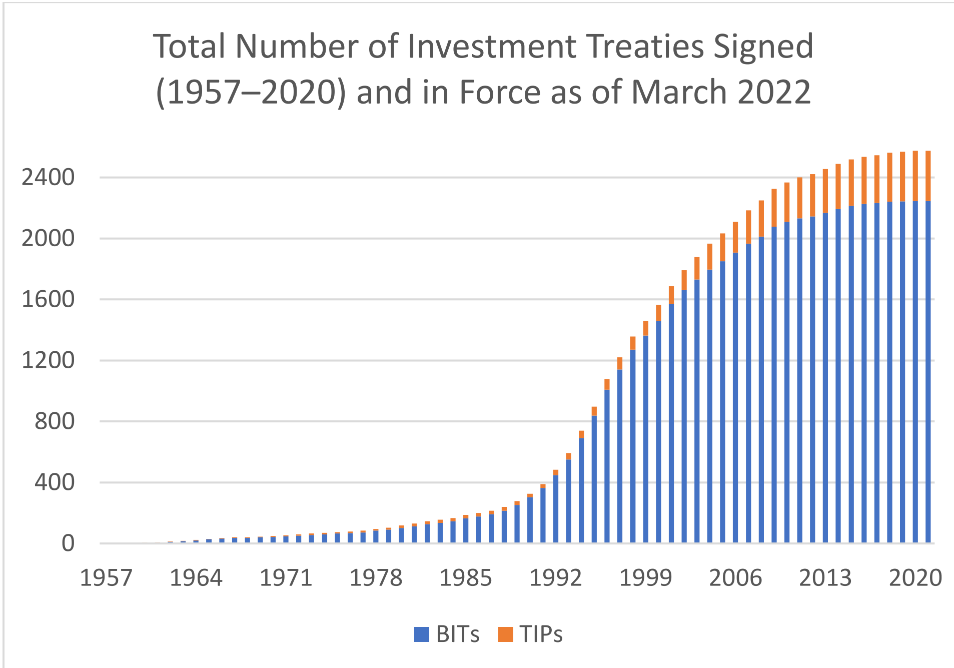
9 Similarly, states need to stop maintaining an investment protection regime that—among other flaws—does not even try to regulate investment or to phase out high-emission investments.[8] Since 1994, states have concluded roughly 2000 investment treaties that are still in force. The Energy Charter Treaty (ECT) is an important one from a climate action perspective—but not the only one.[9] All those treaties protect coal, oil, gas, and other high-emission investments that emit well beyond the carbon budget. Even if investment treaties may not have been intentionally designed to thwart climate goals, the fact that they have that detrimental effect can no longer be ignored.

[6] "Glasgow Climate Pact," United Nations Framework on Climate Change, Glasgow, https://unfccc.int/sites/default/files/resource/cop26_auv_2f_cover_decision.pdf.

[7] Harro van Asselt, "Breaking a Taboo: Fossil Fuels at COP26," *EJIL: Talk! Blog of the European Journal of International Law* (blog), November 26, 2021, https://www.ejiltalk.org/breaking-a-taboo-fossil-fuels-at-cop26.

[8] CCSI, *Primer on International Investment Treaties and Investor-State Dispute Settlement* (New York: CCSI, 2021), https://ccsi.columbia.edu/content/primer-international-investment-treaties-and-investor-state-dispute-settlement.

[9] Martin Dietrich Brauch, "Should the European Union Fix, Leave or Kill the Energy Charter Treaty?" *CCSI* (blog), February 9, 2021, https://ccsi.columbia.edu/news/should-european-union-fix-leave-or-kill-energy-charter-treaty.



Source: Prepared by the author based on data from the [United Nations Conference on Trade and Development (UNCTAD)](#).

Investment Treaties and Arbitration Make Climate Action Costly and Chill Climate Regulation

10 Investment treaties and arbitration make it more costly for states to take legitimate climate action, including the phase-out of fossil fuels and the regulation of high-emitting sectors. Under the existing investment regime, companies are allowed to claim monetary compensation from states for policy measures that negatively affect the companies' interests.

11 For instance, when a government takes measures to restrict oil and gas exploration or exploitation, stop the expansion of pipelines and other fossil fuel infrastructure, or phase out coal-fired power generation, investment treaties and arbitration allow investors to seek compensation for those measures.[10] In other words, investment treaties and arbitration protect and reward investments that interfere dangerously with the climate system.

12 Law firms are making sure that companies are aware of this opportunistic use of investment arbitration against the public interest.[11] As one firm advises: "Climate change litigation […] is an opportunity […] for companies exposed to certain climate-related government measures to vindicate their rights. Companies in industries most affected by states' climate change obligations (e.g., fossil fuels, mining, etc.) should audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty. [...] It is […] important

[10] "Rockhopper v. Italy," The U.S. Global Climate Change Litigation Database, http://climatecasechart.com/climate-change-litigation/non-us-case/rockhopper-v-italy.

Ella Merrill and Martin Dietrich Brauch, "U.S. Climate Leadership Must Reject ISDS: As the United States Faces Another $15 Billion Suit from the Fossil Fuel Industry, it's Time for President Biden to Take a Decisive Stance," *CCSI* (blog), July 13, 2021, https://ccsi.columbia.edu/news/us-climate-leadership-must-reject-isds-united-states-faces-another-15-billionsuit-fossil-fuel.

"Uniper v. Netherlands," The U.S. Global Climate Change Litigation Database, http://climatecasechart.com/climate-change-litigation/non-us-case/uniper-v-netherlands.

[11] Michelle Bradfield, Philip Devenish, James Egerton-Vernon, Carla Gharibian, Melissa Stear Gorsline, Fahad Habib, AND Sylvia Tonova, "Climate Change and Investor-State Dispute Settlement," *JD Supra*, February 28, 2022, https://www.jdsupra.com/legalnews/climate-change-and-investor-state-9102431.

to assess which treaty would best protect the company from any adverse climate-related government measures."

13 Even the possibility of climate-related investment arbitration discourages policy action. Denmark, France, and New Zealand have openly admitted that they pushed back their deadlines to phase out oil and gas exploration or exploitation because of investment treaties and the fear of arbitration claims.[12] There may well be other countries that are delaying action or lowering ambition because of the investment regime, but just not admitting it openly.

14 Fossil companies already account for almost one-fifth of investment arbitrations, and they won about three of every four cases initiated.[13] Without fundamental reform, the investment regime will continue to allow fossil companies to chill climate regulation and to get states (and ultimately taxpayers) to cover losses that result from corporate recklessness.

Climate-Focused Reform Won't Do

15 Various reform proposals aim to make investment treaties and arbitration more climate friendly, by training arbitrators in climate science; changing how damages are calculated to avoid shifting the risk and cost of decarbonization to states; integrating climate carve-outs, exceptions, or right-to-regulate clauses into treaties; or allowing climate-related counterclaims by states.[14] Proponents of these reforms argue that they are steps in the right direction, even if they are piecemeal approaches.

16 The international community should not settle for sub-optimal approaches, for three main reasons.

17 **First**, climate blindness is far from being the sole issue with the investment regime. Investment protection and arbitration constrain states' duty and right to regulate not only in the climate policy space, but also in public health, access to public goods, protection of human rights and the environment, and the pursuit of sustainable development.[15] States and other stakeholders have been increasingly critical of broadly worded provisions—including the promises of fair and equitable treatment (FET) and the protection of legitimate expectations, as well as protections against discrimination and indirect expropriation—that work against public-interest regulation.

12 Elizabeth Meager, "Cop26 Targets Pushed Back Under Threat of Being Sued," *Capital Monitor*, January 14, 2022, https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits.

13 Lea Di Salvatore, *Investor-State Disputes in the Fossil Fuel Industry* (Geneva: International Institute for Sustainable Development [IISD], December 2021), https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf.

14 "Webinar on International Investment Agreements and Climate Action," United Nations Conference on Trade and Development, February 2022, https://unctad.org/meeting/webinar-international-investment-agreements-and-climate-action.

"Investor Obligations and Investor-State Arbitration," CCSI, https://ccsi.columbia.edu/content/counterclaims-investor-state-disputes.

15 Lisa Sachs, Lise Johnson, and Ella Merrill, "Environmental Injustice: How treaties undermine human rights related to the environment," *La Revue des Juristes de Sciences-Po*, no. 18 (January 2020), https://ccsi.columbia.edu/sites/default/files/content/docs/our%20focus/dossier%20Environmental%20Injustice.pdf.

Jesse Coleman, Kaitlin Y.Cordes, and Lise Jonson, "Human Rights Law and the Investment Treaty Regime" (CCSI Working Paper, 2019), https://ccsi.columbia.edu/sites/default/files/content/docs/Coleman-Cordes-and-Johnson-Human-Rights-Law-and-the-Investment-Treaty-Regime_0.pdf.

United Nations General Assembly, Human rights-compatible international investment agreements, UN Doc. A/76/238 (July 27, 2021), https://undocs.org/A/76/238.

18 Attempts at piecemeal reform approaches are already falling short. For example, tribunals have recently ignored carve-outs in treaties protecting states from liability for measures taken to protect the environment.[16]

19 Even more importantly, proposed reforms do nothing to address the fundamental misalignment of investment treaties with a net-zero future, or sustainable development more generally. Third parties directly impacted by an investment have very limited and ineffective means of participating in arbitration proceedings.[17] Some states are paying enormous sums (in some cases equal to or more than their annual health or education budgets, for example) to compensate investors according to a skewed and inconsistent system of valuation and compensation.[18] The vast majority of attempts by states to avoid dispute settlement through the development of investment facilitation centers or dispute prevention mechanisms only enhance the power investors hold over regulators.[19] Private financiers are encouraging investors to bring claims against states by funding claimants in return for a portion of the award.[20] Although the member states of Working Group III of the United Nations Commission on International Trade Law (UNCITRAL) have identified various problematic aspects of investment arbitration,[21] options being considered, such as the proposed standing multilateral mechanism, risk further entrenching states in an already broken dispute-resolution system, without addressing the underlying issues.[22]

20 Policymakers, civil society, and academics are increasingly reaching the conclusion that the existing investment protection and arbitration regime is broken beyond repair.

21 **Second**, there is inconclusive evidence to support that investment treaties and arbitration can perform on their key expected benefits.[23] Existing treaties neither increase the quantity or quality of foreign direct investment (FDI), depoliticize conflicts between home and host countries of investment, promote good governance reform, nor strengthen the rule of law. If a regime cannot achieve its main purposes, and its costs substantially outweigh its uncertain benefits, why put so much effort into fixing it?

[16] J. Benton Heath, "Eco Oro and the twilight of policy exceptionalism," *Investment Treaty News*, December 20, 2021, https://www.iisd.org/itn/en/2021/12/20/eco-oro-and-the-twilight-of-policy-exceptionalism.

[17] CCSI, International Institute for Environment and Development (IIED), and IISD, *Third-Party Rights in Investor-State Dispute Settlement: Options for Reform* (submission to UNCITRAL Working. Group III on ISDS Reform on the work of its 37th session, July 15, 2019), https://ccsi.columbia.edu/sites/default/files/content/docs/our%20focus/uncitral-submission-third-party-participation-en.pdf.

[18] "Valuation and Compensation in ISDS," CCSI, https://ccsi.columbia.edu/content/valuation-and-damages-isds.

[19] Lise Johnson, Lisa Sachs, and Ella Merrill, "Investor-State Dispute Prevention: A Critical Reflection," *Dispute Resolution Journal* no. 4 vol. 75 (2021), https://ccsi.columbia.edu/sites/default/files/content/docs/Dispute%20Resolution%20Journal%20-%20Johnson%20et%20al.%20-%20Investor-State%20Dispute%20Prevention[16689].pdf.

[20] "Third Party Funding in Investor-State Dispute Settlement," CCSI, https://ccsi.columbia.edu/content/third-party-funding-investor-state-dispute-settlement.

[21] "CCSI and UNCITRAL's Working Group III on Investor-State Dispute Settlement Reform," CCSI, https://ccsi.columbia.edu/content/ccsi-and-uncitrals-working-group-iii-investor-state-dispute-settlement-reform.

[22] CCSI, *Public Consultation on a Multilateral Reform of Investment Dispute Settlement* (New York: CCSI, March 1, 2017), https://ccsi.columbia.edu/sites/default/files/content/docs/publications/CCSI-EU-Court-public-consultation-submission-15-Mar-17-FINAL.pdf.

Lise Johnson, "Proposed Standing Multilateral Mechanism for Investor-State Disputes: Navigating the Negotiations," *CCSI* (blog), February 14, 2022, https://ccsi.columbia.edu/news/proposed-standing-multilateral-mechanism-investor-state-disputes-navigating-negotiations.

[23] Joachim Pohl, "Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence Reference" (OECD Working Papers on International Investment No. 2018/01, Paris: OECD, January 19, 2018), https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en.

Lise Johnson, Brooke Skartvedt Güven, and Jesse Coleman, "Investor-State Dispute Settlement: What Are We Trying to Achieve? Does ISDS Get Us There?" *CCSI* (blog), December 11, 2017, https://ccsi.columbia.edu/news/investor-state-dispute-settlement-what-are-we-trying-achieve-does-isds-get-us-there.

22 **Third**, it is irresponsible vis-à-vis present and future generations to keep in place a knowingly flawed regime, with uncertain benefits and great known costs, in hopes that tweaking it at the margins will cause the necessary fundamental change.[24] Given the global climate emergency, too much is at stake.

Overhauling Investment Protection and Arbitration in Favor of Investment Governance

23 The optimal, most effective solution is to build a new international investment regime to help achieve global goals, advancing the types of investments that are desirable, supporting the phase-out of climate-wrecking investments, and preserving and strengthening states' right and duty to take climate action and other measures in the public interest. States should move away from the existing regime, which puts profit above people and planet, by terminating or withdrawing from existing investment protection treaties and arbitration and not negotiating new ones that do not align with their climate and sustainable development objectives.[25]

24 From a clean slate, the international community can design a regime that shapes and governs investment to achieve climate goals and the Sustainable Development Goals (SDGs). Investment governance treaties could contain guidance and commitments on governing investment in line with the SDGs, including climate action; establish cooperation mechanisms to address challenges in the governance of international investment, including with respect to intellectual property, technology transfer, and data; and support domestic administrative and judicial systems to facilitate investment governance and enforcement. Importantly, the regime could foster international cooperation, research and development (R&D), and financing mechanisms for climate-aligned investments, including in energy efficiency, renewable electricity, green hydrogen, batteries, recycling, and climate-resilient infrastructure.[26] It could also affirm states' binding commitments to phase out investment protections and incentives for fossil fuels and other high-emission investments; and create climate justice and just transition mechanisms to protect the rights and interests of those affected by zero-carbon investments.

24 Lise Johnson, Lisa Sachs, Brooke Güven, and Jesse Coleman, *Costs and Benefits of Investment Treaties: Practice Considerations for States* (New York: CCSI, March 2018), https://ccsi.columbia.edu/sites/default/files/content/docs/publications/07-Columbia-IIAinvestor-policy-briefing-ENG-mr.pdf.

25 Lise Johnson, Lisa Sachs, Brooke Güven, and Jesse Coleman, *Clearing the Path: Withdrawal of Consent and Termination as Next Steps for Reforming International Investment Law* (New York: CCSI, April 2018), https://ccsi.columbia.edu/content/clearing-pathwithdrawal-consent-and-termination-next-steps-reforming-international.

Lise Johnson, Jesse Coleman, Brooke Güven, and Lisa Sachs, "Alternatives to Investor-State Dispute Settlement" (CCSI Working Paper 2019, New York: CCSI, April, 2019), https://ccsi.columbia.edu/sites/default/files/content/docs/blog/Alternatives-to-ISDS-11-April2019_0.pdf.

Lise Johnson, Lisa Sachs, and Nathan Lobel, *Aligning Investment Treaties with Sustainable Development* (New York: CCSI, November, 2019), https://ccsi.columbia.edu/content/aligning-investment-treaties-sustainable-development.

26 Martin Dietrich Brauch, "Reforming International Investment Law for Climate Change Goals." In *Research Handbook on Climate Finance and Investment Law*, edited by Michael Mehling and Harro van Asselt (Cheltenham: Edward Elgar Publishing Ltd, forthcoming), https://academiccommons.columbia.edu/doi/10.7916/d8-300v-7h63.

Contribution of the Confederation of Portuguese Business - CIP

1. Trade and investment tools can accompany and support a global transition towards a climate neutral economy, including accelerating investments in clean energy, and promote value chains that are circular, responsible and sustainable. This includes promoting responsible business conduct and the respect of environmental, human rights and labour standards. Simultaneously there is a need to create conditions and opportunities for sustainable products and services.

2. We already see in the new generation of bilateral trade agreements the facilitation of trade in green technologies, goods, services and investments. In addition to these ambitious trade and sustainable development chapters in the agreements, the sustainability dimension should continue to be reflected in many aspects of the trade and investment agreements:

- They support the diffusion of clean and more efficient production methods and technologies and create market access opportunities for green goods and services.

- They also help secure access to third country markets for EU`s renewable energy industry and ensure undistorted trade and investment in the raw materials and energy goods that are required to secure the necessary supplies to support the transition to climate neutral economies.

- Moreover, they provide an essential platform to engage with our partners on climate change, biodiversity, circular economy, pollution, clean energy technologies including renewable energy and energy efficiency and on the transition to sustainable food systems.

3. The respect of the Paris Agreement is an essential element in future trade and investment agreements.

4. Finally, the approval of trade and investment agreements with G20 countries should be based on a common ambition to achieve climate neutrality.

Sofia Baião Horta
Departamento de Relações Internacionais
Praça das Indústrias | 1300-307 Lisboa
T: +351 21 316 47 00 | F: +351 21 357 99 86
E.mail: **sofiabhorta@cip.org.pt**

OECD Public consultation on investment treaties and climate change

Dr Julia Dehm, School of Law, La Trobe University

1. The accelerating climate crisis is one of the most urgent and serious global challenges. As the Independent Expert on human rights and solidarity noted in his 2020 report on climate change "Climate change results from globally interlocking economic systems that drive unsustainable modes of production and consumption, especially of fossil fuels and other extractive commodities".[1]

2. **In order to meet the international goal of holding the average surface temperature rise to 1.5 degrees Celsius a rapid phrase down of fossil fuel use is necessary.**

3. Analysis published in *Nature* in September 2021 showed that in order to have a 50% chance of limiting warming to 1.5 degrees, by 2050 nearly 60 per cent of oil and fossil methane gas, and 90 per cent of coal must remain unextracted. The study also found that oil and gas production must decline globally by 3 per cent each year until 2050 and that therefore most regions must reach peak production now or during the next decade, rendering many operational and planned fossil fuel projects unviable.[2]

4. The modelling prepared by the International Energy Agency in its NetZero 2050 scenario came to similar conclusions. It was confirmed that after 2021 no new oil and gas fields should approved for development, nor any new coal mines or mine extensions as part of its net-zero pathway. Additionally, it found that no new coal power stations can be built, and indeed existing coal fired power stations need to be decommissioned by 2030 in the developed world and by 2040 globally.[3]

5. The need to urgently and rapidly phrase out fossil fuels has been recognised by the international community. Within climate policy discussions there is a growing recognition of the need to complement the traditional 'demand side measures' with 'supply-side' policies to align fossil fuel production with the Paris targets.[4] The COP26 outcome document, the "Glasgow Climate Pact", called on countries to 'accelerat[e] efforts towards the phasedown of unabated coal power and phase-out of inefficient fossil fuel subsidies'.[5]

6. Phasing out fossil fuels and moving to a low-carbon society entails comprehensive socio-economic transformation. This transformation will require government action to guide and accelerate this transformation. Yet this is potentially incompatible with the role of the state as envisioned by international investment law and investor-state dispute resolution (ISDS).

7. **There are real risks that that investment treaties could pose a barrier to such as rapid transition away from fossil fuels and increase the costs of the energy transition.**

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[1] A/HRC/44/44, para 7.
[2] D. Welsby, J. Price, S. Pye, and P. Ekins, 'Unextractable fossil fuels in a 1.5 C world' (2021) 597 *Nature* 230–34.
[3] *Net Zero by 2050: A Roadmap for the Global Energy Sector* (International Energy Agency, May 2021) https://www.iea.org/reports/net-zero-by-2050.
[4] M. Lazarus and H. van Asselt, 'Fossil fuel supply and climate policy: exploring the road less taken' (2018) 150 *Climatic Change* 1–13.
[5] Decision 1/CP.26, 'Glasgow Climate Pact', para 20.

8. In 2016, the Sierra Club published analysis that showed how the ISDS provisions in TPP and TTIP could give corporations a 'backdoor way to challenge and potentially undermine U.S. policies that keep fossil fuels in the ground'.[6]

9. A 2020 report published by the International Institute for Environment and Development (IIED), *Raising the Cost of Climate Action?: Investor-State dispute settlement and compensation for stranded assets* by Kyla Tienhaara and Lorenzo Cotula [7] shows that:

> Foreign investors may resort to ISDS to sue states over measures to phase out fossil fuels. Even in the absence of legal proceedings, the explicit or implicit threat of recourse to ISDS can enhance businesses' position in negotiations with states. As a result, more public funds may be spent on compensating the fossil fuel sector than would otherwise be the case, making it more costly — and thus more difficult — for states to take energy transition measures.[8]

10. There are now several examples of countries being sued by energy companies for their decarbonisation policies. These include:

    a. *Uniper v Netherlands*[9] where energy company Uniper is, seeking compensation because the Dutch Coal Prohibition Act would prevent coal-fired power stations owed by these companies operating after 2020. According to some reports Uniper is seeking compensation of one billion euros because the exit law would either force its Maavlakte power station to close less than 15 years after it opened, or required it to run on different fuel, and the law 'lacks adequate compensation for stranded investments'.[10]

    b. *RWE v Kingdom of the Netherlands*[11] where energy company RWE is seeking compensation because the Dutch Coal Prohibition Act would prevent coal-fired power stations owed by these companies operating after 2020.[12] RWE is seeking 1.4 billion euros on the basis that the Netherlands had not offered adequate time or money for its 2015 Eemshaven power station to be converted from coal to biomass, arguing that the exit law was 'not legal' as it did not include 'adequate compensation for this interference with the company's property'.[13]

    c. *Rockhopper v Italy*[14] where UK company Rockhopper Exploration is claiming damages of $275 million against Italy under the *Energy Charter Treaty* because

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[6] Ben Beachy, *Climate Roadblocks: Looming Trade Deals Threaten Efforts to Keep Fossil Fuels in the Ground* (Sierra Club, 2016) https://www.sierraclub.org/sites/www.sierraclub.org/files/uploads-wysiwig/climate-roadblocks.pdf.

[7] K. Tienhaara and L. Cotula, 'Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuel assets.' (2020) *IIED Small and Medium Forest Enterprise Series*.

[8] Ibid, 1.

[9] http://climatecasechart.com/climate-change-litigation/non-us-case/uniper-v-netherlands/

[10] M Darby, '"Not appropriate": Uniper seeks compensation for Dutch coal phrase-out' *Euractiv,* 22 May 2020 euractiv.com/section/energy/news/not-approprite-uniper-seeks-compensation-for-dutch-coal-phase-out/; Tienhaara, ibid.

[11] See http://climatecasechart.com/climate-change-litigation/non-us-case/rwe-v-kingdom-of-the-netherlands/.

[12] 'Uniper seeks judgement for the future of Maasvlakta', Media Release, 16 April 2021, uniper.energy/news/uniper-seeks-judgement-for-the-future-of-maasvlakte; K Tienhaara, 'We need to rethink investment treaties to ensure a rapid and just energy transition', *International Institute for Environment and Development,* 22 April 2021 iied.org/we-need-rethink-investment-treaties-ensure-rapid-just-energy-transition.

[13] K Mathiesen et al, 'EU governments whipsawed by climate and coal lawsuits' *Politico,* 4 February 2021, politico.eu/article/eu-government-climate-and-coal-lawsuits/.

[14] http://climatecasechart.com/climate-change-litigation/non-us-case/rockhopper-v-italy/

the Italian government imposed a ban on all oil and gas projects within 12 nautical miles of the Italian coast, thereby impacting on its 2014 license to drill for oil off Italy's Adriatic coast.[15]

d. *Westmoreland v Canada*[16] where US company Westmoreland is alleging it has been wrongly excluded from compensation schemes designed to protect investors in the Alberta coal industry after Alberta's provincial government in 2015 planned to phase out coal-fired power plants in the province by 2030.

e. *Lone Pine v Canada*[17] where US-reigster company Lone Pine is alleging breaches of NAFTA after the Quebec government revoked all permits for oil and gas exploration in the St Lawrence River Basin, in a move linked to a moratorium on fracking.

f. Additionally, when the Canadian company TransCanada in January 2016 announced it would sue the United States for the Obama's Administration's rejection of the Keystone XL pipeline, after massive environmental activist mobilizations against it, it showed the tens of thousands of climate activists who had mobilized against the pipeline how international economic law could undermine their victories. This claim was suspended after the Trump Administration issued a permit, and then claim was revived again in June 2021 by TC Energy (formally TransCanada) when the recently elected Biden Administration cancelled the permit for the project.

11. ISDS either directly or indirectly (through pressure) will incentivise the allocation of resources for the benefit of those responsible for climate change just because they managed to get their economic interests internationally protected. This will undermine the efforts for a just transition.

12. Law firms are already advising their clients to review and modify their corporate structure to ensure they can access the treaty with the 'superior investor protections' to protect them from any adverse climate-related measures. A piece by Jones Day, published in *Lexology* states:

> ISDS is therefore likely to be an increasingly important avenue for the resolution of climate change disputes. Companies in industries most affected by States' climate change obligations (e.g., fossil fuels, mining, etc.) should audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty. Such restructuring should take place before any climate-related dispute with the State has arisen or is reasonably foreseeable. Notably, some treaties have superior investor protections than others. It is thus important to assess which treaty would best protect the company from any adverse climate-related government measures.[18]

13. **There is no rational reason why fossil fuel business should be entitled to compensation from states for energy transition measures.** Providing compensation perversely shifts resources away from states who are already facing costs associated with climate adaptation and climate loss and damage and transfer resources to fossil fuel corporations who are some of the entities most responsible for causing climate change

[15] J Moulds, 'Outrage as Italy faces multimillion pound damages to UK oil firm' *The Guardian,* 25 July 2021.
[16] http://climatecasechart.com/climate-change-litigation/non-us-case/westmoreland-v-canada/
[17] http://climatecasechart.com/climate-change-litigation/non-us-case/lone-pine-v-canada/
[18] Michelle Bradfield et al, 'Climate change and investor-state dispute resolution' *Lexology,* 1 March 2022, https://www.lexology.com/library/detail.aspx?g=086370ea-bd96-4c3d-9446-24ca72136151.

(for example 90 companies are responsible for approximately 60% of greenhouse gas emissions since the Industrial Revolution) and who have already reaped substantial profits from activities that have caused climate change.

14. Investors have known about the need for global action on climate change and the implications this has for investment in fossil fuel resources and associated infrastructures since at least the late 1980s. There were 385 international investment agreements in place at the end of the 1980s. The subsequent growth of international investment treaties, to the approx. 3000 currently in force, took place during a period of time in which the international community knew of the risks of climate change and was committed to taking action to address this global threat.

    a. The scientific community has been warning about the harms of climate change since around the middle of last century. In the 1960s, the President of the United States clearly identified the causes and impacts of climate change before federal legislators.[19] More broadly, knowledge of the causes and harms arising from climate change was firmly established in the 1980s. For example, in 1988, the UN General Assembly held extended discussions about climate change, during which it acknowledged that its causes include combusting fossil fuels and deforestation.[20] The Intergovernmental Panel on Climate Change published its first assessment report in 1990, confirming the risk of damage from climate change.[21] Subsequently, in the 1992 United Nations Framework Convention on Climate Change, states vowed to take measures to prevent climate change.

    b. Already in the late 1980s, a report funded by the Dutch government showed that climate stabilisation requires keeping significant proportion of the world's conventional fossil fuels in the ground. The report articulated a 'fossil carbon budget', and then used this budget to quantify how the consumption of fossil fuels would need to be limited, based on a number of alternative fuel mixes.[22]

    c. A key 2009 paper published in *Nature,* calculated the allowable 'carbon budget' until 2050 if we are to have a reasonable chance of limiting warming to below 2 degrees Celsius, and mapped this against the embedded carbon dioxide in fossil fuel reserves that can be extracted given current technology and prices.[23] They showed that carbon dioxide that is contained in the known global resources of fossil fuels – coal, gas and oil – is many times in excess of this 'carbon budget' and that 'less than half the proven economically recoverable oil, gas and coal reserves can still be emitted up to 2050 to achieve such a goal'.[24] Subsequent studies have updated this analysis or examined the geographical distribution of what fossil fuels need to be left unused.[25]

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[19] Neela Banerjee and others, 'CO_2's Role in Global Warming Has Been on the Oil Industry's Radar since the 1960s', *Inside Climate News* (13 April 2016).
[20] See, eg, UNGA, Report of the Second Committee: 'Conservation of the Climate as Part of the Common Heritage of Mankind', UN Doc A/43/905 (1988).
[21] IPCC, *Climate Change: The IPCC Response Strategies* (1990).
[22] F. Krause, J. Koomey, and W. Bach, 'Energy policy in the greenhouse' (1992).
[23] M. Meinshausen, N. Meinshausen, W. Hare, S. C. Raper, K. Frieler, R. Knutti, D. J. Frame, and M. R. Allen, 'Greenhouse-gas emission targets for limiting global warming to 2 C' (2009) 458 *Nature* 1158–62.
[24] ibid, 1158-1162.
[25] C. McGlade and P. Ekins, 'The geographical distribution of fossil fuels unused when limiting global warming to 2°C' (2015) 517 *Nature* 187–90.

d. Since at least 2013 investors have been aware that the vast majority of majority of fossil fuel reserves represented 'unburnable carbon' and that these and associated infrastructures could become 'stranded assets'.[26]

15. Given this level of knowledge from investors about the need for an urgent and rapid transition away from fossil fuel powered energy system, they should have prepared for and anticipated that national governments would take reasonable policy actions to prohibit the extraction of further fossil fuels or to transition away from fossil fuel infrastructures.

16. **Additionally, fossil-fuel companies should not be entitled to compensation from states for energy transition measures as such corporations are themselves subject to obligations to reduce their emissions (including scope 3 greenhouse gas emissions).** This was confirmed by the ruling by the Hague District Court in *Milieudefensie et al. v Dutch Royal Shell* where the court held the multinational corporation responsible under Dutch tort law for its contribution to climate change. Christina Eckes, Professor of EU Law at the University of Amsterdam and the Director of the Amsterdam Centre for European Law and Governance (ACELG) has therefore argued:

> The *Shell* case changes the calculation of whether further investment in fossil fuel has a business case. It weighs against investing in a line of business of which *we know* will destroy the planet and is also unlikely to bring market profits in a medium-term future. Royal Dutch Shell is given official legal notice that it has a legal responsibility to act in the face of climate change.
>
> Royal Dutch Shell can also no longer claim that it did not know that fossil fuels are under legal pressure. Hopefully, it could not make claims based on an ignorant 'right to invest' under the ECT.
>
> ISDS claims are usually based on the presumption that (arbitrary) government action violated the legitimate expectations of the investor. The Shell ruling, both in its reasoning and use of evidence, undermines the argument that fossil fuel companies can reasonably have any expectation that their investments will not be affected by government action. In other words, the framework of consideration for private parties is redefined by the *Shell* ruling. The risk has heightened that pay-off by claiming taxpayer compensation in arbitration settings is not possible.[27]

17. There is an urgent need to reform international investment law to make sure it does not create a regulatory chill that slows the necessary energy transition and to make sure it does not increase the costs of undertaking such an energy transition.

18. Current public consultation about the reform of international investment law and climate change is welcome as are current debates about the future of international investment law. However, the current parameters of these debates is too narrow and limited. Rather than considering how international investment law can contribute to sustainable development by encouraging sustainable investment, there instead to be a broader debate about how the international community can achieve a rapid and just energy transition. As part of such a discussion on how the international community can achieve a

[26] J. Leaton, *Unburnable Carbon – Are the world's financial markets carrying a carbon bubble?* (2013); B. Caldecott, 'Introduction to special issue: stranded assets and the environment' (2017) 7 *Journal of Sustainable Finance & Investment* 1–13; K. Bos and J. Gupta, 'Stranded assets and stranded resources: Implications for climate change mitigation and global sustainable development' (2019) 56 *Energy Research & Social Science* 101215.
[27] Eckes, Christina: *The Courts Strike Back: The Shell Case in Light of Separation of Powers, VerfBlog,* 2021/6/15, https://verfassungsblog.de/the-courts-strike-back/, DOI: 10.17176/20210615-193332-0.

rapid and just energy transition, the question of whether international investment treaties facilitate or hinder such a transition needs to be critically considered. Based on the evidence provided above, we suggest that international investment law is currently hindering a rapid and just energy transition.

19. Reforms need to be put in place that prevent international investment treaties from hindering a rapid and just energy transition.

20. The first necessary reform is the cancellation of or withdrawal from investment agreements that are operating as a block on climate action, primarily the *Energy Charter Treaty.*

21. Secondly, it is necessary to abolish ISDS as it is designed to prevent comprehensive socio-economic transformation such as the one needed for a just transition. Generally, international environmental groups have been skeptical about the possibility or desirability of reforming ISDS, concerned that 'further "legitimiz[ing]" this inherently flawed system would only perpetuate inequality and corporate impunity,'[28] and calling for 'dismantling the mechanism/system in its entirety.'[29]

22. A further reform option would be to include provisions in international investment treaties clearly stating that states are allowed to invoke climate regulations as a legitimate basis for barring investments. However, environmental exception clauses have often been interpreted very narrowly by investment tribunals, for example in *Eco Oro v. Republic of Colombia* the tribunal treated the environmental exception provisions as effectively irrelevant in investment arbitration. Therefore, if such an approach is adopted, provisions in all international investment treaties should be very clear and explicit that investors are barred from bringing ISDS claims in cases where the host government was taking action to address climate change and/or to promote a just and equitable energy transition.

23. Addressing the climate crisis requires 'reimagining the laws and regulations that have been implicated in years of extraction of natural resources'.[30] The globalized neoliberal economic system has created 'extreme carbon inequality', and there is an urgent need for systemic change and new economic models.[31]

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[28] *A World Court for Corporations: How the EU Plans to Entrench and Institutionalize Investor-State Dispute Resolution* (Center for International Environmental Law, Seattle to Brussels Network & Rosa-Luxemburg Stiftung, 2017).
[29] Friends of the Earth International, *Friends of the Earth International positions on key trade and investment issues* (May 25, 2016).
[30] Nicolás M. Perrone, *Oil Companies Don't Deserve Reparations for Fossil Fuel Bans. They'll Still Want Them*, *The Guardian* (Apr. 19, 2021).
[31] *Confronting Carbon Inequality: Putting Climate Justice at the Heart of the COVID-19 Recovery* (Oxfam Media Briefing, 2020).

INTERNATIONAL INVESTMENT AGREEMENTS, AFRICAN STATES AND THE CLIMATE-CHANGE IMPERATIVES

Response to the OECD's "The Future of Investment Treaties: Public consultation on investment treaties and climate change"

By

Professor Uche Ewelukwa Ofodile

March 12, 2022

INTRODUCTION

Thank you for the invitation to participate in OECD's consultation on investment treaties and climate change. The opportunity for countries and stakeholders to engage the investment and climate regimes more meaningfully than has been the case in the past is welcomed. This comment is written with African states in mind. This comment focuses primarily on the risk to an inclusive and just energy transition posed by old-generation international investment agreements (IIAs) involving African states. In my comment, I do not propose new treaty terms and phrases. The reason is two-fold. First, I believe that there are already many great suggestions out there on how to integrate climate change considerations into IIAs. A good example is the 'Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation,' the 2018 winner of the Stockholm Treaty Lab prize.[1] Second, from the perspective of African states, while introducing new treaty languages in future IIAs is a worthwhile endeavor that should be encouraged, what to do with old-generation IIAs is a more urgent and more immediate problem for most countries in Africa. A climate-aligned investment governance requires that immediate and urgent action be taken to reform the existing stock of old-generation IIAs involving African states. The comment poses and answers three questions:

- Does the existing stock of IIAs involving African states hinder them from taking measures to address climate change and to promote climate-friendly investment? Do they hinder or catalyze the transition to climate-friendly investment opportunities?

- What is being done to address shortcomings in the existing stock of IIAs involving African states? What must be done today to address old-generation IIAs involving African states?

- Why is addressing the problem posed by old-generation IIAs the most urgent problem facing African states as far as the IIA reform agenda is confirmed and what can be done to address the situation?

A forward-looking approach to IIA reform that ignores the problems that old-generation IIAs pose to low- and middle-income countries is hypocritical at best and dangerous at worst. The danger of a narrow IIA reform agenda is that IIAs could become the new tool for climate colonialism which has been defined as the "deepening or expansion of foreign domination through climate initiatives that exploits poorer nations' resources or otherwise compromises their sovereignty."[2]

1. Climate Change in/and Africa

1.1. Africa as a whole has a relatively small carbon footprint, about 3.7 per cent of global CO_2 emissions in 2020. Nevertheless, collectively, countries in Africa have committed

[1] https://stockholmtreatylab.org/wp-content/uploads/2018/07/Treaty-on-Sustainable-Investment-for-Climate-Change-Mitigation-and-Adaptation-1.pdf
[2] https://slate.com/technology/2019/03/green-new-deal-climate-colonialism-energy-land.html

to reduce the continent's contribution to greenhouse gas emissions by 32 percent by 2030.[3]

1.2. The African continent is already bearing a disproportionate burden of the negative impacts of climate change. Climate change and broader environmental degradation (i.e. land degradation, ecosystem degradation, habitat destruction, water and air pollution and biodiversity loss amongst others) are having a devastating impact on the African continent.

1.3. Climate-related challenges including flooding, rising sea levels, retreat of mountain glaciers, drought, and intense heat waves are on the increase. These challenges will worsen in the coming years.

1.4. Without drastic action, Africa will experience more and more climate-related disruptions. The *State of Climate Change in Africa 2020* presents a chilling picture of the impact of climate change on the African continent.[4] According to the *State of Climate Change in Africa 2020*:

- the warming trend for 1991–2020 was higher than for the 1961–1990 period in all African subregions and significantly higher than the trend for 1931–1960;[5]
- across Africa annual average temperatures in 2020 across Africa were above the 1981–2010 average;[6]
- the rates of sea-level rise along the tropical and South Atlantic coasts and Indian Ocean coast are higher than the global mean rate;[7]
- the current retreat rates of the African mountain glaciers are higher than the global mean and if this continues will lead to total deglaciation by the 2040s;[8] and
- Mount Kenya will be deglaciated by the 2030s and will be one of the first entire mountain ranges to lose glaciers due to anthropogenic climate change, experts predict.[9]

2. Fossil Fuel in Africa's Energy Mix

2.1. Africa is rich in hydrocarbon resources and hydrocarbons is strategic for many countries in Africa. Fossil fuel plays and is likely to continue to play a significant role in Africa's energy mix. According to the BP Statistical Review, Africa is a net exporter of hydrocarbons and accounts for as much as 8% of global gas exports and 10% of global oil exports.[10]

[3] Africa commits to cut 32% of emissions by 2030, Africa News, 23 April 2021. Accessed at https://www.africanews.com/2021/04/23/africa-commits-to-cut-32-of-emissions-by-2030// on 10 August 2021.
[4] The World Meteorological Organization, *State of Climate Change in Africa 2020* (2021).
[5] Id.
[6] Id.
[7] Id.
[8] Id.
[9] Id.
[10] British Petroleum (2017), BP Statistical Review 2017 – Africa's energy market in 2016.

2.2. Many countries in Africa have their sight set on hydrocarbon haul despite global shift to renewables.[11] To meet growing energy demand, projected to triple by 2030, hydrocarbon remains a very attractive option.[12]

2.3. With Russia's invasion of Ukraine and Europe's energy diversification away from Russia's energy market, interest in Africa's fossil fuel is likely to intensify despite the commitments to net-zero.

2.4. Investment in coal plants in Africa are forging ahead. Africa has many planned coal-fired electricity projects. Five countries in Africa - Botswana, Malawi, Mozambique, South Africa and Zimbabwe - are forging ahead with their coal power plant plans despite the global 'no new coal' agenda.[13]

2.5. Hydrocarbon exploration continues in Africa. However, with mounting pressure from activists more and more governments are likely to consider canceling existing contracts in the coming years.[14] In 2016, Ghana canceled a 7,000-megawatt coal power plant in the country's Ekumfi district, that was backed by Shenzen Energy Group, a Chinese energy company.

3. Africa is Committed to Climate Change Adaptation and Mitigation

3.1. Africa States understand the urgency of addressing African (and broader) environmental challenges. Climate change is addressed in *Agenda 2063: 'The Africa We Want'*.

3.2. "*Promoting renewable energy, energy efficiency and access, and supporting the "Just Transition" to clean energy*" is one of five priority goals identified in African Union Green Recovery Action Plan. The Green Recovery Action Plan builds on existing work under various initiatives, including:

- The Africa Adaptation Initiative,
- Africa Renewable Energy Initiative,
- The SDG7 Initiative for Africa,
- Africa Blue Economy Strategy,

[11] https://financialpost.com/commodities/energy/oil-gas/africa-has-sights-set-on-hydrocarbon-haul-despite-global-shift

[12] International Energy Agency, Africa 2030: Roadmap for a Renewable Energy Future, p. 6. Accessed at https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2015/IRENA_Africa_2030_REmap_2015_low-res.pdf on 26 July 2021.

[13] https://www.esi-africa.com/industry-sectors/generation/coal-power-plant-plans-remain-in-five-countries-energy-mix/#:~:text=African%20nations%20are%20well%2Dpositioned,have%20become%20operational%20since%202015.

[14] Activists are fighting for a renewable future in Sub-Saharan Africa. Chinese coal projects threaten to dirty those plans. https://www.cnn.com/2020/12/09/business/africa-coal-energy-goldman-prize-dst-hnk-intl/index.html

- African Union Sustainable Forest Management Framework,
- Pan-African Action Agenda on Ecosystem Restoration for Increased Resilience,
- Adaptation of African Agriculture Initiative,
- African Climate Resilient Agricultural Development Programme,
- Just Rural Transition initiative,
- African Forest Landscape Restoration Initiative,
- The Great Green Wall for the Sahara and Sahel and Southern Africa, and
- The Climate for Development in Africa Programme.

3.3. African countries can play a leading role in the fight against climate change but need help.[15] African States are committed to the concept of a just transition from investing in fossil fuels but need ample policy space to do so.

3.4. To break away from a fossil fuel-dependent pathway and shift their energy stance toward renewables, countries in Africa would need the policy space to cancel some existing contracts.

4. Just Transition

4.1. Just Transition "is a complex and longterm process," and is "dependent on national circumstances, capabilities and the provision of adequate support."

4.2. In its flagship report, *Net-Zero by 2050: A Roadmap for the Global Energy Sector*,[16] the International Energy Agency (IEA) set out 400 milestones for governments to reach. The IEA is adamant that reducing global carbon dioxide (CO2) emissions to net zero by 2050, "calls for nothing less than a complete transformation of how we produce, transport and consume energy," "requires all governments to significantly strengthen and then successfully implement their energy and climate policies," and "requires … rapid deployment of all available technologies as well as widespread use of technologies that are not on the market yet."[17]

4.3. The IEA further warned that to achieve net zero, exploitation and development of new oil and gas fields must stop immediately and no new coal-fired power stations built if the world is to stay within safe limits of global heating and meet the goal of net zero emissions by 2050.

[15] Okonjo-Iweala, N. 2020. Africa can play a leading role in the fight against climate change. In: Chapter 4 - Combatting Climate Change: An urgent call for comprehensive global and local action. In: Foresight Africa 2020 report. Brookings Institute.
[16] https://www.iea.org/reports/net-zero-by-2050
[17] Id., p. 15.

4.4. To break away from a fossil fuel-dependent pathway, shift their energy stance toward renewables and achieve most of the milestones identified in the IEA's report, countries in Africa would need the policy space to cancel some existing contracts.

4.5. In order to navigate the climate change crisis within the necessary (and shortening) timeframes, countries in Africa must take urgent measures some of which will have serious implications for international investment policy.

4.6. Just transition requires that countries take three bold steps as far as their IIAs are concerned: (i) demote inefficient and unsustainable investments including by canceling current and proposed investments in fossil fuel; (ii) ensure a just transition including by promoting and enforcing responsible business conduct and corporate accountability especially in the extractive industry; and (iii) promote and protect SDG-oriented investments. Consequently, just and effective transition may require that countries in Africa:

- deny, suspend or revoke construction permits relating to pipelines;
- deny, suspend or revoke construction permits for the development, transport, or burning of fossil fuels
- cancel existing projects that are based on fossil fuel such as coal, oil and gas
- cancel exploration contracts;
- discontinue fossil fuel subsidies;
- impose carbon taxes;
- implement stricter emissions standards;
- phase-outs of specific energy sources;
- plans to strand existing fossil fuel reserves;
- nationalize and decommission fossil fuel companies; or
- change zoning laws to limiting development in areas threatened by rising sea levels.

4.7. Just transition also requires that countries take active steps to enhance private sector investment in renewable energy projects including by liberalizing the renewables sector, improving regulatory and political frameworks, and more generally becoming more environmentally sustainable in the long run.[18] A climate-friendly IIA regime could help countries in Africa attract sustainable, climate-friendly investments and conclude new projects based on renewable generation technologies.

5. Old Generation IIAs, African States, and "Just Transition"

[18] Obonyo R., Push for renewables: How Africa is building a different energy pathway, Africa Renewal, 6 January 2021. Accessed at https://www.un.org/africarenewal/magazine/january-2021/push-renewables-how-africa-building-different-energy-pathway on 10 August 2021.

5.1. African States have jumped into the IIA reform bandwagon. A growing number of recent BITs involving African states introduce sustainable development-oriented clauses (e.g. clarifications to treaty scope and substantive obligations as well as safeguards) not typically found in the old IIAs involving states in the region. Such is the wave of reform in Africa that the continent has been described as "laboratory for innovative approaches for a relatively long time."[19]

5.2. The emergence of "reformed" IIAs and model IIAs including the Pan-African Investment Code[20] and the 2019 Morocco Model BIT[21] has prompted some analysts to suggest that we are witnessing the "Africanization" of investment policy rule-making.

5.3. The "Africanization" ignores the risk posed that old-generation IIAs present for African states. New, "reformed" IIAs with reformed treaty clauses are co-existing uneasily with old, "unreformed" IIAs containing unreformed treaty clauses.[22] The landscape of IIA reform in Africa is deeply concerning for three reasons:

- While most of the new reformed IIAs are not in force and have no legal effect; a significant percentage of old IIAs involving African states are in force and are binding.
- With the exception of South Africa, most countries in Africa have done very little to reform their old-generation IIAs.
- Model agreements such as the Pan-African Investment Code and the 2019 Morocco Model BIT contain very innovative elements but do not address the problem posed by old generation IIAs nor are they being used to renegotiate old IIAs.

5.4. Old-generation IIAs dominate in Africa.[23] Many countries in Africa concluded their first IIA in the 1960s and 1970. Tanzania and Rwanda concluded their first BITs with Germany in 1965 and 1967 respectively. Kenya concluded its first BIT in 1970 (with Libya).

[19] Sarah Brewin, Developing and Negotiating Based on a Model Investment Treaty: Background Note to the IISD Webinar Series on Investment Law and Policy (2018).
[20] See also African Union Commission, Draft Pan-African Investment Code (2016), Art. 43, available at: <https://au.int/sites/default/files/documents/32844-doc-draft_pan-african_investment_code_december_2016_en.pdf>.
[21] Agreement Between the Kingdom of Morocco and ……. For the Reciprocal Promotion and Protection of Investment. https://edit.wti.org/document/show/b5908c50-ef94-4902-b71d-12024f285ef8 (hereinafter Morocco Model BIT 2019). See also: Accord entre le Royaume du Maroc et … pour la promotion et la protection réciproques des investissements. [Moroccan Model BIT] https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5895/download.
[22] https://unctad.org/system/files/official-document/diaepcb2017d3_en.pdf
[23] Johnson "Rethinking bilateral investment treaties in sub-Saharan *Africa"* 2015 *Emory Law Journal* 920

5.5. A significant proportion of old-generation IIAs involving African states are with European countries and countries that are home states to some of the largest oil & gas companies in the world including the United Kingdom, France, The Netherlands, Luxembourg and Belgium, Germany, Italy, Switzerland.

5.6. While many of the recent IIAs involving African are not in force, many of the old generation IIAs involving African States are actually binding and in force.

5.7. Characterized by "broadly worded definitions and substantive provisions, and few safeguards,"[24] the old-generation IIAs involving African states are not designed to promote "sustainable investment" or to address the climate crisis. In general, the IIAs:

- Are "technology neutral" in the sense that they protect all types of energy investment.
- Do not empower African states to demote or deny protection to "unsustainable investment."
- Do not provide avenues for stakeholders to challenge states, investors, or investments that take action inconsistent with the just transition imperatives.
- Do not impose binding climate-related obligations on investors.
- Have, in the past, enabled investors to challenge core domestic policy decisions – for instance, regarding the environment, energy, and water.

5.8. South Africa's Department of Trade and Industry rightly noted, "Existing international investment agreements are based on a 50-year-old model that remains focused on the interests of investors from developed countries. Major issues of concern for developing countries are not being addressed in the BIT negotiating processes."[25]

6. Old Generation IIAs, Investor-State Dispute Settlement and Just Transition.

6.1. African States play a significant role in the ICSID system. A majority of African countries have been involved in ICSID proceedings.[26] Of the 54 states in Africa, forty-four have been involved in a known ICSID arbitration.

6.2. The number of ISDS cases involving African states continues to rise.[27] As of December 31, 2021, ICSID had registered 869 cases under the ICSID Convention and Additional

[24] https://unctad.org/system/files/official-document/diaepcb2017d3_en.pdf
[25] "South African trade department critical of approach taken to BIT-making", Damon Vis-Dunbar, Investment Treaty News, 15 July 2009, http://www.iisd.org/itn/2009/07/15/south-african-trade-department-critical-of-approach-taken-to-bit-making/
[26] The following countries in Africa have never been involved in an ICSID arbitral proceedings but may have been involved in proceedings in other fora: Botswana, Chad, Comoros, Lesotho, Malawi, Mozambique, Sierra Leone, Somalia, Swaziland, and Zambia. See International Center for the Settlement of Investment Disputes, Advanced Search < https://icsid.worldbank.org/en/Pages/cases/AdvancedSearch.aspx > accessed 31 July 2019.
[27] ICSID, 'The ICSID Caseload – Statistics (Issue 2022 – 1)', (2019)[hereinafter 'The ICSID Caseload – Statistics 2022']

Facility Rules.[28] Sub-Saharan Africa (SSA) accounts for fifteen percent (15%) of the 869 cases registered by the ICSID and the Middle East and North Africa account for an additional eleven percent (12%) of registered cases.[29] *The ICSID Caseload – Statistics (Special Focus – Africa)*, based on ICSID cases registered as of May 31, 2017, provides an overview of the ICSID caseload involving all African State Parties. [30] As of May 31, 2017, ICSID had registered 613 cases under the ICSID Convention and Additional Facility Rules. One hundred and thirty-five (135) of these cases (22%) involved an African State Party.

6.3. A growing number of countries faced their first ISDS only in the last decade. The Republic of Benin faced its first ISDS case in 2017,[31] the Republic of Mauritius in 2016,[32] Cabo Verde in 2015,[33] Mauritania[34] and the Republic of Sudan in 2014,[35] the Republic of Madagascar in 2013,[36] and both the Republic of Equatorial Guinea and the Republic of South Sudan in 2012.[37]

6.4. African states have been at the receiving end of some of the largest known investment treaty awards in ICSID history. [38] In 2018, an ICSID tribunal ordered the Arab Republic of Egypt (Egypt) to pay approximately US $2 billion in compensation to Unión Fenosa Gas.[39] In 2013, a tribunal ordered Libya to pay US $935 million in a dispute over a land-leasing contract.[40]

6.5. In terms of distribution of all cases registered under the ICSID by economic Sector, African countries have cause to be worried. There is also cause for concern from the perspective of climate change action. Of the 135 disputes involving African states as of

[28] *Id., at 7.*
[29] *Id.,* 12.
[30] THE ICSID CASELOAD – STATISTICS SPECIAL FOCUS – AFRICA (MAY 2017)
[31] *Puma Energy Holdings SARL v. the Republic of Benin*, SCC Case No SCC EA 2017/092.
[32] *Thomas Gosling and others v. Republic of Mauritius*, ICSID Case No ARB/16/32.
[33] PT Ventures, SGPS, S.A. v. Republic of Cabo Verde (ICSID Case No. ARB/15/12)
[34] Tamagot Bumi S.A. and Bumi Mauritania S.A. v. Islamic Republic of Mauritania (ICSID Case No. ARB/14/23)
[35] *Michael Dagher v. Republic of the Sudan*, ICSID Case No ARB/14/2.
[36] *Peter De Sutter, Kristof De Sutter, DS 2 S.A. and Polo Garments Majunga S.A.R.L. v. Republic of Madagascar*. See also, *Courts (Indian Ocean) Limited and Courts Madagascar S.A.R.L. v. Republic of Madagascar*, ICSID Case No ARB/13/34.
[37] *Grupo Francisco Hernando Contreras v. Republic of Equatorial Guinea*, ICSID Case No ARB(AF)/12/2. The case against South Sudan was registered on August 29, 2012. See *Sudapet Company Limited v. Republic of South Sudan*, ICSID Case No ARB/12/26.
[38] The largest win in ICSID's history, US $8.7 billion plus interests, was recorded in March 2019. See *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30.
[39] See *Unión Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No ARB/14/4 [*Unión Fenosa Gas v. Egypt*] (US $2,013,071,000 awarded in damages. This amount does not include interest or legal costs).
[40] *Mohamed Abdulmohsen Al-Kharafi & Sons Co. v. Libya and others*. Award of 22 March 2013, available at < https://www.italaw.com/sites/default/files/case-documents/italaw1554.pdf > accessed 20 July 2019.

May 1, 2017, Oil, Gas & Mining accounted for 33% and Electric Power & Other Energy accounted for 5%.[41]

6.6. A significant number of arbitral cases initiated against African states are based on IIAs. Of the 135 ICSID cases involving an African State Party as of May 31, 2017, 45% were based on BITs.[42]

6.7. Old treaties "bite" African states very hard. As of end-2021, all known ICSID investment arbitration involving African states were based on treaties concluded prior to 2010.

7. Reforming Old-Generation IIAs Involving African States

7.1. Underscoring the need to address old IIAs, in 2017, UNCTAD announced that "It [was] time to move to phase 2 of IIA reform: modernizing the existing stock of old-generation treaties."[43] UNCTAD went on to propose 10 policy options for phase 2 of IIA reform: (1) jointly interpreting treaty provisions; (2) amending treaty provisions; (3) replacing "outdated" treaties; (4) consolidating the IIA network; (5) managing relationships between coexisting treaties; (6) referencing global standards; (7) engaging multilaterally; (8) abandoning unratified old treaties; (9) terminating existing old treaties; and (10) withdrawing from multilateral treaties.[44]

7.2. To date, very few countries in Africa have implemented or sought to implement phase 2 of IIA reform.

7.3. African states that dare to terminate their old IIAs face considerable backlash from Western nations.[45] When the South Africa government decided to terminate BITs with certain European Union (EU) members[46], the EU's response was "forthright and scathing."[47] "Put simply, the EU regards the cancellation of the BITs as hostile and symptomatic of what it regards as 'emerging protectionism' in South Africa," Professors Soko and Qobo surmised.[48]

[41] P. 12.
[42] P. 11 Thirty-nine per cent (39%) of the cases relied on consent found in an investment contract between the investor and the Host-State and 16% of cases relied on the investment law of the Host-State.
[43] UNCTAD, IIA Issue Note, Issue 2 (2017). https://unctad.org/system/files/official-document/diaepcb2017d3_en.pdf
[44] Id.
[45] Gazzini "Rethinking the Promotion and Protection of Investment: The 2015 South Africa's Investment Act" available at https://dx.doi.org/10.2139/ssrn.2960567
[46] The South African government terminated BITs with the following countries the UK, the Netherlands, Switzerland, Germany, France, Cuba, Denmark, Australia, Italy, Sweden, Argentina, Finland, Spain & Greece, as well as Belgium-Luxembourg Economic Union.
[47] https://www.news24.com/Fin24/sas-cancellation-of-bilateral-investment-treaties-strategic-or-hostile-20180928-3
[48] Id. See also, Woolfrey, S. (2014). South Africa's Promotion and Protection of Investment Bill - tralac. [online] Tralac.org. Available at: http://www.tralac.org/discussions/article/5345-south-africa-s-promotion-and-protection-of-investmentbill.html

7.4. Although unilateral termination of expired BIT is permissible under international law, such unilateral act by countries have tended to trigger unwarranted alarmism in the West.[49] The decision of the South African government "was met with discontent by the international investment community."[50]

7.5. While affirming South Africa's sovereign right to terminate expired treaties, European governments and European investors nevertheless condemned the move as inconsistent with South Africa's need to need to attract investment.

7.6. Some law firms fuel the hostility that greet states that unilaterally terminate expired BITs. When the South African government terminated the country's BIT with some European states, attorneys at Herbert Smith Freehills LLP opined that South Africa's IIA reform was driven by the desire to promote "South Africa's Black Economic Empowerment … Policy (an affirmative action policy)" and warned that "[t]he redistributive aspects of this policy could be incompatible with the expropriation and fair and equitable treatment provisions in most BITs."[51]

7.7. Signed under pressure in the 1960s, 1970s, 1980s and 1990s, old-generation IIAs hang like albatrosses around the neck of African states. "I have to say I do have sympathy with the government here, I do think they signed these BITs under ignorance and pressure from the UK…the South African government should have obtained advice about what they were signing from international investment lawyers. They did so under pressure on the basis that this would open a veritable Pandora's box for a whole flood of investments" Peter Leon, Partner at Webber Wentzel is quoted as saying. [52]

7.8. Many IIAs involving African states have been in force for longer than their initial periods of operation and have reached a stage where they could be unilaterally terminated by one contracting party immediately. Moreover, as UNCTAD rightly note, the Vienna Convention on the Law of Treaties "allows parties to terminate an agreement by mutual consent at any time."[53]

8. Conclusions

[49] Phillip de Wet, Ramaphosa just activated a law that scares foreign investors – and makes it harder for them to fight expropriation, BUS. INSIDER: S. AFR. (July 13, 2018, 5:29 PM), https://www.businessinsider.co.za/protectionof-investment-act-commencement-gazetted-foreign-mediation-bee-section-25- constitution-2018-7

[50] Mossallam, Mohammad (2015) : Process matters: South Africa's experience exiting its BITs, GEG Working Paper, No. 2015/97, University of Oxford, Global Economic Governance Programme (GEG), Oxford

[51] https://hsfnotes.com/arbitration/2013/08/21/south-africa-terminates-its-bilateral-investment-treaty-with-spain-second-bit-terminated-as-part-of-south-africas-planned-review-of-its-investment-treaties/

[52] https://www.geg.ox.ac.uk/sites/default/files/GEG%20WP_97%20Process%20matters%20-%20South%20Africas%20experience%20exiting%20its%20BITs%20Mohammad%20Mossallam.pdf

[53] https://www.whitecase.com/publications/insight/africa-focus-autumn-2021/renewable-energy-africa-update-era-climate-change

8.1. African states need support if they are to achieve sustainable and green recovery from the pandemic while also enabling effective climate action. Action is needed on all fronts including with respect to existing network of IIAs.

8.2. There is wide consensus that developed nations can and should assist developing nations to meet climate targets. At the U.S.-led climate summit in April 2021, South Africa's president Cyril Ramaphosa "call[ed] on developed economies which historically bear the greatest responsibility for emission to meet their responsibilities to developing economies." "This will be vital to restoring the bonds of trust between developed and developing economies", said Ramaphosa.[54]

8.3. Africa's old-generation IIAs pose risks and impose considerable limitations on the ability of African governments to pursue the radical, transformative, and revolutionary agenda the climate change crisis demands.

8.4. UNCTAD is right in its conclusion that "[d]espite significant progress, much remains to be done."[55] A comprehensive IIA reform requires among "not only concluding new treaties but also modernizing the existing ones."[56]

8.5. The IEA is right in its conclusion that just transition "requires nothing short of a total transformation of the energy systems that underpin our economies."[57] Moreover, according to the IEA, the "gap between rhetoric and action needs to close if we are to have a fighting chance of reaching net zero by 2050."

8.6. A clean and resilient recovery in Africa is possible but requires that existing IIAs be aligned with the continent's sustainable development agenda. States in Africa need ample policy space to effectively pursue the common priorities identified by the AU Green Recovery Action Plan.

8.7. African states that wish to implement bold new climate mitigation policies, face threats of expensive investment arbitration claims

8.8. Just transition demands that African states limit their exposure to climate-related ISDS claims under their existing IIAs.

9. Recommendations

[54] https://www.africanews.com/2021/04/23/africa-commits-to-cut-32-of-emissions-by-2030//
[55] https://unctad.org/system/files/official-document/diaepcb2017d3_en.pdf
[56] Id.
[57] Emphasis.

The battle for earth's climate change will be fought in Africa, experts predict. The IEA is clear that the global pathway to net-zero requires that all governments including African States "significantly strengthen and successfully implement their energy and climate policies." It means that African voices must be heard in matters relating to IIA reform especially as they relate to old generation IIAs.[58] To "significantly strengthen and successfully implement their energy and climate policies" as recommended by the IAE, African countries must be free to adopt necessary measures without fear of long, drawn-out, and expensive ISDS arbitration. Africa cannot have a "green revolution" without revolutionizing IIA regime. Total transformation is necessary to avoid IIAs becoming instruments of what Ghana's first prime minister, Kwame Nkrumah, first called "neocolonialism."

9.1. UNCTAD is right in its conclusion "[c]omprehensive reform of the IIA regime would benefit from intensified multilateral backstopping."

9.2. Developed countries and the OECD can add value to the reform process. It is recommended that developed countries, OCED, and OECD Members among other things:

- Refrain from condemning countries that exercise their sovereign right to unilaterally terminate IIAs that have reached their expiry date and are up for termination.
- Commit to terminate all the old-generation IIAs that they have concluded with states in Africa.
- Investigate why low- and middle-income countries are slow to move to phase 2 of IIA reform.
- Specifically, investigate, from the standpoint of African states, the cost and benefits of the ten options for reforming old generation IIAs that UNCTAD identified.
- Investigate the major challenges, for low- and middle-income countries, of attempting to reform old-generation IIAs through joint interpretations, treaty amendment, or treaty replacement.
- Identify and address the capacity and other constraints to reforming old IIAs.
- Promote transparency in IIA rule-making as well as transparency in investment contract regimes.
- Discourage investors from circumventing and undermining IIA reform by concluding investment contracts with host governments that incorporate stabilization clauses and effective dispute resolution provisions.

[58] https://www.wilsoncenter.org/article/battle-earths-climate-will-be-fought-africa

Simplifying the Pathway to 2030; an investment treaty exclusively for climate-related investment

Authors: Reg Fowler, independent legal consultant, formerly with Shell
Michael Putra, PhD candidate at Erasmus University.

Neither author has any interest in, or is employed or advises a party to, any investor state investment dispute. The views expressed are personal opinions of the authors.

Summary

Climate change and the energy transition present a wicked problem, a multifaceted issue which cannot be addressed by a single solution, necessitating difficult trade-offs. Private investment in the energy transition is especially exposed to policy risk, and therefore deserves investment protection. Investment treaty reform and retrenchment create uncertainty. The authors propose a multilateral investment treaty which exclusively protects investments which qualify as contributing to the host state's nationally determined contributions under the Paris Agreement ("NDCs") in a publicly transparent manner. The investor will be protected against the impact of host state's dilution or deferral of its NDC implementation plans, provided that the relevant investment is meeting its pre-agreed technical objectives. The purpose is to incentivise climate change related private investment as swiftly as possible, on "future proof" terms, without complicating negotiations by introducing measures to deter fossil fuel investment or resolve longstanding debates on investor-state dispute settlement.

1. The Wicked Problem

1.1 The International Energy Agency estimated in its Net Zero Emissions by 2050 Scenario (NZE) the amount of clean energy investment required to achieve net zero by 2050 is close to $4 trillion every year for the period 2026-2030, in which more than $2.5 trillion of it is expected to come from the private sector[1]. The scale of the challenge is stark when comparing such investment needs with the global energy investment of 2021 that was "only" in the range of $1.9 trillion[2]. This means shifting existing investments from carbon-intensive energy chain towards a cleaner one is far from sufficient. An additional investment of $2 trillion per year is required for the energy transition. This is roughly equivalent to the annual government budgets of United Kingdom and Japan combined.

1.2 Apart from the widely reported implementation gap between States' Nationally Determined Commitments under the Paris Agreement and the steps required to maintain the global climate increase significantly below 2.0° C, there is also a funding gap between the Global North and the Global South. This is particularly acute in relation to private finance; in developed countries, private finance into renewable

[1] International Energy Agency (2021), *World Energy Outlook 2021*, Paris: International Energy Agency
[2] International Energy Agency (2021), *World Energy Investment 2021*, Paris: International Energy Agency

energy is 5 times the level of public finance, whereas in the Global South, whereas in the Global South, the proportion of private finance compared to public finance is 1.64:1[3].

1.3 Energy transition is a wicked problem in which there is no silver bullet[4]. An important step to navigate through it is by establishing clear priorities: the climate goal and the global energy transition can be largely achieved by a handful of "carbon-critical countries" which:

- Account for over half of projected global population in 2030 and still rely on fossil fuels,
- Hold significant resources of climate-critical minerals,
- Hold significant opportunities for nature-based solutions,
- Host companies who are likely to invest in energy transition.

2. The Case for a Climate Change Investment Treaty

2.1 The kind of investment required at scale will involve long-term, low margin infrastructure projects (renewable energy, grid upgrading, mining of climate critical minerals) which depend upon stable demand and stable pricing, often relying upon domestic markets and supply chains which are State-controlled. The Energy Transition has already seen some "false starts" in developed economies, where investors have recovered significant damages from host States which have withdrawn renewable energy subsidies critical to those investments[5]. Investment is even less certain in developing countries which have yet to formulate detailed implementation plans for their NDCs, exposing investors to the risk that the State will change policy and support for their investment in midstream.

2.2 Such policy risk is particularly relevant for any climate change-related investment. Carbon is not a true commodity; it has no inherent supply and demand characteristics which would enable a business to predict its price[6]. Carbon markets are presently diverse and uncoordinated. In 2021, only 21.5% of global greenhouse gas emissions are covered by carbon pricing initiatives[7]. OECD reported in 2019:

> *The extent of carbon pricing is increasing - however, progress remains slow. While the number of national and sub-national carbon pricing schemes has increased from 16 to 56 between 2009 and 2019, 46% of energy-related CO_2 emissions in OECD and G20 countries do not face a carbon price. Indeed, 88% of emissions in the same countries are priced below EUR 30 per ton of CO_2 –*

[3] Haščič, I. et al. (2015), "Public Interventions and Private Climate Finance Flows: Empirical Evidence from Renewable Energy Financing", OECD Environment Working Papers, No. 80, OECD Publishing. http://dx.doi.org/10.1787/5js6b1r9lfd4-en

[4] The degree of complexity and wickedness of energy transition was assessed using a framework offered in Van Tulder, R. (2018), *Business & sustainable development goals: a framework for effective corporate involvement*, Rotterdam: Rotterdam School of Management, Erasmus University

[5] Discussed in Peter D Cameron "International Energy Investment Law – the Pursuit of Stability" OUP 2nd edition 2021.

6 However, the carbon price is still exposed to geopolitical risks. "EU carbon permit prices crash after Russian invasion of Ukraine" The Guardian 2nd March 2022. Available at https://www.theguardian.com/environment/2022/mar/02/eu-carbon-permit-prices-crash-after-russian-invasion-of-ukraine. Accessed 2nd March 2022.

[7] https://carbonpricingdashboard.worldbank.org/

a low-end estimate for carbon prices necessary by 2020 to be in line with meeting the goals of the Paris Agreement[8].

2.3 Monetising a climate-related investment on the carbon markets is subject to policy risk to a degree which is not shared by any other form of investment with the exception of an investment in a fully regulated utility such as power or water where retail prices are subject to state control.

2.4 Experience has shown that when increased energy costs come to public attention, there have been cases of political backlash. The "gilets-jaunes" movement in France was triggered by increases in government-controlled electricity and gas prices[9]. Even before the Covid-19 pandemic, Governments in Iran[10] and Ecuador[11] have each faced civil unrest in the face of changes to state-controlled energy prices. Removal of LPG subsidies triggered unrest and appalling levels of loss of life in Kazakhstan in January this year[12].

2.5 A mechanism needs to be found whereby private investment in carbon critical countries is facilitated urgently, by minimising as far as possible the policy risk carried by the investor. We believe that a multilateral investment treaty between those states that protects climate-related investment from policy risk in a balanced manner, and learns from certain lessons from existing controversies, would be a valuable contribution.

3. Protecting both "climate-related investment" and the right to regulate

3.1 A wide range of increased and new industrial activity, including mining of critical minerals required to enable growth in renewable energy, will be required by the energy transition. Indeed, much of that activity is likely to be carbon intensive. Significant investment will be needed in the enhancements of electricity grids, power storage and hydrogen energy. During the transition, nuclear power and/or natural gas may be needed to address shortages of interruptible power from solar and wind sources. The energy transition needs to be planned on a "whole supply chain" basis; there is little point in encouraging green investment in a project which through its supply chain relies upon energy intensive resources which are being priced out of the market by other, well-meaning, climate change policies.

[8] Nachtigall, D., et al. (2021), "The economic and environmental benefits from international co-ordination on carbon pricing: Insights from economic modelling studies", OECD Environment Working Papers, No. 173, OECD Publishing, Paris, https://doi.org/10.1787/d4d3e59e-en.

9 "France to block gas and electricity price rises until the spring" Financial Times 30th September 2021. Available at https://www.ft.com/content/f11a62dc-1a71-437f-a7a5-493bc4b1dcda accessed 2nd March 2022.

10 "Rises in the price of petrol are fuelling unrest in Iran" The Economist 23rd November 2019. Available at https://www.economist.com/middle-east-and-africa/2019/11/21/rises-in-the-price-of-petrol-are-fuelling-unrest-in-iran. Accessed 2nd March 2022.

11 "Governments subsidise fossil fuels to the tune of $427bn a year" The Economist 14th October 2019. Available at https://www.economist.com/graphic-detail/2019/10/14/governments-subsidise-fossil-fuels-to-the-tune-of-427bn-a-year Accessed 2nd March 2022.

12 "Kazakhstan: Dramatic price hike for liquefied petroleum gas triggers mass protests" Business & Human Rights Resource Centre 3rd January 2022. Available at https://www.business-humanrights.org/en/latest-news/kazakhstan-dramatic-price-hike-for-liquefied-petroleum-gas-triggers-mass-protests/ Accessed 2nd March 2022.

3.2 States need the flexibility to set the pace of their energy transitions, taking into account their *"common but differentiated responsibility and respective capabilities*"[13]. Dictating a fixed definition of what is and is not a green investment entitled to protection will complicate and delay negotiation of the treaty. There are many legitimate definitions of "green investment" but they have all been evolved for a different purpose and are narrower than the definition this paper proposes[14].

3.3 Under the proposed treaty, each state is entitled to define "green investment" for itself. This respects the state's "right to regulate", consistent with the state's right to set its own nationally determined contributions. **The treaty we propose will require each contracting State to "operationalise" its Nationally Determined Contributions (NDCs) by developing and publishing a detailed, business-orientated implementation plan, providing a tangible and time bound guide to the projects it envisages that will deliver its NDCs in the timeframe set out by those commitments.**

3.4 The UNFCCC's approach to NDCs can be criticised for taking a "book-end" approach; it provides detailed guidance setting out how NDCs may be expressed and its Enhanced Transparency Framework (ETF)[15] sets out further information on the process of verification, accounting and reporting of progress against the proposed NDCs. There is no requirement for a state to signal how it will achieve its NDCs before and during the process of achieving them. As a result, the opportunity to correct a state's "direction of travel" whilst delivering against its NDCs is lost because, in accordance with the ETF process, the state provides only retrospective reports for scrutiny by the international community.

3.5 Our proposal provides a form of "invitation to contract" with the investment finance market, providing a "one-stop" mechanism for market signalling across a state's entire NDC activity[16]. By virtue of the implementation plan's detail and time-bound nature, it will provide an opportunity for the international community and civil society to challenge its scope and feasibility. By limiting protected investment to projects that deliver a component of the implementation plan in a tangible manner, the state retains its flexibility to devise its own pathway to carbon neutrality whilst at the same time enhancing the credibility of the Paris Agreement itself.

3.6 This would also allow for targeted correction. Carbon pricing and the availability of emissions certificates in a carbon market provide one form of market signalling which governments may employ,

[13] See "Introduction to Climate Finance" UNFCCC https://unfccc.int/topics/climate-finance/the-big-picture/introduction-to-climate-finance/introduction-to-climate-finance accessed 2nd March 2022/.
[14] See for example the World Bank Green Bond definition - https://treasury.worldbank.org/en/about/unit/treasury/ibrd/ibrd-green-bonds#2 accessed 2nd March 2022.
[15] Refer to https://unfccc.int/enhanced-transparency-framework accessed 3rd March 2022.
[16] The UNFCCC Enhanced Transparency Framework recognises the need. *"Developing country Parties that need it in the light of their capacities are provided with specific flexibilities for reporting some of this information (see chap. 3 for further information). In addition, developed countries must, and other Parties that provide support should, provide information on the financial, technology development and transfer and capacity-building support provided and mobilized to developing countries to support their implementation of the Paris Agreement. Developing countries are encouraged to communicate the support they need and have received. All Parties should also provide information on climate change impacts and adaptation."* Reference Manual for the Enhanced Transparency Framework under the Paris Agreement Page 15. Available at https://unfccc.int/sites/default/files/resource/ETFReferenceManual.pdf Accessed 11th March 2022.

but the signalling is unspecific. Implementation plans will permit governments to draw the market's attention to specific sectors for investment where supply crunches and price spikes can be foreseen. The public availability of implementation plans will provide investors and industrialists with insights into regional demand over time, improving the efficiency of the market used by the supply chain for the energy transition.

3.7 Critically for the purposes of the investment treaty, a state's NDC implementation plan becomes ultimately its published statement of its climate change strategy, an act of sovereign policy-making, but one open to international scrutiny nonetheless. Requiring states to publish their implementation plans together with certified investments will provide a tool for policing "green washing" and the offshoring of carbon-intensive activity. Significantly, the Paris Agreement permits a state to enhance or accelerate its NDCs, but not to weaken them[17], and international scrutiny may prevent states from "backsliding" on their commitments, and more effectively so because the implementation plans will make it harder to hide such behaviour.

4. Defining covered investment

4.1 **Protection under the treaty would be limited to an investment which tangibly contributes to a specific aspect of the host state's NDC implementation plan.** We envisage the treaty requiring a contracting state to provide an administrative mechanism or permitting process by which any investor can request that its investment is approved as qualifying for protection, either before establishment of the investment or at any time thereafter. This would enable an investor to have the status of its investment confirmed before any dispute arose, in the interests of certainty and risk mitigation. However, having issued such certification, the state would be precluded from denying investment protection under the treaty to the relevant investment on the grounds that it failed to meet the definition of "covered investment".

4.2 Certification provides a flexible vehicle for a state and investor to interact without the need of a formal contract. It provides an opportunity for the state to impose certain conditions on the protection of investments which are expedient for the implementation plan, but do not themselves mitigate or abate carbon emissions. Accordingly, an investment which proposes to enhance power grid capacity in order to facilitate the connection of interruptible power sources such as solar and wind can be certified, on condition that its technical "nameplate" capabilities are delivered. This would enable a state to certify such important investments for protection without compromising the linkage between such protection and the state's legitimate climate change strategy. Such linkage could be further strengthened if the investments protection under the treaty is made conditional upon the investment's achievement of the technical objectives upon which its certification was conditional.

4.3 The concept of conditional certification and its linkage to investment protection under the treaty provides a mechanism for the allocation of risk between state and investor. If the investment fails to meet its technical objective, it is not protected; thereby the investor accepts technical risk. On the other hand, the state should be dissuaded from adjusting its NDC implementation plan in a manner which negatively impacts existing investments which have been or are entitled to be certified for protection, unless that state is prepared to incur certain liability for compensation. Should the state have the right to regulate with impunity to the extent that such regulation is an evasion of its climate change commitments? We contend that the state should bear such policy risk.

[17] Paris Agreement Article 4.11.

4.4 The treaty we propose would define the investor as the single person which applies for and is granted certification at any stage. An investor's right to protection would be subject to subrogation. This would eliminate the opportunity for a multiplicity of claims. More importantly, it would enable the state to monitor investment activity connected to its implementation plan. This would provide an extremely useful regulatory tool, enabling the state to foresee the impact of policy changes on existing investors. This would in turn enable the state to avoid unforeseen investment disputes by crafting its policy decisions to avoid impact on existing investments.

5. Protection Standards under the Treaty

5.1 Indirect Expropriation

This protection would be triggered in the event that a change to the implementation plan which impeded or delayed the state's achievement of its previous NDCs had a material and permanent effect on the value of the protected investment[18]. Such protection would not apply where, counterintuitively, an investment was impacted by a change in the implementation plan which enhanced or accelerated achievement of the state's NDCs; the treaty should not interfere with such "right to regulate"" which is provided by Article 4.11 of the Paris Agreement.

5.2 Fair and Equitable Treatment

Likewise, we would envisage the investment to be protected against harm caused by failure to apply appropriate standards of fairness and equity in managing the planning, consultation and implementation of such changes[19]. The UNFCCC may adopt the concept of implementation plans for NDCs, and it may develop procedures and statement of good practice for publishing and amending implementation plans transparently and fairly, as part of its ETF strategy. The treaty could protect the investor against material infringements of such procedures.

5.3 Most Favoured Nation Clause

The treaty would not include a "most-favoured-nation" provision. Allowing an investor to bring into play the provisions of an entirely different investment treaty, possibly one which applies to all investment, and not just investment recognised to contribute to climate change mitigation, threatens to destroy the logic of the allocation of risk upon which this treaty would rely. The equity of the underlying package behind this treaty must be preserved, particularly if its acceptability to civil society is to survive future challenges.

5.4 Fork in the Road/Exclusivity

The treaty could include an "exclusivity" or form of "fork in the road" provision, requiring any investor to rely exclusively upon its rights to protection under the treaty, waiving any other right to protection under

[18] This would be part of a more detailed definition of indirect expropriation consistent with the UNCTAD's first option- see "UNCTAD's Reform Package for the International Investment Regime" page 37. Available at https://investmentpolicy.unctad.org/uploaded-files/document/UNCTAD_Reform_Package_2018.pdf accessed 11th March 2022.

[19] In keeping with UNCTAD's recommendations, we would propose following the Canadian model Bilateral Investment Treaty by linking the standard of fair and equitable treatment to the minimum standard treatment under customary international law. "UNCTAD's Reform Package for the International Investment Regime" page 36. See Article 5 of the Canadian Model Bilateral Investment Treaty available at https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2820/download accessed 11th March 2022.

any other investment agreement. This again would preserve the integrity of the balance of interests between state and investor which the treaty offers.

5.5 Human rights, environmental and social performance standards

We propose that a qualifying investment must comply with internationally recognised standards of human rights, environment and social performance required by the home state or host state, as in force from time to time. By requiring the investor to comply with the home state's adopted standards, one avoids the "race to the bottom" which may arise where the host state offers to release investors from such standards as an incentive for investment. Such requirement forces the investor to apply abroad standards of good practice which it espouses publicly in its home state.

It is impossible here to provide a full description of the proposed treaty. The following table provides a high-level summary of the key terms.

Investment Treaty Key Characteristics	
Investor	An entity whose investment is certified as covered by the host state or is declared as appropriate for certification by a dispute court or tribunal.
Covered Investment	An investment the technical objectives of which are reasonably expected to contribute to an identified component of the host state's NDC Implementation Plan.
Expropriation	Direct & Indirect, expressly including as indirect expropriation any material impact on a covered investment caused by a change to a state's NDC implementation plan which increases the likelihood that the corresponding NDC will not be achieved.
Fair and Equitable Treatment	Minimum Standard Treatment, applying Canadian Model BIT, expressly extending to the host state's procedures for publishing and amending its NDC Implementation Plans and certifying covered investments
Full Security and Protection	Minimum Standard Treatment as for Fair and Equitable Treatment above
National Treatment	Applicable and extending to pre-establishment
Most Favoured Nation	None
Investor State Dispute Settlement	ICSID or UNCITRAL wording should require the disputing parties to apply the latest Arbitration Rules adopted from time to time
Fork in the Road	Investor must waive rights and withdraw any proceedings under any other treaty as a pre-condition for bringing proceedings under this treaty
Treaty specific provisions	States required to legislate for, implement and administer NDC Implementation Plans and certification procedures in line with international standards

6. Conclusion

6.1 This proposal seeks to answer the challenge – how to respond to the urgent need for private investment for climate change mitigation and adaptation without having to resolve the ongoing controversies surrounding international investment agreements. The climate change crisis is unprecedented and therefore it is dangerous to assume that investment protection is unnecessary because its ability to incentivise investment in the past is not proven. Indeed, climate change investment is particularly exposed to policy risk.

6.2 A multilateral investment treaty focused on the host state's delivery of its nationally determined contributions and investment which tangibly contributes to the implementation of such NDCs can be devised on "future proof" terms. By reason of such focus, the treaty's protections can strike a legitimate balance between the host state's right to regulate and the investor's exposure to policy risk. By making that balance express and publicly visible, it is less likely that the treaty protections will be challenged as unreasonable by civil society. By connecting the scope of covered investments to the state's NDC implementation plan, the state obtains a powerful regulatory tool enabling it to monitor fulfilment of its plans and foresee the impact of changing those plans; likewise, the international community and civil society obtain an insight into the host state's progress, or lack of progress, on the road to net zero. That focus, combined with careful drafting, can prevent the treaty from being abused and its protections exaggerated by future claimants.

The authors have been asked to develop a policy paper for presentation by the T20 for the Indonesia Presidency of G20 in 2022. If their proposal is accepted for further action, we would welcome the support of readers in criticising, improving, polishing and indeed implementing this proposal.

Global Justice Now submission to the OECD public consultation on
Investment treaties and climate change

March 2022

Introduction

1. Global Justice Now welcomes the opportunity to make a submission to the OECD's public consultation on investment treaties and climate change. Global Justice Now is a democratic social justice organisation working to create a more just and equal world.
2. Key points in this submission are:
   - We are seeing an increase in the use of ISDS by fossil fuel companies over climate related policies.
   - Some countries have acknowledged that the risk from ISDS has prevented them from being more ambitious in their climate policy.
   - ISDS clauses are incompatible with climate action
   - The OECD should
     - in the short term, recommend a coordinated moratorium or suspension of ISDS on climate related measures and support governments in implementing such
     - in the longer term, facilitate a coordinated process for countries to cancel and withdraw from ISDS clauses in existing treaties
     - recommend that ISDS clauses are not included in any new treaties

Investor state dispute settlement

3. Investor state dispute settlement clauses in trade and investment agreements allow foreign corporations to sue governments outside of the national legal system. It takes the arbitration model common for commercial disputes, but applies it to a public policy setting, including over climate goals and environmental policy. The amounts involved can often be far higher than would be the case in national courts.
4. Just in the past couple of years we have seen four energy companies launch investor state dispute settlement (ISDS) cases against governments over climate related policies:
   - Ascent Resources (UK registered) is suing Slovenia over fracking (June 2020)
   - RWE is suing the Netherlands over coal phase out (Feb 2021)
   - Uniper is also suing the Netherlands over coal phase out (April 2021)
   - TC Energy is suing the US over cancellation of the tar sands Keystone pipeline (Dec 2021)
5. These join previous cases of similar nature:
   - Lone Pine is suing Canada over a moratorium on fracking (2013)
   - Rockhopper is suing Italy over a ban on offshore oil drilling close to the coast (2017)
6. The speed at which these cases are arising is increasing. Industry analysts themselves predict that increased climate ambition of national emissions plans with reference to the Paris climate agreement will drive a rise in ISDS cases.[1]
7. The concept of stranded assets in relation to the climate energy transition refers to fossil fuel reserves and infrastructure that will need to be left in the ground and decommissioned if we are to have any chance of meeting climate targets. These assets have therefore lost some or

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[1] Berkeley Research Group quoted by AFP, "Governments risk 'trillions' in fossil fuel climate litigation", France24, 11 Nov 2021, https://www.france24.com/en/live-news/20211112-governments-risk-trillions-in-fossil-fuel-climate-litigation

all of their value and need to be written off. Mark Carney, then governor of the Bank of England, highlighted the risks in 2015.

8. ISDS cases however, provide a route for fossil fuel companies to try their luck at recouping some of those losses. An example is seen in the RWE and Uniper cases, where coal power stations are being phased out in the Netherlands by 2030. These plants were built when the science was already clear, so the companies should have been well aware of the risks they were taking. Nonetheless the Dutch government was offering compensation for the phaseout (€512m for RWE and €351m for Uniper). However this was not considered adequate by the companies and they are suing for €1.4bn and €1bn respectively under the Energy Charter Treaty. The Energy Charter Treaty is an investment agreement on the energy sector between over fifty countries, which includes ISDS.

9. Sometimes merely the threat of the existence of ISDS is enough for fossil fuel companies to get more money - it is not always even necessary for a case to be brought. As part of the German coal phaseout, two energy companies were awarded compensation that independent think tanks assess to be up to twelve times higher than would be normal. The German government has faced ISDS cases in the past and is thus very aware of the potential for such cases, and at the time Uniper was already threatening a case against the Netherlands. The German government got the energy companies (RWE again and LEAG) to sign a contract agreeing not to use the Energy Charter Treaty. The German Federal Ministry of Economics has acknowledged that the agreement to waive the use of ISDS played a ‘role’ in the high level of compensation.[2]

10. ISDS cases will therefore drive up the costs to governments and the public purse of the climate transition that is necessary to address the climate crisis. A recent editorial in the Financial Times and Bloomberg columnists have criticised this. As the FT piece says:

> “These governments — and their taxpayers — are thus being asked to bear all the risk associated with assets rendered less valuable or worthless by necessary climate action. The prospect of “bailing out” fossil fuel projects risks disincentivising the steps needed now, from both markets and government, to secure swift decarbonisation.”[3]

11. As the FT quote highlights, the danger is not just in the increased cost, it is also in the risk that in order to avoid those costs, governments do less, act more slowly or do not take action at all – a chilling effect. We are already too slow and too late in taking climate action. The world cannot afford more barriers that cause delay.

12. Recently governments have explicitly acknowledged that the threat of ISDS has prevented them from being more ambitious in their climate policy. New Zealand’s climate change minister said the country did not join the Beyond Oil and Gas Initiative launched at COP26 because by doing so it "would have run afoul of investor-state settlements”, and the Danish government set a climate target of 2050 rather than earlier in order to avoid “incredibly expensive” payments on stranded assets through ISDS.[4]

13. This is a chilling effect on the governments of developed countries. It is very likely that such chilling effect will be even stronger on the governments of developing countries, for whom even just the legal costs of fighting ISDS cases is a much higher proportion of limited government budgets, let alone the risk of losing a case and facing a requirement to pay billions.

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[2] “Wie Schiedsgerichte Europas Klimaziele bedrohen”, *BuzzFeed News* 23 Feb 2021, https://www.buzzfeed.de/recherchen/energiecharta-vertrag-schiedsgerichte-europa-klimaziele-90214917.html in German. The relevant sentence is: “"Die Qualität und der Umfang des Rechtsbehelfsverzichts haben bei der Entschädigungsdiskussion sicherlich eine Rolle gespielt, sie waren jedoch nicht allein maßgeblich.", or translated “The quality and scope of the legal waiver certainly played a role in the compensation discussion, but they were not the only deciding factors."

[3] Editorial board, “Governments should not foot the bill for stranded assets” *Financial Times*, 21 Feb 2022 https://www.ft.com/content/6e480f92-894a-494e-90ee-c60d20ce22f9

[4] Elizabeth Meager, “Cop26 targets pushed back under threat of being sued” *Capital Monitor* 14 Jan 2022, https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/

14. ISDS clauses are incompatible with climate action and are a risk for the entire world. The OECD should:

- in the short term, recommend a coordinated moratorium or suspension of ISDS on climate related measures and support governments in implementing such
- in the longer term, facilitate a coordinated process for countries to cancel and withdraw from ISDS clauses in existing treaties
- recommend that ISDS clauses are not included in any new treaties

For more information, please contact Jean Blaylock, jean.blaylock@globaljustice.org.uk, 07540 833659

Submission to OECD Public consultation on investment treaties and climate change

Dr Fergus Green
Lecturer in Political Theory & Public Policy
Department of Political Science / School of Public Policy
University College London

Author background and expertise

1. My expertise is in the politics, governance and ethics of low-carbon transitions. My doctoral thesis considered the normative question of how governments ought to deal with the transitional losers (and winners) from legal change, and the implications of alternative normative principles for transition policy. Though not a law PhD, the principles I consider employ concepts that are common across political theory, law, and transition policy practice (i.e. property; legitimate expectations; efficiency and welfare / Law & Economics). Numerous academic articles from my PhD have been published in peer-reviewed journals, while others are at advanced stages of preparation, and I am currently completing a book manuscript based on this research. I have a legal background and retain an interest in climate-related legal issues, though I am not an expert in international investment law. I hold a first class honours degree in law from the University of Melbourne, where I was Editor of the *Melbourne Journal of International Law* (2006) and I have three years' experience as a lawyer at a large Australasian corporate firm, where I specialised in climate, energy water and environmental regulation (2009–2012).

2. My submission relates to the traditional use of investment treaties to protect post-establishment investments, specifically the "predictability" aspects thereof. The OECD has highlighted how this issue relates to the broader question of appropriate "transition policy" to address the losers from legal reform, and whether covered investors should enjoy special protections.[1] My comments seek to inform reflection on these issues by discussing some of the key normative philosophical considerations they raise (i.e. I engage with the underlying *political morality* of investor protections).[2] I will relate these comments to arbitral jurisprudence and legal scholarship where applicable.

3. The bulk of my comments (Part A) are drawn largely from two unpublished papers-in-progress[3] (relevant to my discussion of indirect expropriation), and one published

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[1] David Gaukrodger, *The Future of Investment Treaties - Possible Directions*, OECD Working Papers on International Investment (Paris, 2021), pp. 12–13 <https://www.oecd-ilibrary.org/finance-and-investment/the-future-of-investment-treaties-possible-directions_946c3970-en>.
[2] A similar methodological approach is adopted by Oisin Suttle, 'Justice and Authority in Investment Protection: What We Disagree About When We Disagree About Investment Law', *Law and Development Review*, 2021, 1–26.
[3] Fergus Green, 'Progressive Aims and Conservative Claims: What We Owe the Losers from Legal Change' (Working Paper on file with author); Fergus Green, 'Sore Losers: Should Investors Be Compensated for the Adverse Effects of Regulatory Change?' (Working Paper on file with author).

article in a leading peer-reviewed journal (relevant to legitimate expectations)[4]—each of which is informed by my doctoral research.[5] In my more applied research and consulting work, I consider normative, governance and political-economy questions relating to climate change policy, with a particular interest in the "just transition" agenda.[6] My remaining comments (Part B) are based on this body of work.

A The limited normative justification for conservative protection of investments in the face of regulatory change

4. Here I consider the following questions: should foreign investors enjoy protections from the adverse effects of legal change via the doctrines of "indirect expropriation" and "fair and equitable treatment"? If so, to what extent? Unless otherwise indicated, I shall assume that the legal changes in question are non-discriminatory laws in the public interest, enacted in good faith by a legitimate legislature (or valid secondary legislation). While my comments apply to any kinds of legal change within these parameters, it is climate change laws that are of interest here.

Indirect expropriation

5. It has been widely affirmed in international investment law that government regulations may amount to an indirect expropriation, or "taking", of an investment, necessitating compensation.[7] However, the entire edifice of indirect expropriation jurisprudence rests on shaky philosophical ground.

6. In the face of a new law or regulation by a host state that reduces the value of an investment, the central philosophical question of interest is whether a foreign investor has a moral right to what I shall call *the fruits of the regulatory status quo*—that is, to the profits it would have made *but for* the legal change.

7. It is important to distinguish here between (i) a direct claim justified by a moral *right*, enjoyed by the investor in its personal (typically corporate) capacity, to the fruits of the regulatory status quo and (ii) a derivative claim based on impersonal consequentialist

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[4] Fergus Green, 'Legal Transitions without Legitimate Expectations', *Journal of Political Philosophy*, 28.4 (2020), 397–420.

[5] Fergus Green, 'Who Should Get What When Governments Change the Rules? A Normative Theory of Legal Transitions' (London School of Economics and Political Science, 2019) <http://etheses.lse.ac.uk/3980/>.

[6] Fergus Green and Ajay Gambhir, 'Transitional Assistance Policies for Just, Equitable and Smooth Low-Carbon Transitions: Who, What and How?', *Climate Policy*, 20.8 (2020), 902–21; Thomas Spencer and others, 'The 1.5°C Target and Coal Sector Transition: At the Limits of Societal Feasibility', *Climate Policy*, 18.3 (2018), 335–51; John Wiseman, Stephanie Campbell, and Fergus Green, *Prospects for a "Just Transition" Away from Coal-Fired Power Generation in Australia: Learning from the Closure of the Hazelwood Power Station*, CCEP Working Paper (Canberra, 2017) <https://ccep.crawford.anu.edu.au/files/uploads/ccep_crawford_anu_edu_au/2017-11/wiseman_campbell_green_prospects_for_a_just_transition_away_from_coal-fired_power_generation_in_australia_ccep_wp1708.pdf>.

[7] Rudolf Dolzer, 'Expropriation', in *Principles of International Investment Law*, ed. by Ursula Kriebaum, Christoph Schreuer, and Rudolf Dolzer, 3rd edn (Oxford: Oxford University Press, 2022), sec. 3.

calculations that justifies the payment of compensation to the investor (though not necessarily of an amount equal to the fruits of the status quo).[8] In the first case, the moral entitlement *logically entails* a remedy (e.g., compensation) equivalent to the fruits of the regulatory status quo, i.e. the remedy follows from the kind of justification that supports the claim. In the second case, the payment of a sum of compensation is justified because and to the extent that it promotes some other, impersonal value, such as welfare maximisation, meaning that the connection between the claim and the payment is merely instrumental and contingent on empirical conjecture.

8. Investor claims of property-based moral rights to the fruits of the regulatory status quo are difficult to support, morally speaking. To see why, it is necessary to distinguish two distinct conceptions of property:[9]

   a. *The classical conception of property / personal property*: On one ("classical") conception of property, property refers to tangible "things" possessed by the owner, and is thought to confer on the owner "absolute dominium", implying potentially unfettered control over the owner's personal use and enjoyment of the thing and the right to exclude others. Normative justifications for these extensive rights, especially those offered by natural law theorists, converged on the conduciveness of such rights to the self-preservation (meeting subsistence needs) and self-determination (independence, autonomy) of free, equal and rational beings. The value promoted by property, so understood, was limited to the *use value* accruing to its owner (hence "personal property"). Thus the limits to *legitimate* personal property claims are said to arise from either failures to use the thing in question for the owner's direct and personal benefit (since the purpose of property is to secure the owner's subsistence and independence), or from conflicts between the owner's uses and the self-preservation or self-determination of other free and rational beings.[10]

   b. *The neoclassical conception of property / property-as-capital*. Beginning in the mid-19th century, a different understanding of property emerged. The shift was prompted by changes in the structure of economic production that saw property increasingly employed not for the direct satisfaction of its owner but as *capital* employed in economic transactions for the ultimate satisfaction of others. Property was reconceptualised in relational terms: it was fragmented into a set of specific *uses*, which could in principle be held by persons without physically possessing or controlling any underlying "thing", and which resulted from transactions between interdependent agents (including

[8] Carl Knight 'What Is Grandfathering?', *Environmental Politics*, 22.3 (2013), 410–27 (pp. 414–416) (discussing similar distinctions, albeit applied to "grandfathering").
[9] References are largely excluded from these expository paragraphs to economise on footnotes/words. Readers are referred to Enrico Rossi, 'Reconsidering the Dual Nature of Property Rights: Personal Property and Capital in the Law and Economics of Property Rights', *SSRN Electronic Journal*, 2020, 1–125 <https://doi.org/10.2139/ssrn.3659193> for an excellent discussion, on which I have drawn here.
[10] Rossi, pp. 30–35, 42–43.

corporations). Property thus became conceptualised as a *bundle of rights* in relation to things, and its value determined by the alternative uses to which it could be employed in a market—i.e. its *exchange value*. The normative justification for private property, so conceptualised, offered by neoclassical economists appeals to its conduciveness to the maximisation of exchange value (wealth or efficiency[11])—either because exchange value itself is thought to be morally valuable or (more plausibly) because it is thought to be instrumentally conducive to aggregate *welfare/utility* (though the latter connection is not automatic and depends crucially on how the wealth is distributed).[12]

Many leading political and legal theorists have recognised the ongoing significance of both conceptions of property within contemporary property regimes.[13]

9. Crucially, the normative justification of private property for each of these two alternative conceptions functions differently. On the classical conception, the normative justification applies directly at the level of an individual ownership claim; it purports to justify "particular rights over particular things held by particular persons".[14] By contrast, on the neoclassical conception of property, whether a particular agent should have a particular thing depends entirely on whether their having it conduces to the maximisation of aggregate wealth/efficiency (or welfare/utility); the value that accrues to the owner is irrelevant other than to the extent it contributes to the aggregate sum.[15]

10. When it comes to evaluating investors' moral claims to the fruits of the regulatory status quo, framed in terms of "indirect expropriation", this difference in the normative justification applicable to the two alternate conceptions of property is of fundamental importance. Essentially, such investor claims equivocate as to the two distinctive conceptions of property: investors by definition employ *property-as-capital* with a view to earning profit from the exchange value yielded by the products or services in which that capital is employed; yet when that value is threatened or diminished by government regulation, they claim to have rights equivalent to an owner of *personal property*, even though the classical conception of property cannot coherently admit of rights to the exchange value from the employment of property-as-capital (see para 8(b), above).[16] Nonetheless, such claims (if substantiated by the facts of the case) are routinely validated by the prevailing investment law regime and jurisprudence.

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[11] On the connections between wealth and efficiency (in the Kaldor-Hicks sense), see Ronald Dworkin, 'Is Wealth a Value?', *Journal of Legal Studies*, 9 (1980), 191–226; Ronald Dworkin, 'Why Efficiency? A Response to Professors Calabresi and Posner', *Hofstra Law Review*, 8 (1980), 563–90.
[12] Rossi, pp. 53–81.
[13] See, e.g., Margaret Jane Radin, 'Property and Personhood', *Stanford Law Review*, 34.5 (1982), 957–1015.
[14] Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), p. 238.
[15] Louis Kaplow, 'An Economic Analysis of Legal Transitions', *Harvard Law Review*, 99.3 (1986), 509–617.
[16] Green, 'Sore Losers'.

11. This conceptual confusion has generated bad law. *If* investors in fact enjoy moral rights to the fruits of the regulatory status quo as an incident of their property rights, then logically *no* government regulatory action that diminishes the value of the investment would be permissible unless full compensation is paid. This is a patently outrageous and untenable position that would imply a radical, undemocratic curtailment of legislative sovereignty. But instead of rejecting the underlying rights claim (and its spurious purported justification) outright, tribunals have instead sought to "balance" the government's legitimate authority to regulate in the public interest against the investor's purported right to the fruits of the status quo and/or devise more or less arbitrary tests to distinguish between a non-compensable regulation and a compensable expropriation.[17] Little wonder, then, that "[t]he contours of the definition of an indirect expropriation are not precisely drawn" and that—a century after the early case law on the subject—"the debate goes on".[18] Moreover, scholars have raised concerns that the jurisprudence in this area, along with valuational challenges required to calculate compensation awards under existing doctrine, raise "serious concerns about the workability of existing jurisprudence as a practical matter".[19]

12. The only internally coherent way to determine whether states should pay compensation to investors for the adverse effects of regulation on the value of property is to ask whether (and to what extent) such a payment would maximise the aggregate social value that justifies and legitimises property-as-capital in the first place. In this calculation, the risk of underinvestment arising from time-inconsistent (i.e. purely opportunistic) behaviour by the host state is relevant.[20] However, the efficient level of investment is generally that which is induced when investors bear all real costs and benefits of their decisions.[21] A transition rule/policy that protects investors from downside policy risk by paying compensation for adverse effects from legal change allows investors to socialise their losses while keeping the gains from legal change. This asymmetric socialisation produces moral hazard: it induces over-investment, raising the total social costs of legal change.[22] By contrast, leaving investors to absorb both the losses and gains from their investments incentivises investors to better anticipate and manage those risks on their own, in accordance with their own risk preferences.[23] By

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[17] See Jonathan Bonnitcha and Emma Aisbett, 'Against Balancing: Revisiting the Use/Regulation Distinction To Reform Liability and Compensation Under Investment Treaties', *Michigan Journal of International Law*, 42 (2021), 231–90.
[18] Dolzer, 'Expropriation', p. 153.
[19] Emma Aisbett and Jonathan Bonnitcha, 'A Pareto-Improving Compensation Rule for Investment Treaties', *Journal of International Economic Law*, 24.1 (2021), 181–202 (p. 202).
[20] Aisbett and Bonnitcha.
[21] Kaplow, pp. 527–32, 552–55, 586, 615.
[22] Kaplow, pp. 528–531.
[23] Daniel Shaviro, *When Rules Change: An Economic and Political Analysis of Transition Relief and Retroactivity* (Chicago, Ill.: University of Chicago Press, 2000), pp. 35–36.

incentivising foresight and prudent risk-management, this approach reduces the total social costs of legal change.[24]

13. In conclusion, investors have no justifiable property-based moral right to the fruits of the regulatory status quo. Whether (and how much) compensation should be paid to investors for losses incurred as a result of regulatory change should be determined by instrumental consequentialist considerations consistent with those that ultimately legitimise property-as-capital in the first place (preferably some form of wellbeing consequentialism[25])—a calculus that applies equally to domestic investors. Due to the incentives effects of transition policy on future investor behaviour, the appropriate amount of compensation for foreign investors will often be zero.[26]

Fair and equitable treatment: stability and legitimate expectations

14. In addition to claims of indirect expropriation, investors adversely affected by a regulatory change will often claim that the change violates the "fair and equitable treatment" (FET) standard of protection.[27] Among the specific applications of the FET standard, the *stability* of the legal framework and investors' *legitimate expectations* play a "central role".[28]

15. "Stability" (of the host State's legal framework) could be, and appears to have in practice been, interpreted in two ways: (i) it could require that the legal framework pertaining to an investment literally remain the same as when the investment was made (a standard seemingly implied by the *Tecmed* decision, for instance[29]) (the *strict interpretation*); or (ii) it could be interpreted as protecting against only changes that pass

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[24] Kaplow, pp. 528–31.

[25] See para 8(b), above, and footnote 26, below.

[26] Aisbett and Bonnitcha adopt a broadly similar welfare-economic approach to the linked questions of justification for compensation and quantum of compensation advocated so far. They argue for a transition rule that would pay the investor the minimum amount of compensation necessary to address the problem of under-investment arising from time inconsistency / host-state opportunism. Consistent with my argument so far, I believe this rule would be a significant improvement on current practice. However, my proposal would likely imply even lower levels of compensation for two reasons. First, arguably investors should assume and price-in the risk of opportunistic state behaviour. That risk is likely to be more limited in practice than Aisbett and Bonnitcha assume due to the repeat-play nature of host state-investor relations (e.g., host state reputational risks), as those authors acknowledge (at p. 190). Second, Aisbett and Bonnitcha conflate efficiency with welfare, meaning they do not take into account how distributional considerations mediate the relationship between the two concepts. On a genuinely welfarist approach (which is, roughly, what I advocate), justified compensation payments to investors will tend to be lower on average than they would be if an efficiency metric were used, given that foreign investors tend to be few in number and already wealthy, while the primary beneficiaries of public interest regulation (and especially climate regulation) tend to be numerous and less wealthy.

[27] Rudolf Dolzer, 'Standards of Protection', in *Principles of International Investment Law*, ed. by Ursula Kriebaum, Christoph Schreuer, and Rudolf Dolzer, 3rd edn (Oxford: Oxford University Press, 2022), p. 186.

[28] Dolzer, 'Standards of Protection', p. 205.

[29] *Tecmed v Mexico*, Award, 29 May 2003, [154].

a high threshold in terms of their deviation from the framework that applied at the time of the investment, which has been expressed by tribunals using language such as "fundamental change to the regulatory regime"[30] or "unpredictable radical transformation in the conditions of the investments"[31] (the *threshold interpretation*).

16. Philosophically, the strict interpretation has no merit and should be rejected because it would unduly constrain parliamentary sovereignty and the ordinary regulatory rights and duties of states. It would also constitute a radical reallocation of "policy risk" compared with ordinary commercial practice. Similar criticisms were made by the Tribunal in *EDF v Romania*.[32]

17. The threshold interpretation, though an improvement on the strict interpretation (insofar as it allows states greater regulatory space), is also philosophically flawed. There is no sound philosophical basis for an independent,[33] general restriction on the *extent* to which a state may change its laws. Part of the difficulty lies in specifying a general threshold: what some will see as a "fundamental" and "radical" transformation, others will see as a legitimate exercise of legislative sovereignty in the public interest. Indeed, this is why such decisions are best worked out through democratic deliberation, which is better approximated in representative legislatures than in arbitral tribunals.[34] Climate change brings this problem into sharp relief: in order to protect the material conditions for human civilisation, all states must engage in extensive legal reforms—reforms that, from the perspective of a conservative or incrementalist investment regime, might seem "radical" or "fundamental" compared with the legal regime that existed at the time certain (e.g., fossil fuel) investments were made. Accordingly, I submit that stability, as a general and independent standard of protection, should be abandoned in a future investment regime (or, in the alternative, that it be interpreted extremely narrowly—perhaps limited, for example, to fundamental changes in the state's political or economic system, such as the dissolution of the former USSR).

18. The concept of legitimate expectations should be interpreted consistently with these remarks regarding "stability". Building on my philosophical work on legitimate expectations, I submit that the concept should be understood as a species of special rights that is characteristically applicable in interpersonal morality and private law, the function of which is to allow agents to shape their intersubjective normative environment through specific social practices that may or may not involve express representations.[35] It should not, therefore, be considered a source of general rights capable of constraining the ordinary legislative function of states. This rules out claims

[30] *Eiser v Spain*, Award, 4 May 2017, [363].
[31] *RREEF v Spain*, Decision on Responsibility and on the Principles of Quantum, 30 Nov. 2018, [315].
[32] *EDF v Romania*, Award, 8 October 2009, [217].
[33] Of course, other moral reasons and legal grounds of investor protection, might indirectly restrict the extent of state regulatory action.
[34] Jeremy Waldron, *The Rule of Law and the Measure of Property* (Cambridge: Cambridge University Press, 2012).
[35] Green, 'Legal Transitions without Legitimate Expectations'.

by adversely affected agents (including investors) that they had a generic legitimate expectation of "legal stability" or similar.

19. However, consistent with the general tendency for certain private law-like standards to be applied to certain forms of public administration that are more interactive in character, my formulation of the concept's conditions of applicability allows that it may in principle apply to administrative decision-making. Insofar as the principle of legitimate expectations in international investment law is restricted to specific representations and assurances made by the host state to the investor in the course of interpersonal interactions, it would be consistent with my proposed approach.

20. That said, there are two reasons why the standard of protection afforded investors by the legitimate expectations doctrine should be lower than is often provided in arbitral decisions. First, the principle should apply to investors' *actual* expectations. This is consistent with the "special rights" character of legitimate expectations and the underlying normative value of protecting expectations, which is that agents' *actual* expectations support their ability to make plans (which is prudentially and—at least in the case of natural persons—morally valuable).[36] In this regard, the current investment law conceptualistion of legitimate expectations as a purely objective standard[37] is incoherent and poorly motivated. Of course, it is *necessary* (to meet the legitimacy standard) that the expectation satisfy an objective standard of reasonableness (see next paragraph), but that should not be *sufficient*: the investor should also be required to establish that it actually held the relevant expectation.

21. Second, the objective component of the doctrine should impute to the "reasonable investor" an understanding of political and policy processes in the host country (since this should be incorporated into investor due diligence). This should include knowledge of the basic fact that governments and their priorities change over time for explicable and legitimate reasons (electoral cycles, new information, etc.).[38] As such, investors should not necessarily take government statements at face value—at least not insofar as such statements purport to govern the entire duration of the investment, which may span many electoral cycles and changes of government. Rather, a reasonable investor would arguably evaluate the risk that a government statement will be reneged upon.

B Climate change, just transition, and the opportunity costs of compensating investors

22. The extensive legal reforms that are needed to induce rapid decarbonisation typically require countries to incur high up-front costs in order to reap non-excludable global climate benefits over the longer term (and domestic co-benefits that often arise over the

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[36] Green, 'Legal Transitions without Legitimate Expectations', pp. 398, 417–19.
[37] Dolzer, 'Standards of Protection', pp. 209–10.
[38] See also Jonathan Bonnitcha and Emma Aisbett, 'Against Balancing: Revisiting the Use/Regulation Distinction To Reform Liability and Compensation Under Investment Treaties', *Michigan Journal of International Law*, 42 (2021), 231–90 (pp. 283–84).

medium term). These and other features of climate mitigation policy make enacting climate laws profoundly challenging for political actors.[39] Compensating investors adversely affects governments' fiscal position.[40] The threat of adverse ISDS judgements can thus have a chilling effect, making the politics of climate mitigation even more difficult.[41]

23. Adverse ISDS judgements may also come at the cost of public investments needed for a "just transition": complementary social, industrial and regional policies that smooth the transition for vulnerable workers, consumers and communities.[42] The support of these groups will be needed if ambitious reforms are to be enacted. These groups, moreover, have far stronger moral claims to transitional assistance from the state than business investors.[43]

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[39] Jared J. Finnegan, 'Institutions, Climate Change, and the Foundations of Long-Term Policymaking', *Comparative Political Studies*, 2022; Thomas Bernauer, 'Climate Change Politics', *Annual Review of Political Science*, 16 (2013), 421–48.
[40] See, e.g., Bonnitcha and Aisbett, p. 233.
[41] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement', *Transnational Environmental Law*, 7.2 (2018), 229–50.
[42] Green and Gambhir.
[43] Green, 'Progressive Aims'; Green, 'Who Should Get What When Governments Change the Rules?'.

Public consultation on investment treaties and climate change, OECD

Submission by Prof. Jessica F. Green
Associate Professor, University of Toronto
Department of Political Science and School of the Environment
jf.green@utoronto.ca
9 March 2022

In this contribution, I address the first of the three goals outlined in the background paper: Contributing to sustainable development by encouraging sustainable investment and preserving sufficient policy space. In general, sustainable investment has relied on the voluntary actions of firms – including measurement and disclosure of GHG emissions and net zero pledges. First, I discuss the importance of the OECD's work. Though the Sustainable Development Goals provide a partial framework for mainstreaming climate into intergovernmental cooperation, few multilateral treaties have explicitly taken on this important task. Second, I discuss the origins and challenges of measurement, with the hope that this provides some useful context for how to integrate climate considerations into investment treaties. Here I also touch on the growth of the voluntary market, and the need for better regulation of this sector. Third, I highlight current challenges in the investment treaties regime, and the options for reform.

International climate policy outside the UNFCCC

Climate policy is not simply a matter of emissions mitigation; it is about reorganizing the global economy and overcoming carbon lock-in (see, e.g. Colgan et al. 2021; Unruh 2000). And yet the global climate regime is organized almost exclusively around the United Nations Framework Convention on Climate Change and its associated legal instruments, including the Paris Agreement. There has been extensive legal analysis about the relationship between the trade and climate regimes, but few explicit attempts to reformulate international trade rules to better promote climate goals. The Sustainable Development Goals provide a partial framework for mainstreaming climate into intergovernmental cooperation, but this is principally through soft law mechanisms.

For this reason, serious conversations about investment treaty reform is an important step in broadening our collective understanding of climate regulation. For instance, I have argued elsewhere that tax reform is also climate policy (Green 2021). Similarly, investment treaty reform can potentially provide powerful levers for some of the reorganization of the global economy that deep decarbonization requires. In this vein, the EU's efforts to reform the Energy Charter are a welcome – and much needed – intervention. Along with current conversations in the OECD, they help reframe what constitutes global climate regulation.

Measurement and Disclosure: Standard-setting is the easy part

Non-state actors, including both NGOs and private firms, have had a large role in creating and implementing standards for greenhouse gas (GHG) measurement and disclosure.

My work (see especially Green 2013 and Green 2014) examines how non-state actors served as the engine for creating standards for GHG measurement (and eventually, disclosure). The Greenhouse Gas Protocol is now the gold standard for measuring GHG emissions at the firm level. It was created in the early 2000s by two NGOs – the World Business Council on Sustainable Development and the World Resources Institute. It has since been adopted as a standard by the International Organization for Standardization (ISO). Specifically, the privately-created GHG Protocol serves as the basis for ISO 14064 part 1 and part 2.

The creation of the GHG Protocol was extremely effective in getting private sector support through a robust consultative process, and as a result of this process, enjoyed widespread implementation (Green 2014). Moreover, at the time, the GHG Protocol had considerable political utility. It laid the foundations for emissions mitigation by solving the technical problems associated with the measurement of GHGs. In the early 2000s, there simply weren't any tools for tracking emissions at the firm level. Existing standards focused on the national level (i.e. reporting under the United Nations Framework on Climate Change) or the project level (i.e. to measure emissions avoided through offset projects).

Importantly, the political costs of implementing the Protocol were minimal. Firms that adopted the GHG Protocol simply had to agree to *measure* their emissions; no reductions were required. However, translating the political utility and widespread adoption of the Protocol (and subsequently, the ISO standards) requires government intervention to move from measurement to reduction. As I note elsewhere, private standard-setting arrangements "can serve as an initial building block toward meaningful climate action, but governments will have to finish the job." (Green 2017, 1).

While the creation of standards to measure firms GHG emissions is a relative success, the path to actual *reductions* is much less clear. There is a considerable body of research that seeks to quantify the effects of voluntary emissions reductions efforts – including through disclosure (see e.g. Hsu et al 2018, Hsu et al 2019, Kuramochi et al 2020). In general, this work points to the difficulties of aggregating pledges and avoiding double counting to ensure accurate evaluations.

There are two main challenges of moving from emissions disclosure to emissions reduction. The first challenge with disclosure is measurement along the supply chain – so-called "Scope 3" emissions. Emissions are generally divided into three "scopes." Scope 1 is direct emissions – those emitted by a firm's buildings and transport. Scope 2 is a specific subset of indirect emissions – those resulting from the purchase and use of electricity. Scope 3 emissions are everything else – all the indirect emissions that occur along the supply chain. Scope 3 emissions are a huge challenge to quantify, particularly for large multinational companies. An complete inventory of Scope 3 emissions requires accurate measurement and reporting from all of the suppliers in the supply chain. Moreover, these are very difficult, if not impossible to verify, since this means getting suppliers to open their books to yet another party – a third-party verifier. Finally, Scope 3 emissions vary considerably by industry. One study estimates that industry's Scope 3 emissions are twice as large as its Scope 1 (i.e. direct) emissions; thus, accurate reporting is critical to a full understanding of industry's contribution to climate change (Hertwich and Wood 2018).

The second challenge is completeness of reporting. Given that scope 3 measurement is so challenging, it is not surprising that many companies do not report them. Some domestic regulations require large emitters to report their emissions, but many regulations exclude Scope 3. For those firms that *voluntarily* report their emissions publicly, many use CDP – a non-governmental organization – as their platform. CDP describes itself as CDP is a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.[1]

While CDP provides some basic information on environmental impacts and risk exposure (though note that most of the data is private and proprietary), research indicates that very few firms report their Scope 3 emissions (see e.g. Green et al. 2021). This omission is significant, since in some industries, Scope 3 emission comprise the majority of a firm's total emissions. Scope 3 emissions are similarly absent from most firms net-zero pledges. Net-Zero Tracker provides downloadable data on net-zero pledges made by countries, cities and the largest publicly-traded 2000 firms. As of 22 February 2022, only 17% of those 2000 firms included Scope 3 in their pledge.[2]

Thus, in general, corporate measurement and public reporting of emissions is incomplete. We only have a very partial picture of firms' actual emissions. Moreover, this incomplete picture is replicated in voluntary disclosure initiatives, which simply do not receive enough data to have a meaningful picture of total emissions, and therefore, climate risks. The same problem applies to net zero pledges. Firms cannot legitimately claim to be moving toward net-zero emissions without a full picture of Scope 3 emissions.

Finally, one cannot have a complete picture of carbon measurement and accounting without examining the role of carbon offsets. The voluntary market, which is almost entirely self-governed, is growing rapidly. Ecosystem Marketplace recently estimated that the value of the voluntary market topped $1 billion in 2021.[3] And increasingly, the voluntary market is bleeding into compliance markets, notably through the 2016 aviation agreement, CORSIA. Yet there are serious concerns about the environmental integrity, additionality and permanence of many offsets in the voluntary market (Kreibich and Hermwille 2021).

To the extent that disclosure – of emissions or the use of offsets – becomes part of any climate-oriented measures in investment treaties – the quality of the information and risk revealed by these data should be carefully examined.

Proposals for Reform

Given the problems with emissions measurement and reporting, reforms should look beyond disclosure to financial institutions that will promote green investment, and deter further investment in fossil fuels. Instead of focusing resources and technical effort on improving a

[1] https://www.cdp.net/en

[2] Author's calculation based on data downloaded from https://zerotracker.net/.

[3] https://www.ecosystemmarketplace.com/articles/voluntary-carbon-markets-top-1-billion-in-2021-with-newly-reported-trades-special-ecosystem-marketplace-cop26-bulletin/

flawed tool – the measurement and disclosure of GHG emissions – investment regime reforms should instead focus on disempowering fossil fuel companies and other large emitters. This can happen through two important avenues:

1) Remove protections for the fossil fuel industry through Investor-State Dispute Settlement (ISDS) system to ensure its compliance with the Paris Agreement goal of limiting warming to 1.5 degrees C.

The current rules of the ISDS protect fossil fuel companies and their assets. These protections undermine the utility of disclosure practices, since some potential financial risks may be offset by protections under ISDS. The International Energy Agency has recently stated that no new fossil fuel infrastructure can be built if the world is to meet the goal set forth in the Paris Agreement of limiting warming to 1.5C (IEA 2021). Put quite simply, as long as the ISDS protects rights to compensation on fossil fuel companies and other large emitters, it *cannot* be compliant with the Paris Agreement.

While the political likelihood of far-reaching reforms is low (Birkbeck et al 2020), the indirect effects of reform proposals should not be underestimated. Political science research shows that threats of regulation can prompt potential targets of that regulation to act to lessen the future costs of new rules, and to get a leg up on the competition (Green 2013, Kennard 2020). Thus, countries who back the removal of protections will provide a useful signal that if large emitters wish to maintain their profitability, they must plan for future changes.

2) Expanded discussion of reforming the Energy Charter

As scholars and governments alike have noted, Energy Charter includes considerable protections for the fossil fuel industry. These should be reformed, but there are considerable political challenges to doing so. Others have written in greater detail about the mechanics of such reform (see Tienhaara and Cotula 2020; Tienhaara 2017). I highlight two points here. First, the Energy Charter need not be invoked to protect fossil fuel companies. The simple *possibility* that it may be used is sufficient to deter states from implementing stricter climate treaties (Tienhaara 2017). Second, any proposals for reform will provoke considerable pushback from emissions-intensive sectors (Colgan et al. 2021). This opposition will likely water down any proposals that reduce protections for these sectors. As such, a better opening strategy would be to focus on reforms that empower the renewable energy sector. This will not only direct investment toward decarbonization, but importantly, build political constituencies for further reform.

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MONASH University

Dr Caroline Henckels
Associate Professor
Faculty of Law
Monash University
caroline.henckels@monash.edu

Investment Division
OECD
investment@oecd.org

2 March 2022

Submission: OECD public consultation on investment treaties and climate change

Investment treaties contain a range of substantive obligations on states to protect foreign investment. The application of these protections to climate change mitigation measures could result in state liability for breaching those obligations. It is possible to draft investment treaty provisions in a manner that is more supportive of policy space for measures taken to deal with climate change. There are a number of options that could be explored that will provide greater assurance to governments that bona fide measures adopted to address climate change (and other legitimate public welfare objectives) will not breach investment treaties.

This submission addresses two issues: redrafting the standards of investment protection with greater precision in order to ensure that public welfare measures such as those taken to address climate change do not attract state liability, and the desirability of and approach to the inclusion of exceptions in investment treaties to provide an additional layer of protection for climate change mitigation measures.

Greater precision in specifying states' investment obligations

International investment treaties typically contain broadly worded, open-textured obligations that do not address the relationship between investment protection and the continuing powers of host states to regulate. These provisions give investment tribunals significant discretion in interpreting the obligations of states toward foreign investors and investments. It can be difficult to predict when a state will be held liable to compensate an investor, even where the relevant measure is directed to public welfare. As a result, a concern is that these treaty provisions may unduly expose governments to compensate investors for non-discriminatory laws, regulations and administrative decisions adopted to promote public welfare, including measures adopted to deal with climate change. While in recent years, many investment tribunals have shown greater receptiveness to the right of states to regulate, the potential impact of the broad adjudicative discretion of tribunals on the regulatory autonomy of states remains.

Recently concluded treaties have attempted to deal with these concerns by adopting a more precise approach to treaty drafting in terms of greater specificity regarding states' investment obligations. This approach should be welcomed, as it provides greater certainty to state in terms of the conduct that is and is not proscribed. It also provides far greater certainty as to states' continued regulatory space.

This submission will focus on three instances of greater precision in investment treaty drafting: national treatment, indirect expropriation and fair and equitable treatment. These provisions all provide greater protection for public welfare regulation, and could be considered as models to adopt for future treaties, with any necessary modifications.

National treatment

Investment treaties typically oblige states to accord treatment to foreign investors and investments that is no less favourable than that provided to domestic investors and investments in like circumstances. However, national treatment clauses almost never elaborate on the purpose and scope of the obligation and how bona fide measures with legitimate objectives should be analysed for breach. This imprecision has given rise to significant fragmentation in the decided cases with respect to several issues affecting the breadth of the obligation. The broader the circumstances captured by the obligations of non-discrimination, the greater the potential restrictions on the ability of governments to regulate or take other actions to promote public welfare where this conduct affects foreign investors or investments.

Here, inspiration may be taken from the national treatment clause in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the accompanying drafter's note,[1] which provide:

- Whether treatment is accorded in "like circumstances" "depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."
- The purpose of the obligation is to ensure that foreign investors/investments are not treated less favourably on the basis of their nationality.
- A claimant must be in a competitive relationship with domestic investor/s in order to compare their treatment.
- Tribunals must take into account the measure's objective and whether investors or investments are subject to like legal requirements.
- A measure must be plausibly or reasonably connected to a legitimate public welfare objective and be applied in a non- discriminatory manner to avoid liability.

These stipulations significantly constrain investment tribunals' discretion, making the purpose and scope of the obligation clear and stipulating that public welfare measures that are reasonably connected to their objective will not breach the obligation.

Indirect expropriation

Indirect expropriations are measures that substantially deprive the investor of the investment or that result in the effective loss of the investor's enjoyment of or control over their property. However, the customary international law doctrine of police powers permits states to regulate or take other actions significantly affecting an investment without liability where the measure pursues a legitimate public welfare objective. Investment treaties, however, have historically not provided any guidance as to when a measure will amount to an indirect expropriation or is an exercise of police powers, and customary international law is also unclear in this respect. Investment tribunals have adopted a variety of approaches.

The 2004 and 2012 US Model bilateral investment treaties and treaties based on them provide far greater precision with both the concept of an indirect expropriation and the concept of police powers. With respect to police powers, these treaties clarify that 'Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.'[2] This approach specifies that environmental regulation (such a climate change regulation) is unlikely to contravene the obligation, provided that the relevant actions are designed and applied to protect this objective. Other treaties are more categorical in stating that such measures do not constitute indirect expropriations.[3] This approach provides greater assurance to states that bona fide environmental measures will not amount to indirect expropriations.

Fair and equitable treatment

Fair and equitable treatment is the most frequently invoked and successfully argued standard of investment protection. Fair and equitable treatment clauses in investment treaties are typically brief. Many treaties simply provide that states must "accord fair and equitable treatment" with no further elaboration. Others provide that states must accord fair and equitable treatment in accordance with international law, customary international law or the customary international law minimum standard of treatment of aliens. These references are generally understood to relate to the degree of unfairness or

[1] Comprehensive and Progressive Agreement for Trans-Pacific Partnership Art 9.4 and Drafter's Note.
[2] US Model BIT 2012, Annex B(4)(b).
[3] See e.g. Korea-New Zealand Free Trade Agreement, Annex 10B.

inequitable conduct that would give rise to liability, rather than articulating the normative content of the obligation itself.

In this regard, the approach taken by the EU in its Comprehensive Economic and Trade Agreement with Canada provides some much welcome clarity as to the normative content of the fair and equitable treatment obligation, providing that a Party breaches the obligation of fair and equitable treatment where a measure or series of measures constitutes:[4]

- Denial of justice in criminal, civil, or administrative proceedings.
- Fundamental breach of due process, including a fundamental breach of transparency in judicial and administrative proceedings.
- Manifest arbitrariness.
- Targeted discrimination on manifestly wrongful grounds, such as gender, race, or religious belief.
- Abusive treatment of investors, such as coercion, duress, and harassment.
- A tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.

What is significant about this formulation of the fair and equitable treatment standard is that bona fide public welfare regulation, including measures to address climate change, will be beyond the scope of the clause unless the regulation is 'manifestly arbitrary', which appears to be very unlikely. To the extent that legitimate expectations can be relevant to a fair and equitable treatment claim, it appears that only where frustration of those expectations is 'manifestly arbitrary' can a breach be made out. Again, this is unlikely to be the case with respect to climate change measures.

Public policy exceptions and climate change measures

Public policy exceptions in investment treaties permit a government to lawfully take action directed at a particular regulatory objective, industry, or sector of the economy that would otherwise be inconsistent with its substantive treaty obligations. Exceptions have become an increasingly popular mechanism in investment treaties.

General exceptions in investment treaties usually incorporate by reference or are modelled on the general exceptions in the World Trade Organization General Agreement on Tariffs and Trade and the General Agreement on Trade in Services,[5] which provide exceptions for, among other areas, measures 'necessary to protect human, animal or plant life or health' and those 'relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.' It is not entirely clear that these exceptions will cover measures to address climate change. No investment treaty contains a specific climate change exception, but this is an option to consider. Another option relied on in some investment treaties is to include a general exception for measures adopted to protect the environment.[6]

When drafting exceptions, one issue to consider is the appropriate legal test for exceptions: whether a measure should be 'necessary' to address climate change or merely 'related to' it (or some other legal test, such as 'designed and applied to' or 'appropriate to'. 'Necessary' is a higher threshold, usually understood as requiring a tribunal to consider whether there were alterative measures reasonably available to the host state that impact to a lesser degree on foreign investment. A test of 'related to' only requires a rational connection between the measure and its objective, and is therefore easier to satisfy.

Another issue to consider is whether exceptions should be seen as permissions or defences: that is, whether action taken in conformity with the exception falls outside of the investment protections in the treaty or whether the exception should be raised as a defence to an apparent breach of the treaty. The preferable approach is to make it clear in the treaty text that measures conforming with the exception

[4] Canada-EU Comprehensive Economic and Trade Agreement, Art 8.10.
[5] See e.g. Japan-Israel BIT, Art 15.
[6] See e.g. Cambodia-Turkey BIT, Art 4.

are outside the scope of the treaty. This has various benefits, including placing the burden of proof on the claimant to demonstrate that the exception does not apply.

Finally, there is an argument that exceptions are unnecessary to include in investment treaties, and that the preferable approach is to inject greater determinacy into the obligations themselves, as discussed above. It could be that tribunals interpreting exceptions consider the measure's objective only in the context of determining whether the exception applies and not when determining whether there has been a breach in the first place, which is undesirable. Relatedly, an exception that includes a 'necessary' requirement is a stricter test than usually applied in determining compliance with investment treaties' substantive obligations, meaning that states' regulatory space risks being constrained by the interpretation of the exception. Including exceptions may, however, be desirable as an important failsafe against erroneous interpretations of the substantive obligations. This means that the drafting of exceptions is crucially important, particularly the permission/defence issue.

Please do not hesitate to contact me should you require any further information or clarification of the matters raised in this submission.

Yours sincerely,

Caroline Henckels

Caroline Henckels

Proposed Investment Treaty Provisions

On behalf of the International Federation of Business and Professional Women (IFBPW) Prepared by its Standing Committee Environment, Training & Sustainable Development

(Prof. Dr. Catherine Bosshart & Dr. Özge Varış & Angela Donato)

1. **Introduction:**

The sustainable development goals (SDGs) are not only related to environmental issues, but also include other topics, namely equality, education, and gender. Amongst the United Nations (UN) SDGs, No 5 is about gender equality. The content of this SDG is not only achieving gender equality but also targeting the empowerment of all women and girls. The targets of the SDG no 5 are rooted in sociological factors. In other words, the issues have various origins, different cultural and economic reasons; according to contemporary global economic projections COVID-19 will affect global trade and investment flow in many different ways[1], and gender equality will be affected as well.

On the other hand, despite all that and despite all the unconventional developments in the world, international trade and investment flow has been pursing. According to the UNCTAD's World Investment Report 2021, foreign direct investment flow has been decreasing since 2018, and the global trade is no different.[2] However, even before the 2008 economic crisis and trade wars, gender equality and the status of women with regard to international trade and investment is always under scrutiny.[3]

[1] Trade set to plunge as COVID-19 pandemic upends global economy, WTO press release, April 2020, <https://www.wto.org/english/news_e/pres20_e/pr855_e.htm >

[2] UNCTAD World Investment Report 2021, June 2021 <https://unctad.org/system/files/official-document/wir2021_en.pdf >

[3] Foreign Direct Investment and Women Empowerment: New Evidence on Developing Countries, IMF Report, January 2018 <https://www.imf.org/en/Publications/WP/Issues/2018/01/26/Foreign-Direct-Investment-and-Women-Empowerment-New-Evidence-on-Developing-Countries-45597 >
Elisa Braunstein, Foreign Direct Investment, Development and Gender Equity: A Review of Research and Policy, United Nations Research Institute for Social Development Paper <http://www.unrisd.org/80256B3C005BCCF9/(httpAuxPages)/5159E5733338C836C12571390033F5E2/$file/OP12-web.pdf >

According to the current data, approximately 2.4 billion women do not have the same economic rights as men[4], and the legal framework for women's rights does not support it.[5] According to the data, women have a very limited share in global foreign direct investment (FDI) flow.[6] Although these two data may not have a direct correlation, they complement each other. The data regarding women's status in the FDI highlights the vulnerability of women in the FDI environment[7] and the data regarding women's status in a legal context explicitly shows that, with a supportive and legal regime, the gender gap can be eliminated. Therefore, with a supportive international investment legal regime, gender equality and empowerment of women and girls is an SDG target which is possible to achieve.

However, in the contemporary world, a few points should not be ignored. Firstly, the SDGs have a multi-dimensional framework, and they have a strong connection with each other. They work accordingly and support each other's targets.[8] Hence they can be achieved together; the second point reveals as the status of women because of the climate change and environmental issues.[9] As a result, international investment law can have a strong impact on reaching targets relating to the environment, climate change and SDG no 5.

2. Legal Issues & Solutions & Proposed Provision:

As mentioned above, SDGs, climate change and environment and FDI regime have a strong connection to each other, as a result the main challenges may arise based on a sustainable development approach and the provision of investment treaties. On the other hand, the solution can come through investment treaties as well. For instance, the most practical way is reforming sustainable development provisions and key personnel provisions in investment treaties.

Before the potential solutions are discussed, possible challenges and issues under international investment law should be analysed. The primary challenge may arise under the national implication processes of the SDGs and national legal systems. International investment law does not have a direct effect on gender equality and the

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[4] World Bank Data < https://www.worldbank.org/en/news/press-release/2022/03/01/nearly-2-4-billion-women-globally-don-t-have-same-economic-rights-as-men > 05/03/2022

[5] World Bank Women, Business and Law , Measuring Legal Environment in Practice Chapter <https://wbl.worldbank.org/content/dam/sites/wbl/documents/2021/02/WBL2022%20Chapter%203.pdf > 05/03/2022

[6] IMF, Foreign Direct Investment and Women Empowerment: New Evidence on Developing Countries 2018 <https://www.elibrary.imf.org/view/journals/001/2018/025/article-A001-en.xml > 05/03/2022

[7] Heba Shamskun & Xiang Diao, Why Do Foreign Investors' Attitudes toward Women Matter? World Bank Published on Private Sector Development Blog, 21/06/2018, <https://blogs.worldbank.org/psd/why-do-foreign-investors-attitudes-toward-women-matter > 05/03/2022

[8]< https://www.oecd.org/dac/sustainable-development-goals.htm> 05/03/2022

[9] Introduction to Gender and Climate Change, UNFCC, <https://unfccc.int/gender >
Women, Gender Equality and Climate Change, UN Women Watch < https://www.un.org/womenwatch/feature/climate_change/downloads/Women_and_Climate_Change_Factsheet.pdf >

empowerment of women and girls; however, states have their own agendas on these issues. Therefore, there might be overlapping points and conflicts between national policies and domestic law. In other words, the sustainable development framework may be a significant point of conflict. If that is the case, a new chapter in FTAs or at least a provision regarding the framework relating to the definition and application of SDGs in the treaty could solve possible issues.

The second possible issue may arise from the domestic legal system and social factors and customs of parties to agreements. If that is the case, the domestic legal system or culture of parties may prefer a different regional understanding with regard to gender equality and the empowerment of women and girls. In this regard, a key personnel provision within the bounds of common sense and with respect to the domestic legal system and customs of parties relevant to that issue can provide an important background for the empowerment of women and girls and raising awareness of gender equality.

3. Proposed Provisions:

Based on the above mentioned explanations, the proposed provisions could be drafted as follows:

Interpretation and Framework of Sustainability

"*The objectives of this Title are to comply with the areas of United Nations sustainable development goals, with the trade and investment between the Parties under nationally determined contribution obligations, labour laws and their national legal systems.*"

Key Personnel

"Each Party shall provide an environment conducive to permitting the empowerment of women and girls which could affect the application of this Agreement or any supplemental agreement. Each Party shall endeavour to ensure the participation of personnel of their competent authorities who have expertise in the matter subject to the consultations and recruitment of key personnel."

4. Conclusion:

Despite initially appearing irrelevant, SDG no 5 gender equality, the empowerment of women and girls, and environmental issues and climate change issues have strong bonds to each other. Both economic and sociological data and facts prove their relationship including gender equality and the empowerment of women and girls in terms of an international investment regime.

Although they have not been included in investment treaties yet, SDG no 5 related matters will become an undeniable part of the FDI system in the near future. In order to eliminate potential legal issues in the international investment regime, the possible effective and practical path is the improvement of the new generation of investment treaties by including the framework and definitions relating to sustainable development and gender equality and the empowerment of women and girls.

Angela Donato
IFBPW Standing Committee Chair
Environment, Training &
Sustainable Development

Dr. Ozge Varis
IFBPW Standing Committee Chair
Environment, Training &
Sustainable Development

Prof. Dr. Catherine Bosshart
IFBPW President

Submission to the OECD's Public Consultation on Investment Treaties and Climate Change

Lise Johnson*

March 24, 2022

1. Given the range and importance of these issues, the OECD should be commended for its stream of work on the Future of Investment Treaties, and for organizing this consultation.

2. Opportunities and challenges for climate and investment treaties can be grouped into three main categories.[1] These are the extent to which investment treaties:

    a. catalyze climate-aligned investment flows, and withhold support for investment that undermines the Paris Agreement;

    b. allow or constrain climate-aligned and sustainable governance of investment; and

    c. foster international cooperation to address collective action problems.

3. This submission focuses on the first two, both articulating current problems and identifying possible solutions.

I. Catalyze Climate-Aligned Investment; and Do Not Support Investment that Undermines the Paris Agreement

4. States have committed in innumerable fora to take public action to ensure that private finance is catalyzed and channeled in order to achieve, and not undermine, the goals of the Paris Agreement. Yet investment treaties, which subsidize foreign investment,[2] have thus far operated as blunt tools that both (a) fail to strategically and effectively spur investment into the locations, sectors, and activities where it is needed to achieve climate policy aims, and (b) support investments that undermine Paris Agreement goals. There are, however, new approaches that could be adopted to address each of those issues.

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* Counsel at Curtis, Mallet-Prevost, Colt & Mosle LLP, which represents states in ISDS proceedings; Senior Fellow at the Columbia Center on Sustainable Investment. This submission reflects my personal views and is written in my personal capacity.

[1] This categorization is based on the one set forth in Lise Johnson, Lisa Sachs, and Nathan Lobel (2019), "Aligning International Investment Agreements with the Sustainable Development Goals," 58 COLUMBIA JOURNAL OF TRANSNATIONAL LAW 58, *available at* https://www.jtl.columbia.edu/journal-articles/aligning-international-investment-agreements-with-the-sustainable-development-goals.

[2] As co-authors and I argued, *supra*, n.1, p. 72, investment treaties are "regulatory incentives that, even if not effective at attracting investment, effectively subsidize foreign investments."

5. Lessons could be drawn, for instance, from analogous political risk insurance schemes. While some political risk insurance providers are private companies, many, similar to investment treaties, are created and managed by states in order to catalyze international investment and support certain policy aims.

6. The state schemes may offer concessionary rates or offer insurance for investments in places or activities that a private insurance company would deem too risky to cover, or only cover at a price that is too high to be attractive or accessible to companies. Yet the state entity may complement the private market to provide insurance that will help overcome barriers to those investments likely to produce positive spillovers and that warrant such supportive market and policy intervention.

7. These insurance schemes are often accompanied by conditions and processes ensuring that the supported investments produce desired benefits, and do not cause unwanted harms.[3] There may be, for instance:

    a. ex ante screens excluding certain types of investments (e.g., those producing emissions over a certain amount, or operating above a certain GHG intensity);

    b. ex ante requirements for investments to demonstrate contributions (e.g., to employment, tax, and technology transfer in the home and host country);

    c. ongoing requirements to comply with and report on compliance with relevant standards; and

    d. various consequences for breach of conditions, including a loss of privileges provided under the policy.

8. Treaties could draw from these approaches. The exact content of these conditions and processes do not have to be detailed or hard-wired in the treaty itself. Rather, a treaty could, for instance, establish a body responsible for developing climate-related (and other performance) standards, periodically updating them, and monitoring compliance; or the treaty could delegate the task to domestic officials. Investors seeking treaty protections could have an ongoing duty to report on their compliance with conditions for coverage. Only if those reporting requirements are satisfied can an investor claim the extra privileges offered by treaty protection (without, of course, prejudice to any argument that the investor is not in fact covered).

II. Allow Climate-Aligned Governance

9. There are myriad ways ISDS may affect climate policies, and the effects of such policies. Many concerns around the intersection of ISDS and climate relate to the effects that protection of fossil fuel-related investments can have on countries' willingness and ability to

[3] For more discussion and examples, see *id*. at pp. 65-81.

adopt GHG mitigation measures. ISDS decisions can also affect answers to the question of who pays for such measures – whether it is the government and their taxpayers, or the companies that had invested in fossil fuel-related assets. ISDS can similarly determine how much those measures cost. If an ISDS tribunal orders a government to "compensate" investors for "losses" suffered due to a decision not to allow further extraction of oil, for instance, a tribunal may order compensation based on its forward-looking projections of the price of oil in future decades, and the profits a company might have expected to make from the sale of such oil, without taking adequate (or any) account of factors such as the social cost of carbon, the riskiness of the investment in light of the long-known problem of climate change, the moral hazards caused by providing such compensation, or domestic legislative or judicial determinations on the appropriate approach for fossil fuel phase-outs (and compensation, if any, for such phase-outs) in light of constitutional and other legal norms.[4]

10. Beyond the issue of liability for efforts to halt or slow investment in new or existing fossil-fuel-extraction projects, ISDS could be used to challenge a broad range of mitigation policies across industries – e.g., transportation, construction, agriculture, manufacturing.

11. ISDS could similarly be used to challenge adaptation measures, such as new zoning laws aiming to restrict developments in flood-prone or other areas vulnerable to severe storms likely to occur with increased frequency; mandates on durability of tailings dams; water use policies or restrictions; etc. Indeed, the potential types of mitigation- and adaptation-related claims seem endless.

12. ISDS also poses challenges for efforts to ensure a just and sustainable transition. For instance, the extraction of natural resources that will likely be needed to support a no-carbon economy dependent on rare earths can also have profound social, economic, and environmental effects. All too often, these effects from extractive industry projects are harmful for one or more of those dimensions of sustainable development (economic, environmental, or social). Governments need to be able to avoid or, at least, mitigate those harms and harness benefits of international investment through their laws and policies, and to fairly distribute those costs and benefits; but ISDS can make it more challenging for them to do so.

13. Similarly, as dozens of ISDS cases challenging government adjustments to feed-in-tariff and other renewable energy schemes demonstrate, ISDS can have the effect of locking in investment incentives even if those incentives were not or are not essential to the investors' investment decisions. Incentives that provide more than what is necessary in order to cause the desired investment are distortionary transfers of public resources to private interests. Governments need to be able ensure that incentives schemes – including incentives designed to promote investment in renewable energy – can be adjusted so as to

[4] Even in cases when the challenged measure was not adopted in order to address climate change, the case may nevertheless involve valuation of fossil fuel assets, with valuation decisions at risk of being inconsistent with or complicating climate policy. Additionally, there are various complex factors relevant to ensuring that the transition is a "just" transition. I am concerned that ISDS – including its approach to compensation – is not designed to properly evaluate and decide upon the relative merits of those factors.

ensure that they influence investment decisions, but do not constitute wasteful handouts. ISDS can prevent, or effectively reverse, those crucial adjustments.

III. Ways Forward

14. As requested by the Guidelines for Contributions to Public Consultation on Investment Treaties and Climate Change, I am identifying some of the activities (in addition to the screens and conditions discussed above) that I consider would be helpful for governments when addressing the challenges briefly outlined above:

    a. **Expanding work beyond procedure:** While reform efforts taking place within the United Nations Commission on International Trade Law (UNCITRAL) are concentrating on procedural issues, such as moving from a system of arbitration by party-appointed and party-paid adjudicators, to a more permanent, standing ISDS mechanism of salaried judges, these efforts do not directly address investment treaties' substantive standards of protection, application of which generate the concerns noted above regarding policy space to address climate change mitigation and adaptation, and ensure a just and sustainable transition.
    Such a multilateral standing body, once created under UNCITRAL's work programme, may be less prone to produce overly expansive interpretations than the present arbitration-based ISDS system. But there is no guarantee of that outcome. There are also risks that if a standing body issues an overly expansive interpretation of state obligations in an individual case,[5] then that decision will have greater precedential force and legitimacy than a similar decision of an ad hoc ISDS tribunal, possibly making it even more difficult for states to correct course. Thus, a focus on procedure is an incomplete solution, and may even exacerbate some concerns about the balance of interpretive power between states and adjudicators, and the challenges of dealing with decisions state parties consider to be incorrect interpretations or applications of their treaties.
    The timing of procedural reforms should also be taken into account. While UNCITRAL is presently working on the establishment of a multilateral investment court, it will be years before such an institution is established; and it is yet unclear when and whether there will be widespread acceptance of that new dispute

[5] In a review of all awards publicly available as of June 1, 2010, Gus Van Harten found that arbitrators opted for expansive interpretations of investment treaties on 11 out of 14 issues examined. Gus Van Harten (2016), "Arbitrator Behaviour in Asymmetrical Adjudication (Part Two): An Examination of Hypotheses of Bias in Investment Treaty Arbitration," 53 OSGOODE HALL Law Journal 540. *See also* Simon Batifort and Andrew Larkin, "The Meaning of Silence in Investment Treaties" (forthcoming 2022) (on file with author). Batifort and Larkin (who are also attorneys at Curtis, Mallet-Prevost, Colt & Mosle LLP, engaged in ISDS defence) discuss how arbitral tribunals have often taken matters on which treaties were silent, and interpreted silence as providing relatively expansive investor protections. They conclude that "so long as adjudicators are tasked with interpreting similar instruments, the influence of those decisions may be difficult to avoid." For a standing court to address concerns that ISDS has been overly solicitous and protective of investors, that will mean that such a court may need to reject much of "investment law" as we now know it.

settlement mechanism. Once a standing ISDS mechanism is operational, even assuming that a standing ISDS mechanism *will* generate decisions that predictably raise less of a risk to states for climate action, that shift in ISDS case outcomes may come too late for the states that want, and need, to act on climate now. Moreover, assuming that a standing ISDS body sits alongside the current system of ISDS by party-appointed arbitrators, any climate-sound jurisprudence that may emanate from a court might be avoided by corporate structuring and associated treaty and forum shopping enabling investors to continue pursuing claims under the current ISDS model.

b. **Ensuring states have a meaningful role in treaty interpretation:** The OECD has done work to address overly expansive interpretation of investment treaty obligations, including through efforts to increase the use of states' powers to shape treaty interpretation.[6] Those tools, however, remain under-used by both home states and unduly discounted by tribunals.[7] Whether ISDS takes place through arbitration or a standing mechanism, it is important to try to understand, and address, those hurdles to a meaningful state voice in treaty interpretation and application.[8]

c. **Continuing engagement on the underlying rationale for and role of ISDS:** Research on the costs and benefits of investment treaties and ISDS has been chipping away at the flawed notion that ISDS is pro-investment, and a policy against ISDS is anti-investment.[9] While the volume of academic and policy work on ISDS and its impacts has significantly increased, there remains an overall lack of evidence that investment treaties influence investment decisions.[10] Additionally, even if an investment treaty is a factor that investors do consider when deciding where to invest, it is unclear that the role the treaty plays is important and influential enough to outweigh the risks of litigation and liability that treaties necessarily generate. It is also unclear that the distribution of costs and benefits across and within countries is defensible, much less desirable.

Given these issues, it is essential that states are supported in efforts to meaningfully and timeously evaluate what types of investment protections and dispute

[6] *See, e.g.,* David Gaukrodger (2016), "The legal framework applicable to joint interpretive agreements of investment treaties," OECD Working Papers on International Investment, No. 2016/01, OECD Publishing, Paris, https://doi.org/10.1787/5jm3xgt6f29w-en; Kathryn Gordon and Joachim Pohl (2015), "Investment Treaties over Time - Treaty Practice and Interpretation in a Changing World," OECD Working Papers on International Investment, No. 2015/02, OECD Publishing, Paris, https://doi.org/10.1787/5js7rhd8sq7h-en.
[7] *See, e.g.*, Ladan Mehrenvar and Lise Johnson (2022), "Missing Masters: Causes, Consequences, and Corrections for States' Disengagement from then Investment Treaty System: Summary version," *available at* https://infogram.com/1p76x2x6xkr1w0uzvw5npkqywpcnjexmkry?live.
[8] *Id*.
[9] See Joachim Pohl (2018), "Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence," OECD Working Papers on International Investment, No. 2018/01, OECD Publishing, Paris, https://doi.org/10.1787/e5f85c3d-en.
[10] *Id*. *See also* Josef C. Brada, et al. (2020), "Does Investor Protection Increase Foreign Direct Investment? A Meta-Analysis," 35 JOURNAL OF ECONOMIC SURVEYS 34.

settlement systems make sense in light of their domestic laws and policies, and other international law norms and commitments regarding climate change, environmental protection more broadly, and human rights. There is need for more extensive and ongoing impact assessments to ensure not only that treaties protect "defensive" policy space to adopt climate-related measures, but also that the treaties and ISDS provisions are not being used to frustrate climate policies in partner countries. Similarly, it is important to ensure that where actual or possible adverse impacts are identified, steps can be taken to avoid or mitigate them.

d. **Creating opportunities for bolder reforms:** Recent practices in international investment treaties include the adoption of a state-to-state dispute resolution model (as opposed to an ISDS model) for all or some causes of action.[11] However, states, particularly those with smaller economies, may face significant (often external) pressure to conclude investment treaties with relatively broad standards of investment protection and ISDS clauses that place appropriate climate and other public policies at risk. Such states may also face challenges in getting their treaty parties to terminate or amend existing treaties so as to eliminate or reduce the risk of ISDS provisions and the overly broad readings of state obligations that can emanate from those provisions. Intergovernmental work can help to ensure that states have both the political space to reject ISDS in new treaties and the legal tools to move away from it in existing agreements. This could be achieved, for instance, through a multilateral instrument to terminate or amend treaties removing advance consent to ISDS for all or some claims. Draft language for such an instrument has been proposed and is available here.

   Relatedly, the multilateral instrument currently envisaged as part of the UNCITRAL process in order to implement reforms could be used to efficiently move away from the current model of advance consent to ISDS. Discussions to date seem to envision an approach whereby states can sign on to such a multilateral instrument, and then through that instrument "opt in" to different specific reform options. The multilateral instrument and the components that states opt into can amend underlying investment treaties so as to supplement or replace those investment treaties' procedural (or substantive) provisions.

   One possible option is for that multilateral instrument to, as a default rule, amend investment treaties so as to remove standing offers of consent to ISDS. If states then choose to do so, they could provide renewed offers of consent for all or some claims (potentially under different terms and conditions, and subject to additional limitations) when opting into a particular dispute settlement system or systems (whether that be a new standing multilateral investment court or reformed

[11] The USMCA is an example of both: it removes ISDS entirely as between the US and Canada, but keeps ISDS for certain claims against Mexico and the United States. The EU recently concluded investment agreements with China and Japan that do not include ISDS. Brazil's investment treaties do not include ISDS, and also exclude certain substantive provisions such as those on indirect expropriation and "fair and equitable treatment."

arbitration-based ISDS). Absent agreement by the underlying state parties to a given treaty to opt into a particular mode of dispute settlement, the default dispute settlement mechanism will be state-to-state dispute settlement.

Submission to the OECD's Public Consultation on Investment Treaties and Climate Change

George Kahale, III[1]

March 24, 2022

As someone who has been an active participant in ISDS for the past fifteen years and acted as lead counsel in several of the world's largest international arbitrations, I fully support this OECD initiative and any other that would dedicate intergovernmental attention to the threat that ISDS poses, not just for climate change policy but more broadly for the ability of states to exercise their sovereign prerogatives in addressing environmental, health, safety and other issues of public interest.

A recent law firm bulletin reveals why there should be concern about the ISDS threat in the context of climate change policy. It says:

> ISDS is therefore likely to be an increasingly important avenue for the resolution of climate change disputes. Companies in industries most affected by States' climate change obligations (*e.g.*, fossil fuels, mining, etc.) should audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty. Such restructuring should take place before any climate-related dispute with the State has arisen or is reasonably foreseeable. Notably, some treaties have superior investor protections than others. It is thus important to assess which treaty would best protect the company from any adverse climate-related government measures.[2]

[1] The author is the Chairman of Curtis, Mallet-Prevost, Colt & Mosle LLP, an international law firm with wide experience in the representation of states in ISDS. However, the above are the views of the author in his personal capacity.

[2] Jones Day (Michelle Bradfield, James Egerton-Vernon, Melissa Stear Gorsline, Fahad A. Habib, Sylvia Tonova and Philip J. Devenish), *Climate Change and Investor-State Dispute Settlement*, February 22, 2022, *available at* www.jonesday.com/en/insights/2022/02/climate-change-and-investorstate-dispute-settlement.

In fact, there is little doubt that many investors, third-party funders and their counsel are eyeing ISDS with a view to challenging, and even profiting from, governmental action relating to climate.[3]

I have previously written and spoken in detail about the problems and dangers of ISDS, as seen from my vantage point as counsel defending respondents in ISDS cases.[4] Of course, opinions on the subject vary greatly. There is no shortage of defenders of ISDS, who wax eloquent about its function in promoting foreign direct investment (FDI) and providing a neutral, peaceful way of settling investment disputes. On the other side, critics of ISDS question whether it really has a discernible positive impact on FDI and see investment treaties as weapons of legal destruction.

By 2017, the criticism of ISDS reached a decibel level that could no longer be ignored. UNCITRAL Working Group III was formed to address the issue of whether ISDS reform was needed and, if so, to make recommendations for reform. But in recognition of the difficulty in reaching consensus on a full-blown model investment treaty, the mandate of the Working Group was limited to issues of procedure.[5] This limitation is a

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[3] In 2021 alone, investors have brought at least three climate-related ISDS claims against European states. These are *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22; and *Discovery Global LLC v. Slovak Republic*, ICSID Case No. ARB/21/51. More are undoubtedly on the drawing board. See also the Keystone Pipeline case against the United States. *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, ICSID Case No. ARB/21/63.

[4] *See*, for example, *Rethinking ISDS*, TDM 5 (2018), *available at* www.transnational-dispute-management.com/article.asp?key=2603; *The Inaugural Brooklyn Lecture on International Business Law: "ISDS: The Wild, Wild West of International Practice"*, 44 BROOK. J. INT'L L. 1 (2018), *available at* https://brooklynworks.brooklaw.edu/bjil/vol44/iss1/1; DAMAGES IN ISDS: JUST COMPENSATION OR HIGHWAY ROBBERY? WEBINAR HOSTED BY THE COLUMBIA CENTER ON SUSTAINABLE INVESTMENT (CCSI), November 2, 2020, *available at* https://d20qsj1r5k97qe.cloudfront.net/news-attachments/George-Kahale-DAMAGES-IN-ISDS-Nov-2-2020.pdf; *It's quantum!*, COLUMBIA FDI PERSPECTIVES NO. 314, September 20, 2021, *available at* https://d20qsj1r5k97qe.cloudfront.net/news-attachments/George-Kahale-Its-Quantum-Columbia-FDI-Perspectives-September-2021.pdf.

[5] United Nations Commission on International Trade Law, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Thirty-Fourth Session (Vienna, 27 November-1 December 2017)*, U.N. Document No. A/CN.9/930, dated December 19, 2017, ¶ 20 ("It was also recalled that ISDS provided a method to enforce the substantive obligations of States. It was noted that critical questions on possible ISDS reform involved the underlying substantive rules. Nonetheless, it was clarified that the mandate given to the Working Group focused on the procedural aspects of dispute settlement rather than on the substantive provisions.").

source of frustration for states that have become progressively more disillusioned with and concerned about the dangers of ISDS. From their perspective, ISDS has not delivered the promised benefits in the form of substantial increases in FDI, at least not desirable FDI,[6] but it has brought with it all the attendant risks of subjecting what normally would be considered ordinary and legitimate exercises of sovereign authority to the scrutiny of ISDS tribunals.

The camp of the frustrated and disillusioned is not confined to the capital importing countries. Rather, it now includes the traditional capital exporting countries of Europe, with the European Commission playing a leading role in the reform movement. That sea change in the attitude of capital exporting countries is not unrelated to the fact that European countries in recent years have unexpectedly found themselves in the position of respondent in so many ISDS cases – it is a lot easier for a state to see the downside of ISDS when it is on the receiving end of claims it never imagined possible. One might expect the United States to participate more actively in the reform movement if it happens to suffer its first ISDS defeat in the US$15 billion dollar Keystone Pipeline case, but as schedules go in these cases, the outcome of that case is not likely to be seen for years.

Despite best efforts and good intentions, a realistic assessment of the current reform movement as embodied in UNCITRAL Working Group III is that no reform is imminent. Five years have already passed without any tangible result, and that might only be a midterm report. Moreover, particularly given the Working Group's limited mandate, one cannot be optimistic that any reform ultimately emerging would satisfactorily address the major concerns surrounding ISDS, and it is hard to see how any serious "procedural" recommendations proposed by the Working Group, including the proposals for a multilateral investment court, would be implemented. In the meantime, ISDS becomes more entrenched and the dangers it presents grow more serious with

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[6] *See, e.g.*, Josef C. Brada, Zdenek Drabek and Ichiro Iwasaki, *Does Investor Protection Increase Foreign Direct Investment? A Meta-Analysis*, 35 JOURNAL OF ECONOMIC SURVEYS 34 (2020); Lorenz Reiter and Christian Bellak, *Effect of BITs on FDI: The Role of Publication Bias*, in HANDBOOK OF INTERNATIONAL INVESTMENT LAW AND POLICY(J. Chaisse, L. Choukroune and S. Jusoh eds., Springer 2020); Joachim Pohl, *Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence*, OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2018/01 (OECD Publishing 2018), *available at* https://doi.org/10.1787/e5f85c3d-en.

each passing year. This is not bad news for the defenders and beneficiaries of ISDS, but it is for the real stakeholders in the system: the states that created it.

Why is all this important? Because ISDS tribunals are not merely deciding issues of international law for the textbooks; they are rendering awards that too often are not only inexplicable from a substantive standpoint but also shocking in amount. There was a time when a fifty million dollar award was considered huge. Now billion and even multibillion dollar claims are commonplace. Of course, not all end in awards against states, and not all awards against states are bad awards. But that is not the point. The size of claims in today's ISDS, coupled with the undeniable fact that some investor-friendly tribunals have not shied away from adopting novel and expansive theories of liability, poses a clear and present danger not only to respondent states but in some cases even to international peace and security. Every state finding itself on the wrong end of a particularly egregious mega-award can attest to that. Again, not all awards are egregious and not all are mega-awards, but far too many are, and even one is too many when the stakes are so high.

The impact of ISDS is not limited to states actually suffering a huge defeat. Anyone familiar with states' policy-making processes appreciates that the threat of an ISDS claim has a chilling effect on state action.[7] The chill actually increases in accordance with the knowledge and experience of the state actors. Naturally, the more one is aware of a risk, the more concerned one becomes. This means that informed state officials around the world are factoring into their decision-making processes in virtually all matters that could have an impact on foreign investors the risk of an ISDS claim, which often costs millions to defend even if totally meritless and could have disastrous consequences if the defense does not succeed.

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[7] For recent climate-related examples, see, for example, Elizabeth Meager, *Cop26 Targets Pushed Back Under Threat of Being Sued*, CAPITAL MONITOR, January 14, 2022 (updated February 21, 2022), *available at* https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/ ("Countries party to the Energy Charter Treaty are under yet more pressure to reform the agreement following the Cop26 climate summit, with Denmark and New Zealand admitting the threat of investor-state lawsuits has hindered their climate policy ambitions.").

There is no easy remedy for this situation. The reality is that ISDS is a system built to last, and the obstacles to meaningful change are formidable. The question then is: what is to be done or, as a practical matter, what can be done? That is what the OECD initiative should address as a matter of urgency. I would offer just a few basic suggestions:

- First, avoid the temptation to get bogged down in endless debate over the pros and cons of ISDS. Acknowledge that a problem exists, even if the solution is not readily apparent. The head-in-the-sand approach of simply denying the existence of a problem and seeing only virtue in ISDS is not credible. Absent acknowledgement of the fact that a problem exists, solutions will remain elusive.

- Second, the acknowledgement should be express and widely disseminated. Public declarations of concern from various corners, including academia, may not be binding, but they are useful in creating momentum for change and are often cited to ISDS tribunals to encourage them to exercise self-restraint when faced with the temptation to adopt overly expansive interpretations of concepts such as indirect expropriation and fair and equitable treatment.[8] OECD declarations would carry even greater weight.

- Third, see if consensus can at least be reached on certain basic principles. For example, in the context of climate issues, it would be useful if consensus could be achieved on a declaration along the following lines: "It is understood and agreed that measures taken by states to mitigate the effects of climate change do not constitute expropriation or a violation of the fair and equitable treatment standard incorporated in

[8] *See, e.g.*, Public Statement on the International Investment Regime, August 31, 2010, *available at* www.osgoode.yorku.ca ("Awards issued by international arbitrators against states have in numerous cases incorporated overly expansive interpretations of language in investment treaties. . . . This is especially evident in the approach adopted by many arbitration tribunals to investment treaty concepts of corporate nationality, expropriation, most-favoured-nation treatment, non-discrimination, and fair and equitable treatment, all of which have been given unduly pro-investor interpretations at the expense of states, their governments, and those on whose behalf they act."); 230 Law and Economics Professors Urge President Trump to Remove Investor-State Dispute Settlement (ISDS) from NAFTA and Other Pacts, October 25, 2017, *available at* https://www.citizen.org/wp-content/uploads/migration/case_documents/isds-law-economics-professors-letter-oct-2017_2.pdf; 220+ Law and Economics Professors Urge Congress to Reject the TPP and Other Prospective Deals that Include Investor-State Dispute Settlement (ISDS), September 7, 2016, *available at* https://ccsi.columbia.edu/sites/default/files/content/docs/publications/isds-law-economics-professors-letter-Sept-2016.pdf.

investment treaties." If consensus cannot be reached on such simple principles without unduly complicated analysis, the prospects of any meaningful outcome from the OECD initiative are dim.

- Fourth, express concern over the proliferation of huge damage awards in ISDS cases, particularly those calculated based on the discounted cash flow methodology, which is inherently speculative and susceptible to abuse. In that regard, it is worth recalling the warning in the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment that "[p]articular caution should be observed in applying this method as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits."[9] That warning has gone unheeded by too many ICSID tribunals.

- Fifth, acknowledge that the foregoing are only baby steps that are not intended to foreclose or substitute for more radical change. States should be encouraged to undertake in-depth reviews of their own investment treaties to analyze whether they yield any significant, measurable benefits and, if not, to consider the action to be taken to avoid or mitigate the substantial risks of ISDS. Many states are already in the process of reevaluating their investment treaties with a view toward amending, interpreting or terminating them. This is a process that undoubtedly will and should continue, both within and outside of UNCITRAL Working Group III.

In sum, the OECD initiative is long overdue. The issues for consideration are not the traditional ones debated at ISDS conferences around the world. Rather, the initiative should address the fundamental question of whether states, either individually or collectively, should retain the exclusive responsibility for addressing the full range of issues of public interest, including climate change, or whether ISDS tribunals and the private participants in the system should be left to play an increasingly important role in directly or indirectly shaping policy and determining the consequences of policy decisions. At bottom, the question is whether states wish to cede a significant portion of their sovereignty to ISDS tribunals, giving them the authority to decide which state measures

[9] LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT, VOLUME II: REPORT TO THE DEVELOPMENT COMMITTEE AND GUIDELINES ON THE TREATMENT OF FOREIGN DIRECT INVESTMENT (World Bank 1992), p. 26.

taken in the public interest are legitimate and to award billions of dollars in damages for those that they deem not to pass muster. If the answer is yes, then there is no need for action. If it is no, action is urgent.

Thomas Kentsch

Siemens AG
Supply Chain Management
Functional Excellence
Standards
SCM FE STD
Otto-Hahn-Ring 6
Perlach
81739 Munich, Germany
Fax.: +49 (89) 636-88594
Mobile: +49 (174) 1539539
mailto:thomas.kentsch@siemens.com
www.siemens.com

SIEMENS

Siemens Supply Chain causes approx. 10 Mega tons CO_2e annually by purchasing goods and services. It is our duty to reduce this amount as fast as possible.

1. Unfortunately, we could not find any tools or practical experience of others on how to measure our suppliers' CO_2 footprint (by far most of them had no own experience), to compare their implemented reduction measures, and/or use supplier information on their activities for our sourcing decisions.
2. **Use of secondary data**: In a first step, we used '**estell'** - developed by an external service provider – which relies on recognised statistics and data sources to reflect the emission intensity of products and services, broken down into country of production. The results of these calculations are interactive dashboards that allow Siemens to track calculated emissions down to the level of individual suppliers.
3. **Use of primary data**: In a second step, we contacted our suppliers in order to find out if the calculated data (secondary data) was correct or if our suppliers had implemented (plan to implement) CO_2 reductions which go beyond the industry/country averages calculated in the first step. In order to do so, Siemens developed the **Carbon Web Assessment CWA**.
4. The CWA has two implications:
   a) tutorials with possible CO_2 reduction activities tailored to the industry the supplier belongs to.
   b) a questionnaire asking the supplier which of the CO_2 reduction activities were already executed (or planned in the future)
5. **The path to net zero**: by using the CWA, our suppliers individually can plan their path to net zero over the years. CWA (powered by 'estell' – the calculation engine of our external partner) calculates each action taken by the supplier and shows the supplier its efforts. Also, the supplier can see what was achieved in comparison to the Industry Average. In parallel, the Siemens buyers can compare the suppliers' activities against its competitors and can base the sourcing decisions on comparable CO_2 emissions and reduction efforts. In the next step, Siemens buyers can and will set specific reduction targets (defined by specific reduction measures) with each supplier. Since January 2021, Siemens contacted approx. 10,000 suppliers and provided the CWA free of charge for their own use.

Attached please see a screenshot of the Carbon Web Assessment CWA.

For further information, we made our Scope 3 upstream journey publicly available under www.siemens.com/carbon-suppliers . There, we explain our strategy, the Carbon Web Assessment CWA, and the target setting process (available in April 2022) in four short videos (3-6 Minutes)

Will an ISDS Appeals Process Promote Sustainability?

Submission for the OECD's public consultation on
Investment Treaties and Climate Change

Jeffrey Kucik and Andrew Shepherd [i]
University of Arizona

I. Introduction

1. Demand for more sustainable international economic law gathers momentum at the same time the UNCITRAL's Working Group III considers reforming investor-state dispute settlement (ISDS). One of the main reform proposals is creating an appellate mechanism (AM).[1] The AM would provide an additional layer of review of tribunal decisions.

2. This Note considers whether an AM would promote sustainability and help address climate change. We assess the potential AM's pros and cons as they pertain to sustainability. On one hand, an appeals process may offer States a way to review unsatisfactory tribunal decisions. In doing so, the AM may help States protect their domestic environmental regulations. On the other hand, creating an AM will also introduce additional costs, deepening the imbalance between large, resource-rich investors and poorer, resource-scarce States. Under the AM, States may find it harder to "green" their economies without risking additional litigation from investors.

3. We focus on energy-related investments, which include raw materials extraction and utilities supply. The energy sector is a heavy user of ISDS. As such, it faces criticism for opposing environmentally sustainable market regulations, particularly in smaller States.[2] We assess the implications of an AM as it relates to the energy sector. We note that an AM may worsen the resource disparity already seen under current rules, exposing States to more litigation as they attempt to "green" their markets.

4. We conclude that any version of an AM must take this tension seriously. The document offers several suggestions for specific AM features that may promote sustainability. We also include some recommendations for impact assessment.

II. Arguments for an Appeals Process

A. General benefits

5. Proponents of reform point out an AM's numerous potential benefits. We mention

[1] See A/CN.9/WG.III/WP.202.
[2] This tension is clear in places like Mexico, where there are worries that renewables policies may precipitate additional litigation. See Magallanes, Adrian and Rodrigo Barradas, "The next wave of ISDS cases could be 'powered' by recent policy changes in the renewable energy sector in Mexico," *IBA Arbitration Committee*, November 2020.

just a few of these here.

6. For starters, an AM can correct tribunal rulings.[3] "Incorrect" interpretations of treaties are common in ISDS decisions. Tribunals sometimes drift from the treaty text by taking an overly expansive view of the law. One result is that rulings "over-reach"—i.e., arbitrators decide issues beyond their jurisdiction or outside the investment treaty provisions. An AM may help avoid these problems by reversing decisions not grounded firmly in the treaty text. The AM may also help clarify the rules through its review of tribunal decisions.

7. There are also less tangible benefits. An AM may reduce bias in tribunal decisions that arises from the current, *ad hoc* appointment system. Under existing rules, there are few limits on arbitrators prejudging legal issues or "double-hatting" (whereby individuals assume multiple roles in one dispute).[4] This opens the door for bias[5], which may originate from:

a. non-random selection of arbitrators predisposed to a party's interests;
b. arbitrators' incentives to rule in ways to increase reappointment; and
c. epistemic biases that shape how the law is read

An AM should help reduce bias if a standing body of members are immune to the kinds of bias that affect tribunal rulings.

8. The proposed AM may also discourage "impractical," politically infeasible recommendations by tribunals. In so doing, an AM may help the entire ISDS enterprise appear more legitimate.

B. Positive implications for sustainability

9. These benefits could have a positive knock-on effect. Creating an additional layer of review may help governments defend "greener" standards and regulations. An AM may also help reduce those biases to which big investors sometimes expose arbitrators. For example, a standing body of appellate members may be less vulnerable to the short-term incentives facing *ad hoc* arbitrators. Therefore, in theory, an AM promise opportunities for more robust governmental regulations.

III. Arguments against an appeals process

A. General costs

10. The proposed AM is not entirely good news, however. There are several dangers

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[3] A/CN.9/WG.III/WP.185 para. 7.
[4] A/CN.9/WG.III/WP.151 para. 31.
[5] See an overview of bias in Puig, Sergio. (2016) "Blinding International Justice," *Va. J. Int'l L.* 56(3): 647.

associated with creating an additional layer of review.[6] These dangers may undermine sustainability and weaken the forces combating climate change.

11. The single biggest problem with an AM may be higher costs, both in terms of the duration of disputes and the legal and administrative fees incurred.

12. On duration, the average length of an arbitration proceeding is 40 months (or, 3.3 years). Under current rules, annulment lengthens that dispute process by about 48%. We can expect any new AM to have a similar consequence. Disputes will be significantly longer, delaying decisions that have meaningful impacts on environmental (or any other) regulations.

13. Longer disputes have an additional implication: higher litigation expenses. Arbitration includes numerous fees, consisting mainly of legal fees. The International Centre for Settlement of Investment Disputes reports average annual expenditures of $127,000 per case.[7] At an average length of 3.3 years, this totals $420,000. Annulment proceedings add another $230,000, on average. These costs will go up with the creation of an AM. Cases will be longer and it is likely that parties will rely on the AM quite heavily. At the World Trade Organization, panel reports are appealed 71% of the time.[8] If ISDS sees similar numbers, then the associated costs will be significant.

B. Negative implications for sustainability

14. Longer duration and higher costs of investment disputes matter for sustainability. Under current rules, there is already an imbalance in who has access to the system. Investment disputes require money as well as legal and bureaucratic capacity. Creating an AM may privilege wealthier litigants over poorer ones. Specifically, it may advantage large, rich investors over smaller, resource-scarce governments who suffer from capacity shortages. States may be less able to defend themselves—and their environmental regulations—in the face of long, expensive legal challenges. The result is more downward pressure on regulations, not less.

IV. Importance of the energy sector

15. The energy industry—including raw material extraction as well as utilities distribution—is arguably more relevant for sustainability than other sectors. It is also the subject of enduring controversy. Advocacy groups, along with some governments, have criticized ISDS rules because of the ways in which large energy companies appear to target environmental regulations for litigation.

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[6] Previous Working Group III proceedings covered additional issues not mentioned in this document. See A/CN.9/1004/Add.1.
[7] Calculations based on financial information from ICSID annual reports. We divide the total annual "expenses related to arbitration/conciliation proceedings" by the total number of disputes active in a given year (at any stage of the legal process). This method produces a simple average that understates the expenditures on some disputes while overstating others.
[8] Kucik, Jeffrey, Lauren Peritz, and Sergio Puig. (*forthcoming*) "Legalization and Compliance: How Judicial Activity Undercuts the Global Trade Regime," *British Journal of Political Science.*

16. Simple numbers illustrate the concern. No fewer than 33% of all disputes involve raw materials extraction ("mining and quarrying") or utilities ("electricity, gas, steam or air conditioning supply").[9] This constitutes a plurality of all ISDS cases. These cases are more frequent—and they involve more money. The median dollar amount claimed in an energy-related dispute is $238 million. For all other industries, it is $105 million.[10]

17. The large financial stakes matter because investors in energy-related areas win at higher rates. Investors generally win 42% of the disputes with formal decisions (212 of 502). However, in the energy sector, investors win 52% of the time. The high win rate feeds concerns that energy is better equipped to defend its interests under current rules.

18. Given the controversial nature of disputes in this area—including the high stakes—parties have shown a willingness to seek a remedy against arbitral decisions. Energy-related disputes are significantly more likely to see follow-on proceedings than are cases involving other economic sectors. They account for 41% of ICSID annulment proceedings and judicial review by national courts.

19. Recent USMCA negotiations reveal the energy sector's favorable view of ISDS. While the USMCA generally limits the scope of investor claims, one exception is the energy sector. Foreign investors in the Mexican oil, natural gas, and power industries retained the ability to use ISDS previously granted under NAFTA.[11] This exemption is a direct result of intense lobbying efforts by major firms in the sector.

20. In general, then, energy-related investments are more active, more committed users of ISDS than are firms in other sectors. Given the environmental implications of these investments (e.g., fossil fuel emissions, groundwater pollution, threats to public health) it is important to consider reforms that do not expose States to additional attacks on sustainable policy efforts.

V. AM design solutions suggestions

21. There are several ways to create an AM to reduce the dangers identified above. These range from simple, practical rules to efforts addressing resource disparities among parties.

22. Since costs are problematic, it may be important to impose short (albeit realistic) timelines on the appeals process. AM rules that reduce the length and/or number of written submissions, or that allow dismissal of issues, could lower the costs of proceedings. Similar

[9] Data from UNCTAD's *Investment Dispute Settlement Navigator*, available online at: https://investmentpolicy.unctad.org/investment-dispute-settlement (accessed March 7, 2022). See also Daniel Behn, Malcolm Langford, Ole Kristian Fauchald, Runar Lie, Maxim Usynin, Taylor St John, Laura Letourneau-Tremblay, Tarald Berge and Tori Loven Kirkebø, "PITAD Investment Law and Arbitration Database: Version 1.0" *Pluricourts Centre of Excellence*, University of Oslo (31 January 2019).
[10] This gap reflects the fact that foreign direct investments in these sectors typically require higher startup costs. However, it also illustrates the size and resources of the firms involved.
[11] See USMCA, Arts 14.4-14.11; Annex 14.E, para. 6(b).

deadlines have benefits in other settings. For example, while the World Trade Organization's (WTO) Appellate Body receives criticism for missing its deadlines, WTO appeals lengthen the average trade dispute by only 20 percent. By contrast, as noted above, annulment proceedings under current ICSID rules lengthen cases by almost 50 percent. Limiting these delays is important for keeping costs down, lest resource-strapped States settle on unfavorable terms.

23. It may also be useful to provide technical assistance. At the WTO, the Advisory Centre has made an important contribution helping smaller States access the law.[12] Working Group III discussed a similar system for ISDS[13], but questions over how to staff and fund such an effort remain open.[14] If feasible, providing technical assistance for least-developed economies may help level the playing field.

24. Any AM also has to consider process for considering issues on appeal. Here, it may help to have filters that effectively screen which issues parties can bring to appeal. For example, a sort of "political filter" may require that the investor's home State agrees with the investors' interpretation prior to the submission of the appeal. Filters of this kind may help limit abuse of the system by parties who can better afford litigation.

Table 1. Summary

Benefits of AM	Costs of AM	Recommendations
1. Correct tribunal errors 2. Clarify the law 3. Reduce bias in decisions	1. Longer duration 2. Higher legal expenses 3. Imbalance in access to system	1. Deadlines for appeals process 2. Technical assistance 3. Political filters for appeal

VI. Guiding principles and impact assessment

25. The above suggestions are just a few of many considerations in AM design. It will also be important to clarify the scope of appeal and to address the redundancies introduced by a second layer of review. Given no perfect solution, we conclude by outlining core principles and encouraging interdisciplinary approaches to impact assessment.

A. Stronger normative commitments

26. The AM must reflect—and be assessed in light of—a normative commitment to sustainability. Existing rules primarily reflect one goal: promoting investment. As such, the current system prioritizes firms while diminishing States' opportunities to regulate the domestic marketplace. The system needs greater flexibility for States to implement and

[12] Shaffer, Gregory, (2011) "Assessing the Advisory Centre on WTO Law from a Broader Governance Perspective." *Minnesota Legal Studies Research Paper, No.11-46.*
[13] A/CN.9/WG.III/WP.212.
[14] A/CN.9/WG.III/WP.212, para 52.

sustain meaningful regulations. Similar proposals have been made in the domain of trade law, where there are calls for more inclusive, more sustainable trade law rules. The unifying idea is that States need carve-outs to regulate the market that will be less vulnerable to challenge on the grounds of discriminatory practice or property rights infringement.

27. Rethinking the role of ISDS on normative grounds creates space for policy innovation. One idea is the creation of carbon-intensive industry carve-outs similar to the Trans-Pacific Partnership's (TPP) rules on tobacco. The TPP carve-out allowed States to block tobacco companies from using ISDS to target tobacco control measures.[15] These rules were justified largely on public health grounds. A similar argument could be made for energy-related investments contributing to climate change. Given the environmental—and health—impacts of energy-related investments, there are strong reasons to consider these kinds of constraints on ISDS use.

B. Heavier reliance on empiricism

28. Assessment requires more dialogue among large-*n*, legal, and policy analysts, each of whom brings useful expertise to the table. In practical terms, more research is needed on issues such as: (i) when disputes are initiated; (ii) how to promote settlement; and (iii) when States comply. Interdisciplinary approaches are required to understand these dynamics.

29. Of crucial importance is a closer look at the distributional consequences of ISDS for States. Debate over the economic impact of arbitral rulings endures. We need fuller analyses of:

a. how investment litigation creates volatility in foreign capital flows;
b. the extent to which reputational effects shape investor behavior; and
c. whether "greener" regulations deter capital

30. Further research into these areas will help reformers look beyond purely ideal institutional types in favor of more practical considerations. Recent world events raise fundamental questions about the strength of international law. Reforms to the ISDS system, including a potential AM, must consider real world institutional pathologies.

VII. Conclusion

31. The goal underpinning the proposed AM is a more coherent, more credible ISDS system. Those goals may be achievable. We only wish to recommend caution. It is possible that an AM will further empower investors vis-à-vis States in ways that slow the world's transition toward sustainable practices. The AM's specific features must be designed in a way that does not stunt progress toward "greening" the global marketplace.

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[15] Puig, Sergio and Gregory Shaffer, (2016) "A Breakthrough with the TPP: The Tobacco Carve-Out." *Yale J. Health Pol'y L. & Ethics*, 16(2): 327.

[i] Jeffrey Kucik is an Associate Professor in the School of Government and Public Policy and the James E. Rogers College of Law (by courtesy).

Andrew Shepherd is an Associate Scholar and the Deputy Director for Global Faculty at the James E. Rogers College of Law.

This work was funded in part by the UA-CONACYT Binational Consortium.

Paving a Credible Investment Pathway to Net Zero for Oil and Gas

Investment treaties will play an essential role in accelerating climate targets in the petroleum sector.

Paasha Mahdavi, Ph.D.
Assistant Professor, Political Science and Environmental Science & Management
Director, Energy Governance and Political Economy (EGAPE) Lab
Co-Founder, The 2035 Initiative @ University of California, Santa Barbara[1]

1. Introduction

1.1. There is little doubt that oil and gas firms face an existential threat from the energy transition.[2] In one of its net zero scenarios, the IEA—long viewed as an ally to energy incumbents—forecasts that fossil fuels will only account for 20% of the world's total energy supply in 2050, down from 80% in 2020.[3] One highly-publicized milestone (among 400 others) for investors to align themselves to the scenario is "no investment in new fossil fuel supply projects."

1.2. Despite their own public rhetoric, investor-owned oil and gas companies are fully cognizant of the inevitability of a carbon-constrained world. State-owned energy giants like Saudi Aramco and Gazprom have far lower extraction costs and carbon intensity of petroleum, owing largely to favorable geology, and will outlast investor-owned companies in the race to be the last one pumping.[4]

1.3. Doubts remain, however, as to when the transition will be realized and at what cost. In spite of this uncertainty, firms are moving forward with climate transition plans out of a combination of financial interest, shareholder pressure, and self-survival to ensure a continued role in regulating the energy industry.

1.4. At the same time, investment treaty reform proposals advocate for fossil divestment "unless they are fully consistent with an ambitious, clearly defined pathway towards

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[1] *Contact: paasha@ucsb.edu. The author bears sole responsibility for the content of the report. Any positions contained herein do not necessarily reflect the views of the University of California.*
[2] Jeff Colgan, Jessica Green, and Thomas Hale, 2020, "Asset Revaluation and the Existential Politics of Climate Change," *International Organization.*
[3] International Energy Agency, 2021, *Net Zero by 2050: a Roadmap for the Global Energy Sector*.
[4] David Victor, 2021, *Energy Transformations: Technology, Policy, Capital and the Murky Future of Oil and Gas*, Engine No. 1.

climate neutrality."[5] This raises a pressing question for investors—what counts as "consistent" with an ambitious transition pathway?

1.5. This contribution to public consultation on investment treaties and climate change evaluates existing debates around oil and gas[6] transition plans in three areas:

1.5.1. The industry sees transition plans as necessary for long-term survival. Yet not all firms agree on strategy: some invest in renewables and electrification, while others see carbon dioxide reduction (CDR) technologies as pathways to continued use of petroleum in a decarbonized world.

1.5.2. Criteria used to assess the credibility of transition plans within the oil and gas sector suffer from considerable inconsistencies. Reporting standards are voluntary or driven by private sector actors, limiting the level of detail needed for accurate monitoring and evaluation.

1.5.3. Proposed changes to reporting standards may close the gap between net zero plans and climate risk management in practice. Public disclosure of detailed emissions and stranded assets will bring into focus which transition plans are credible and which are nothing more than greenwashing.

1.6. This contribution concludes with three recommendations to strengthen the linkages between investment treaties and climate change in the context of oil and gas company net zero strategies: transparency in emissions reporting; disclosure of climate risks and stranded assets; and green conditions for reinvestment of profits into renewables.

2. Oil and gas firms view transition plans as core to long-term survival, but approaches vary considerably.

2.1. While skeptics view oil and gas net zero targets as nothing more than window dressing, firms themselves undertake climate strategies for reasons of self-preservation and protecting the bottom line:

2.1.1. *Comparative advantage*. Oil and gas firms are particularly well-suited to take on investments that can be seen as core to their primary skill sets.[7] These include offshore wind, deep geothermal, biofuels, financial services, and

[5] *European Union text proposal for the modernisation of the Energy Charter Treaty*, sent to the ECT Secretariat on 19 May 2020. See also Lukas Schaugg and Greg Muttitt, 2022, *How the Energy Charter Treaty risks undermining the outcomes of COP 26*, IISD briefing.

[6] Compared to coal producers, oil and gas producers make up two-thirds of the "major emitters"—a list of 90 producers which recent analysis suggests make up 63% of the global carbon dioxide and methane emitted since the industrial revolution. See Richard Heede, 2014, "Tracing anthropogenic carbon dioxide and methane emissions to fossil fuel and cement producers, 1854–2010," *Climatic Change*.

[7] Jessica Green, Jennifer Hadden, Thomas Hale, and Paasha Mahdavi, 2022, "Transition, Hedge, or Resist? Understanding Political and Economic Behavior toward Decarbonization in the Oil and Gas Industry." *Review of International Political Economy*.

carbon capture and storage. For example, two oil majors led the pack in the record $4.37 billion auction for offshore wind development rights in the Mid-Atlantic United States.[8] Companies like TotalEnergies see outsized gains in deepwater offshore wind development—which rely on platform technologies and engineering solutions pioneered by European oil and gas firms—and perceive their comparative advantage strong enough to be among "the world's top 5 renewable energy companies."[9]

2.1.2. *Capturing carbon credits*. Firms see a financial opportunity to dominate CDR given decades of experience in enhanced oil recovery techniques that have paved the way for current approaches to carbon sequestration. Among the largest known carbon storage assets are formations of depleted oil reservoirs, estimated to hold hundreds of billions of tons of carbon dioxide.[10] Firms like ExxonMobil and Occidental pursue carbon capture and sequestration at the source of emissions as well as direct air capture (DAC), which takes diffuse carbon dioxide and stores it in underground reservoirs. While investment in these technologies is ultimately directed at prolonging existing oil and gas production assets, the financial model also relies on government subsidies and tax credits for carbon sequestration such as the United States' Section 45Q payments or the European Commission's proposed Sustainable Carbon Cycles regulatory framework.[11]

2.1.3. *Shareholder pressure*. Oil and gas firms have also pursued climate transition strategies in direct response to shareholder and activist pressure.[12] In recent years, climate activists and green investors scored numerous high-profile victories, including a Dutch court ordering Shell to reduce its carbon emissions by 45% by 2030 and an activist hedge fund winning three board seats at ExxonMobil.[13] These victories have pushed firms to be more active in creating value from the energy transition, with some investors rewarding firms that adopt more aggressive climate-forward strategies.[14] It remains to be seen whether this pressure will persist in a high-oil-price market to convert excess profits into renewable investments or instead to justify staying the course in upstream oil and gas.[15]

[8] Amanda Battersby, "Shell and TotalEnergies among the winners in watershed US offshore wind lease sale," *Upstream Energy Explored*, 22 February 2022.
[9] TotalEnergies, "TotalEnergies Increases Offshore Wind Investments" 14 June 2021.
[10] David Blackmon, "How Oxy's New Carbon Venture Could Become A True Game-Changer," *Forbes*, 11 April 2021.
[11] European Commission, "Sustainable carbon cycles."
[12] Joyeeta Gupta, Arthur Rempel and Hebe Verrest, 2020, "Access and Allocation: The Role of Large Shareholders and Investors in Leaving Fossil Fuels Underground," *International Environmental Agreements*; Naghmeh Nasiritousi, 2017, "Fossil fuel emitters and climate change: unpacking the governance activities of large oil and gas companies." *Environmental Politics*.
[13] Across 1993-2019, 43% of shareholder resolutions related to climate change were tabled in the last 5 years. See Green et al. *supra* 9.
[14] Tom Wilson, "Oil majors under pressure as activists circle," *Financial Times*, 19 December 2021.
[15] Axel Dalman, Mike Coffin, and Mark Fulton, 2022, *Managing Peak Oil: Why rising oil prices could create a stranded asset trap as the energy transition accelerates*, Carbon Tracker.

2.1.4. *Leadership gains*. Voluntary action by oil and gas firms in the form of net zero targets—alongside select disclosure of emissions—could lead to investments in technologies that allow the industry to set the narrative for decarbonization. The voluntary Oil and Gas Climate Initiative, for example, aims to "progress to net zero emissions in the second half of this century" by investing research and development funds in CDR. Scholars view such structural changes as an indicator for greater leadership in climate governance and enhance firms' capacity to undertake meaningful action in the future.[16]

2.1.5. *Sidelining coal*. Pro-climate action by oil and gas firms can also be a tool in gaining market share in a carbon-constrained world relative to coal. Oil majors have backed carbon pricing to maintain a seat at the table to more readily influence outcomes and, perhaps more importantly, to ensure the continued competitiveness of gas relative to coal. As one study notes, carbon pricing "supports the realization of a 'gray' transition toward a lower-carbon future, in which Big Gas can expand its market shares at the expense of coal and become a major bridge fuel next to renewables."[17]

2.2. But there is little uniformity across the sector in pursuing these climate strategies.[18] Many are investing heavily in CDR to maintain the continued extraction of petroleum. Others are shifting investments from oil to gas given its perceived lower emissions footprint. Even the "greenest" of firms are not fully transitioning, but rather are hedging their bets as a means to mitigate risk through diversification rather than moving toward wholesale decarbonization.[19]

2.3. For example, Equinor leads the oil majors in renewable and low-carbon investments as well as reducing the carbon intensity of its operations.[20] The company vies to hit a clean energy target of 50% gross annual capex by 2030, yet in 2020 renewables amounted to only 4% of gross capex, with the remainder targeted towards oil, gas, and petrochemicals.[21] Equinor calls this a "disciplined capital allocation" strategy for the future: stable investments in petroleum combined with high-value growth in renewables, all with the "flexibility to optimize the project portfolio."[22]

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[16] Matthew Bach, 2019, "The oil and gas sector: from climate laggard to climate leader?" *Environmental Politics*; Aseem Prakash, 2000, *Greening the Firm: The Politics of Corporate Environmentalism*, Cambridge University Press.
[17] Vormedal, Irja, Lars H. Gulbrandsen, and Jon Birger Skjærseth. 2020. "Big Oil and Climate Regulation: Business as Usual or a Changing Business?" *Global Environmental Politics*, p.144.
[18] Simon Dietz, Dan Gardiner, Valentin Jahn and Jolien Noels, 2020, *Carbon Performance of European Integrated Oil and Gas Companies*, Transition Pathway Initiative; Ben Caldecott, Ingrid Holmes, Dileimy Orozco, Shane Tomlinson and Lucas Kruitwagen, 2018, *Crude Awakening: Making Oil Major Business Models Climate-Compatible*, E3G Report. See also InfluenceMap, 2019, *Big Oil's Real Agenda on Climate Change*.
[19] Green et al. *supra* 9.
[20] This assessment is based on the top 10 oil majors by market capitalization across 2004-2019: BP, Chevron, ConocoPhillips, ENI, Equinor, ExxonMobil, Occidental, Repsol, Shell, and TotalEnergies. See Green et al. *supra* 9.
[21] Equinor, "Presenting strategy to accelerate Equinor's transition," 15 June 2021.
[22] Equinor, *Capital Markets Update 2022*.

2.4. This underlines a key problem facing both the industry and its investors: how credible are net zero and other climate targets when even the greenest oil major is far behind on hitting even relatively modest milestones?

3. Existing standards make it difficult to assess the credibility of net zero and ESG targets.

3.1. What counts as ESG in the oil and gas sector? Scholars and practitioners alike have struggled to find consistent ratings guidelines that can answer this question across a variety of firms in different contexts.[23] Indeed, there is minimal overlap in ESG measures across major ratings agencies and between ESG ratings and management of greenhouse gas emissions or climate risk management.[24]

3.2. Despite little uniformity in how investors can assess the credibility of transition plans—and ESG in general—there is growing consensus on minimal criteria that can be applied to make this assessment. The academic literature on oil and gas transition plans[25] identifies four key areas:

3.2.1. Do renewables investments constitute an increasing and meaningful percentage of capital expenditures?

3.2.2. Is there a timeline to ramp down fossil fuel production?

3.2.3. Does the firm disclose detailed information on its carbon, methane, and other greenhouse gas emissions?

3.2.4. What are the firm's plans in reducing operational emissions? Is it investing in methane monitoring, remediating abandoned wells, capturing and sequestering carbon, or is it switching away from hydrocarbons entirely?

3.3. Criteria 3.2.1, 3.2.2, and 3.2.4 are all readily disclosed by firms in annual reports, investment calls, press releases, and other public-facing documents. By contrast, reporting on criterion 3.2.3 has remained elusive. There is a lack of consistency in standards over how firms estimate their emissions, broken down into the three conventional categories of emissions from company operations (scope 1); indirect sources, such as purchased electricity (scope 2); and consumption (scope 3).

[23] Sebastian Meyer and Karim Hende, 2021, "Searching for 'Greenium'," IHSMarkit; Julian F. Kölbel et al., "Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact," *Organization & Environment.*

[24] See, e.g., R. Boffo, C. Marshall, and R. Patalano, 2020, "ESG Investing: Environmental Pillar Scoring and Reporting," OECD Paris; Florian Berg, Julian F. Koelbel, Anna Pavlova, and Roberto Rigobon, "ESG Confusion and Stock Returns: Tackling the Problem of Noise."

[25] Green et al. *supra* 9; Vormedal et al. *supra* 19; Dietz et al. *supra* 20.

4. **Proposed changes to disclosure rules will strengthen oil and gas climate commitments.**

4.1. This lack of consistency in standards has led to increased efforts by governments to mandate disclosure of certain ESG targets for publicly-listed firms.[26] For the fossil fuel sector, the most important of these are emissions reporting and climate risk assessments.

4.2. The US SEC has recently proposed both: requirements to disclose climate risks and consistent standards for reporting emissions by all listed firms, including scope 1 and 2 emissions with lighter requirements for reporting scope 3 emissions.[27] The UK and the European Commission have adopted or proposed similar standards, in line with Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.[28]

4.3. These proposed regulations would get at the crux of the net zero dilemma. At present, companies can unveil ambitious plans to drastically cut their emissions footprints decades from now. But share prices in the distant future are the only accountability firms currently face. Existing laws, such as the US Exchange Act of 1934, deem net zero plans as "forward looking statements" that are not bound by the same strict reporting standards as cost and revenue disclosures.[29] By contrast, newly proposed rules aim to regulate any firm's net zero plan as "a material statement about the future of its business" akin to disclosure of profits and losses.[30]

4.4. Proposed net zero targets paired with emissions disclosures in the oil and gas sector have in part been motivated in anticipation of such regulations.[31] However, voluntary disclosures are lacking in detail about scope 3 emissions and climate-vulnerable assets, posing a "hidden risk" for investors.[32] This again points to the need for a holistic approach to ensure full disclosure of the sector's climate risks.

5. **Incorporating climate provisions in the investment treaty regime will accelerate oil and gas transition plans.**

5.1. Investment treaties have the potential to play a significant role in motivating and bolstering confidence in climate targets by fossil fuel firms. It is clear in general that there are considerable linkages between the investment treaty regime and climate

[26] "US climate rules are good for business," *Financial Times*, 23 March 2022.
[27] US Securities and Exchange Commission, "Enhancement and Standardization of Climate-Related Disclosures."
[28] See "UK to enshrine mandatory climate disclosures for largest companies in law," 29 October 2021; European Commission, *Proposal for a Corporate Sustainability Reporting Directive (CSRD)*, 21 April 2021.
[29] Pub. L. 73-291, Sec. 18 (a) and Sec. 21 (e). See also Paasha Mahdavi, Jessica Green, Jennifer Hadden, and Thomas Hale, 2022, "Using Earnings Calls to Understand the Political Behavior of Major Polluters," *Global Environmental Politics.*
[30] Robinson Meyer, "American Companies Can't Sugarcoat Their Carbon Pollution Anymore," *The Atlantic*, 23 March 2022.
[31] Simon Dietz, Dan Gardiner, Valentin Jahn, and Jolien Noels, 2021, "How ambitious are oil and gas companies' climate goals?" Science. See also Green et al. *supra* 9.
[32] Alexandra Thornton, 2021, "Why Companies Should Be Required To Disclose Their Scope 3 Emissions," Center for American Progress.

change.[33] The above discussion suggests three specific proposals that will strengthen these linkages in the context of oil and gas company net zero and other climate strategies:

5.1.1. ***Transparency in emissions reporting***. Just as the OECD has proposed transparency in investor claim resolution,[34] investment treaties should adopt high standards for the reporting of detailed data on emissions resulting from investments in the fossil fuel sector. This includes not only operational (scope 1) and indirect (scope 2) emissions but also consumption-based (scope 3) emissions as well, in line with recent proposals by the SEC, the European Commission CSRD, and the broader objectives of the TCFD.

5.1.2. ***Disclosure of climate risks in oil and gas investments***. Oil and gas firms have historically internalized risk assessments of climate-vulnerable assets, such as the exposure of refineries to sea level rise and increased storm intensity.[35] Yet few report these data to their investors, let alone to the broader public. Exposure to these potentially stranded assets in the fossil fuel sector is estimated at roughly $250 billion.[36] Investment treaties should adopt disclosure standards for climate risk to publicize parties' exposure to stranded assets and climate-vulnerable investments.

5.1.3. ***Green conditions for reinvestment into renewables***. Much like financing incentives for investors to support coal ramp-down in the Global South,[37] investment treaties should adopt provisions to incentivize oil and gas firms and their financiers to reinvest profits into renewable and low-carbon solutions. This could include tax credits, fee exemptions, or low-interest loans and grants. Such provisions could further provide a market-based motivation for oil and gas firms to increase the overall share of renewables in forward capital expenditures.

5.2. By targeting disclosure standards and incentives for clean energy reinvestments, the future of the investment treaty regime holds great promise for further advancing green transitions within the oil and gas sector.

[33] Lauge Poulsen, 2021, "The Investment Treaty Regime," in *The Oxford Handbook of International Political Economy*; David Gaukrodger, "The future of investment treaties—possible directions," OECD Working Papers on International Investment 2021/03.
[34] Angel Gurría, "The growing pains of investment treaties," OECD Insights Blog, 13 October 2014.
[35] Christina Carlson, Gretchen Goldman, and Kristina Dahl, 2015, *Stormy Seas, Rising Risks: What Investors Should Know About Climate Change Impacts at Oil Refineries*, Union of Concerned Scientists.
[36] Carbon Disclosure Project, *World's biggest companies face $1 trillion in climate change risks*, 4 June 2019.
[37] Rocky Mountain Institute, Carbon Tracker, and Sierra Club, 2020, *How to retire early making accelerated coal phaseout feasible and just*.

Investment Agreements and Climate Change: Lessons from International Trade

Prepared for the OECD Public Consultation on Investment Treaties and Climate Change

Timothy Meyer
Professor of Law & Director, International Legal Studies
Vanderbilt University Law School
tim.meyer@vanderbilt.edu

This contribution to the OECD's public consultation on investment treaties and climate change highlights two lessons from the global trading system in considering the relationship between investment treaties and climate change. First, the enforcement of international economic law rules has often favored fossil fuels over renewable energy, operating as an implicit subsidy for fossil fuel production. Reforming investment treaties to limit claims by the renewable energy sector without reforming treaties used by the fossil fuel sector risks worsening this problem. Second, in a bid to expand the amount of policy space states enjoy, states have begun to include in investment treaties general exceptions clauses modeled on a similar clause in the General Agreement on Tariffs and Trade (GATT). Unfortunately, early decisions on the interpretation of these provisions suggest that investment tribunals are taking an even narrower view of these provisions than trade panels, a result that is unjustifiable as a matter of treaty interpretation and threatens the long-term stability of the investment system as a whole.

I. Selective Enforcement as an Implicit Subsidy

International trade agreements, like international investment agreements, contain rules that protect economic activity from certain kinds of government action, such as discriminatory government policies.[1] As a legal matter, these rules apply broadly to most kinds of economic activity. The GATT, for instance, covers any product not excluded, while investment treaties tend to take a very broad approach to what counts as a covered investment.

In practice, though, international trade rules have been selectively enforced against policies that benefit environmentally-friendly products, while similar or identical policies that benefit environmentally harmful products have escaped enforcement.[2] As a result, the enforcement of international trade rules has operated as an implicit subsidy for environmentally harmful products that compete with environmentally-friendlier substitutes. Subsidies reduce the cost of the subsidized product. Enforcement challenges to subsidy policies can increase the cost of the subsidized product by causing countries to reduce subsidies or chilling the government decision to subsidize a product in the first place. When two products compete in the marketplace, selective enforcement acts as an implicit subsidy. It increases the cost of subsidizing the product subject to enforcement, while allowing subsidization of the unchallenged product to

[1] *See, e.g.*, 2012 U.S. Model Bilateral Investment Treaty arts. 3 & 4; Comprehensive Economic and Trade Agreement, arts 2.3, 8.6, & 8.7; GATT arts. I & III.
[2] *See* Timothy Meyer, *Free Trade, Fair Trade, and Selective Enforcement*, 118 COLUMBIA LAW REVIEW 491-566 (2018).

continue. These effects, in turn, decrease the relative cost of the product not subject to enforcement.[3]

A. Selective Enforcement of International Trade Rules

This harmful pattern of selective enforcement in trade law is especially clear when potentially environmentally friendly substitutes for natural resources try to enter markets in which the incumbent industry is dominated by natural resource consuming businesses. Consider two sectors. First, international trade rules have been enforced disproportionately against subsidies for renewable energy while similar subsidies for fossil fuel production have gone unchallenged. My 2018 study found that between 2008 and 2018 governments initiated 25 challenges to renewable energy subsidies, either directly before the World Trade Organization or pursuant to domestic antidumping and countervailing duty laws (actions pursuant to such laws are governed by WTO rules and reviewable by a WTO dispute panel).[4] By contrast, no government has ever brought a direct enforcement action challenging another's support for fossil fuels and its effects on pricing.[5] This pattern exists despite significantly higher subsidies for fossil fuels.[6]

This discrepancy is not a result of a difference in the kinds of subsidies each kind of energy receives. Many of the challenged renewable energy subsidies are tied to local content requirements, making them discriminatory in violation of WTO rules. Yet local content requirements are prevalent in the fossil fuel sector as well.[7] Differences in the design of subsidies thus cannot explain the stark difference in enforcement patterns.

Second, states have targeted government support for aquaculture—fish farming—through antidumping and countervailing duties. Since 1990, there have been at least 16 such challenges.[8] Although aquaculture can result in the loss of habitat, improvements in aquaculture practices are essential to supply the world with a sustainable supply of fish ([the most widely traded food by value]). Targeting subsidies that might improve aquaculture thus risks undermining efforts to secure an environmentally responsible and sustainable food supply chain.

At the same time, governments have continued to provide significant subsidies for wild fishing. Subsidies for fishing fleets lead both to the depletion of global fish stocks via unsustainable levels of wild fishing, as well as significant fossil fuel consumption from the fishing vessels themselves. Governments have never lodged a single trade law challenge to subsidies for wild

[3] *See generally id.*
[4] *Id*. at 506-08.
[5] *Id.*
[6] *Id*. at 506. In 2014, for example, fossil fuels received $914 billion in subsidies globally, while renewable energy received $134 billion.
[7] *See* LOCAL CONTENT AND SUSTAINABLE DEVELOPMENT IN GLOBAL ENERGY MARKETS (2021, Cambridge University Press, Damilola S. Olawuyi, ed.); Silvana Tordo, Michael Warner, Osmel E. Manzano & Yahya Anouti, *World Bank, Local Content Policies in the Oil and Gas Sector* xiii, 93–155 (2013).
[8] Meyer, *supra* note 2, at 518-521.

fishing,[9] and although they have long been the subject of negotiations at the WTO, an agreement has remained out of reach despite years of effort. As in the energy context, the result is that state enforcement policies multiple the effect of what is already a disparate level of government support for environmentally-harmful practices.

Although the causes of selective enforcement vary from product to product, in part selective enforcement reflects the use of legal tools to challenge new market entrants.[10] Distortions caused by long-standing subsidies have already been factored into market relationships and prices. New subsidies for new competitors, though, disrupt existing market relationships and pricing patterns, prompting challenges. This cause of selective enforcement is particularly troubling in the climate change context specifically and the environmental context more generally. Addressing climate change (and many environmental problems) requires innovation that leads to new, environmentally beneficial products that can replace environmentally-harmful incumbents. Because enforcement patterns are likely to selectively focus on new market entrants, enforcement patterns are likely to target the very products that are necessary to combat climate change, thus further fortifying the market position of incumbent (fossil fuel) industries.

B. Selective Enforcement in Investment Law

Selective enforcement in investment law is both a historic reality and a present challenge to addressing climate change. Historically, the extractive sector has been one of the, if not the single biggest, user and beneficiary of international investment law. The extractive sector is among the most exposed to the risks against which investment law is designed to protect. The sector requires large fixed investments that cannot be easily relocated once made. Such investments therefore present a ripe target for discriminatory or expropriatory government measures. By giving investors the ability to recover damages for such actions, investment law operates in practice as a subsidy for the extractive sector.[11] Investment law shifts some of the risk investors face from changes in government policies from the investor to the government.

More recently, investors in the renewable energy sector have invoked investment treaty protections to challenge changes in government policies that support renewable energy. Under the Energy Charter Treaty (ECT) in particular, investors have challenged the withdrawal of state support for the renewable energy sector, with renewable energy cases comprising

[9] *Id*.; Subsidies and Trade Distortion, UN Food & Agric. Org., http://www.fao.org/ fishery/topic/12358/en [http://perma.cc/48QK-T2JP].

[10] *See* Timothy Meyer, *Explaining Energy Disputes at the World Trade Organization*, 17 INTERNATIONAL ENVIRONMENTAL AGREEMENTS: POLITICS, LAW, ECONOMICS 391-410 (2017)L; BOWN C. P., & REYNOLDS, K. M., *Trade flows and trade disputes. World Bank Research Group*, POLICY RESEARCH WORKING PAPER 6979 (2014 WORLD BANK).

[11] *See* Editorial Board, *A Nafta Poison Pill*, WALL STREET JOURNAL (April 9, 2018) (quoting U.S. Trade Representative Robert Lighthizer as describing investor-state dispute settlement as a subsidy for investing overseas).

approximately 60% of the cases brought under the ECT.[12] More recently, ECT members have begun debating reforms to the treaty to curtail challenges. Although these proposed reforms are sometimes justified on the grounds that the ECT protects fossil fuel investments, the European-focused membership of the ECT and the fact that a majority of cases have involved renewable energy—not fossil fuels—suggests that such reforms could actually help the fossil fuel sector globally by removing protections relied on primarily by the renewables sector. Indeed, states have reformed other treaties, such as USMCA, to eliminate investor-state dispute settlement entirely *except* for the extractive sector.

The explanation for these changes is likely that support programs for renewable energy tend to be offered by countries that have traditionally been capital exporting countries and thus are unaccustomed to being respondents in investment disputes. Renewable energy technologies, though, may be owned by foreign investors in traditional capital-exporting countries, increasing those states' potential liability for investment law claims. By contrast, protections for fossil fuel exporters tend to favor these same countries' outbound investments. From a political economy point of view, it thus makes sense for traditional capital exporting countries to curtail claims against renewable energy support programs while preserving claims in the extractive sector.

Unfortunately, this dichotomy makes little sense environmentally and risks undermining the legitimacy of the investment treaty regime as a whole. As in the trade context, these reforms risk putting climate-friendly government policies at a disadvantage within the investment regime as compared to government policies that chill investment in the environmentally-harmful fossil fuel sector. The posture of these cases is, to be sure, different from the trade context. In investment law, enforcement protects industry from harmful government policies, while in trade enforcement challenges government support for industry. Where energy-related industries are concerned, though, the practical effect is the same. The fossil fuel sector obtains an advantage from enforcement patterns that reduce its costs and thus the price of fossil fuels, while the renewable energy sector does not benefit from the same enforcement patterns, raising its relative costs.

To be clear, this critique is not about the appropriate scope of investment law protections, nor a criticism of the outcome in any particular case. Rather, my point is about the market implications of selective enforcement patterns. Because energy markets are global and different energy sources compete with each other in a transition to cleaner energy sources, policies in individual countries can have global effects on relative prices and thus on the speed of the transition to green energy. Protecting the fossil fuel sector's investments in some countries while denying protection to the renewable energy sector's investments in other countries has global consequences for the development and deployment of renewable energy technologies. These market consequences are real even if the individual legal outcomes

[12] *Even more renewable energy investors rely on treaty protection: updated statistics of investment arbitration cases under the Energy Charter Treaty* (Oct. 12, 2020), https://www.energycharter.org/media/news/article/even-more-renewable-energy-investors-rely-on-treaty-protection-updated-statistics-of-investment-arb/

(protection for fossil fuel investments and limited or no protection for renewable energy investments) are justified under the texts of the applicable investment agreements.

Multiple solutions are available to this problem. One is a monitoring initiative, in which the OECD tracks investment cases that apply to energy specifically (or environmental goods in general) and assesses the impact of those cases on prices. Making the results of such monitoring public could spur further debate on reform. Second, when reforming investment treaties states should avoid carving out protections for the fossil fuel sector (as was done in USMCA) without ensuring that renewable energy policies are subject to the same protections. Finally, states should consider paring any reduction in the protection the renewable energy sector enjoys under investment treaties with greater protection for states to pursue renewable energy support programs. This last reform might be accomplished via general exceptions to investment treaties for environmental policies, provided that those general exceptions are interpretated appropriately broadly, a problem to which I now turn.

II. Interpreting General Exceptions

A second lesson for the investment law system from the trade system is that general exceptions to investment treaty obligations should be given an appropriately broad scope. Giving these exceptions their intended scope is critical to ensuring that states have the ability to pursue measures intended to address the climate change crisis.

A. General Exceptions at the WTO

The classic example of a general exceptions clause is GATT art. XX, which provides a list of substantive exceptions, including measures relating to the conservation of exhaustible natural resources and measures necessary for the protection of human, animal, or plant life or health. Since the WTO Dispute Settlement Body's creation in 1995, WTO panels have developed a three-pronged approach to applying the general exceptions. First, panels assess whether the challenged measure pursues a legitimate objective (e.g., the conservation of exhaustible natural resources). This level of review is highly deferential to the state asserting the exception.

Second, panels assess whether the measure is necessary to the pursuit of that objective. This analysis has not always been clearly applied, but generally involves the party asserting the exception making a prima facie showing that the measure's contribution to the objective outweighs its trade restrictiveness, in light of the importance of the value at stake.[13] If the prima facie showing is successful, the party opposing the exception then must show that there are reasonably available, less trade restrictive alternatives that make an equivalent contribution

[13] *See, e.g.*, Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R para. 156.

to the objective.[14] Over the years, WTO panels have more often than not found in favor of the state invoking the exception on this portion of the test.

Third, even if the measure is "provisionally justified" under an enumerated exception, the measure must still survive the chapeau of the general exceptions clause, which requires that the measure not arbitrarily or unjustifiably discriminate between countries where the same conditions prevail or constitute a disguised restriction on trade. Here, WTO panels have generally found fault with challenged measures on the grounds that they do discriminate. Significantly, in the WTO system, the remedy is that the respondent must bring the measure into conformity. In practice, this often involves amending the measure to remove the discrimination and/or negotiating with the complainant to reach an agreed resolution.[15]

WTO panels' application of general exceptions has been subject to extensive criticism over the years. I highlight one particular criticism. General exceptions operate as a defense. By the time they are invoked, the invoking state has already been found to have violated the GATT, often by discriminating. Because the exceptions are a defense to discrimination, and because the chapeau is only applied after a measure has already been found "necessary" to a legitimate objective, only particularly egregious discrimination—only if the panel concludes that discrimination constitutes the primary motive behind the measure—should result in a denial of the exception.[16]

B. Applying General Exceptions in Investment Agreements

Investment tribunals are, of course, not bound by WTO panels' interpretation of the general exception clause. International law lacks a system of binding precedent. Nevertheless, under the rules of treaty interpretation, WTO panels' interpretations of similar or identical language are relevant, either as "relevant rules of international law applicable in the relations between the parties" under Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT) or as supplementary means of interpretation under article 32 of the VCLT. In short, the fact that countries often draft general exceptions clauses in investment treaties that mirror GATT article XX in the included provisions strongly suggests that states intend the interpretation of GATT article XX to inform the interpretation of general exceptions clauses in investment agreements, even if the provisions must be adapted to the investment context.[17]

[14] *Id*. For the conservation of natural resources, the exception requires only that measure be "related to" the objective, meaning that it bears a rational relationship. Investment treaties, however, often use the "necessary" language even as applied to the conservation of natural resources.
[15] *See, e.g.*, Appellate Body Report, *United States – Import Prohibition on Certain Shrimp and Shrimp Products*, *Recourse to Article 21.5 of the DSU by Malaysia,* WT/DS58/AB/R/BW.
[16] Timothy Meyer, *The Political Economy of WTO Exceptions*, 99 Washington University Law Review (2022).
[17] *See, e.g.*, Non-Disputing Party Submission of Canada, *Eco Oro Minerals Corp. v. Repbulic of Colombia,* ICSID Case No. Arb/16/41, paras. 12-16 & n. 17 (Feb. 27, 2020) (citing WTO cases as relevant to the interpretation of a general exceptions clause applicable to investment in the Canada-Colombia Free Trade Agreement).

In practice, this would mean that in general investment tribunals should mirror the deference WTO panels have shown to respondent states invoking an exception in evaluating whether a measure is necessary to a legitimate objective. Tribunals should ask whether the challenged measure is "necessary to" a legitimate objective under the treaty, meaning that the measure's contribution to the objective outweighs its restrictiveness on investment, in light of the importance of the value at stake.

Assuming the measure is provisionally justified in this way, a panel must then evaluate whether the measure constitutes arbitrary or unjustifiable discrimination between investments or investors, or a disguised restriction on investment (as the provision is usually reframed in the investment context). The application of the chapeau should be significantly more deferential in investment treaties, as compared to the WTO, for three reasons.

First, as noted above, WTO panels have erred in interpreting the chapeau as restrictively as they have. Understood in lights of its context and object and purpose, the chapeau of the general exceptions clause should only prevent measures primarily motivated by discrimination. Investment tribunals should not make the same mistake.

Second, while discrimination is the violation in many trade cases, many investment cases have relatively little to do with discrimination. Fair and equitable treatment claims or expropriation claims, for instance, might not involve any discrimination. Where discrimination is absent (and barring a finding that a measure constitutes a disguised restriction, a less frequently relied upon provision in the trade context), the chapeau should pose no bar to the successful invocation of the exception.

Third, the system of remedies in investment treaties is different from the trade context. As noted above, when a WTO panel denies an exception's application under the chapeau, it typically does so by identifying discriminatory aspects. Because WTO remedies apply only prospectively, if those aspects are removed via amendment or agreement with the complainant, the exception applies and the respondent state's violation is excused. In investment law, by contrast, the complainant is entitled to retrospective damages if a panel denies the exception's application. There is no opportunity to amend the offending measure.

This difference—between a prospective opportunity to amend versus an immediately effective award of retrospective damages—is significant in the context of the chapeau's language as between investment and trade tribunals. It suggests that investment tribunals should be especially deferential in applying the chapeau of a general exceptions clause after concluding that a measure is necessary to a legitimate objective. Even if a tribunal concludes that WTO panels have been appropriately probing in applying the chapeau, investment tribunals should still give states a wider margin of appreciation.

Unfortunately, early interpretations of investment agreements' general exceptions clauses have ignored this basic context in interpreting general exceptions clauses. In *Eco Oro Minerals Corp. v. Republic of Colombia*, the panel declined to engage in the analysis directed by the text of the general exceptions clause and analyzed by multiple WTO panels. Instead, the panel concluded that the general exceptions would excuse a violation of the Canada-Colombia FTA but would not excuse the obligation to pay compensation.[18] The panel also concluded that the state-parties could not have intended that all measures that fit the requirements of the general exceptions clause would be free from liability.[19]

OECD members should act swiftly to correct this erroneous interpretation and ensure that it plays no part in the future interpretation of general exceptions clauses.[20] The correct application of such provisions is necessary to ensure that states have the flexibility necessary to address major public policy problems, especially climate change.[21] Defenses like the general exceptions make no sense if they do free respondents from the primary remedy that would otherwise apply—in investment, the obligation to pay compensation. The practice of including general exceptions is on the rise, and members of investment tribunals must pay careful attention to the history and context of such provisions in interpreting them.

[18] ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability, and Directions on Quantum, para. 830 (Sept. 9, 2021).
[19] Para. 831.
[20] States have taken such corrective action before. *See* NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001).
[21] My critique is aimed at the tribunal's analysis in *Eco Oro*. I take no position on whether the outcome in *Eco Oro* is correct. Since the tribunal did not analyze the exception's applicability according to its terms, it is difficult to say whether Colombia was entitled to prevail on its invocation of the exception.

OECD

Public consultation on investment treaties and climate change

Alessandro Monti[1] and Linnéa Nordlander[2]

We would like to congratulate the OECD Investment Committee on launching this public consultation. We are pleased to share our reflections on how investment treaties can be improved, in order to ensure better consistency with climate policies.

We are two postdoctoral researchers at the Faculty of Law at the University of Copenhagen, researching the role of international investment law and human rights in enhancing climate action. In our work, we explore the role of human rights as a tool to foster the integration of climate considerations in investment treaties and investment arbitration. Responding to this public consultation, we would like to share our proposals to support the important work carried out by the OECD Investment Committee on the future of investment treaties.

As a starting point, we would like to note that international investment treaties, while often considered an obstacle to climate action,[3] can also be a powerful enabler for the achievement of international climate goals. Article 2(1)(c) of the Paris Agreement requires that finance flows be consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. By providing for regulatory stability and predictability, international investment law can support the achievement of this goal, and foster the allocation of capitals by private investors towards climate-friendly projects. In this connection, the potential of investment law is well exemplified by the numerous claims brought under the Energy Charter Treaty by investors in renewable energy, in response to retroactive policy changes in renewable energy support schemes.[4]

At the same time, in their current form international investment treaties are not well equipped to respond to the need for decarbonization, which is largely due to the lack of distinction between the protection of carbon-intensive and climate-friendly investments. Therefore, investment agreements can be invoked also by companies aiming to defend their investments in carbon-intensive sectors, which may be negatively affected by climate policies.[5] This is

[1] Postdoctoral Researcher, University of Copenhagen, Faculty of Law.
[2] Postdoctoral Researcher, University of Copenhagen, Faculty of Law.
[3] See, for instance, Kyla Tienhaara, 'Does the Green Economy Need Investor-State Dispute Settlement?' in Kate Miles, *Research Handbook on Environment and Investment Law* (Edward Elgar Publishing 2019).
[4] See, among many others, *The PV Investors v. Spain,* PCA Case No. 2012-14; *Eskosol v. Italy,* ICSID Case No. ARB/15/50.
[5] This lack of differentiation between sustainable and unsustainable investments has been addressed by the proponents of a 'Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation'. See Martin Dietrich Brauch and others, 'Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation: Aligning International Investment Law with the Urgent Need for Climate Change Action' [2019] Journal of International Arbitration 7.

demonstrated by the recent claims brought by investors Uniper and RWE against The Netherlands, in response to the adoption of a national coal phase-out policy.[6]

In order to address these challenges, it is essential to increase the role of public participation in investor-State dispute settlement, to expand regulatory space for climate measures, and to enable counterclaims by host States against investors based on climate change obligations. With regard to all the three areas, human rights law can serve as an important tool to contribute to the greening of investment treaties

Public participation

First, better alignment between climate goals and investment treaties can be achieved by strengthening the possibility for public participation in investor-State disputes, especially in the form of amicus curiae briefs. This concern should be taken into particular consideration in the context of the ongoing negotiations for Investor-State Dispute Settlement Reform, within UNCITRAL Working Group III. In this connection, it is useful to take note of examples arising from human rights-based climate litigation. Amicus curiae briefs submitted by interest groups and experts are frequently admitted in such claims. Examples can be found in several jurisdictions, such as in *Duarte Agostinho and others v Portugal and others*,[7] currently pending before the European Court of Human Rights, as well as in *Future Generations v Ministry of the Environment and Others*, decided by the Supreme Court of Colombia.[8] Amicus curiae briefs can be crucial in providing scientific evidence regarding the link between a state's GHG emissions and the impacts of climate change, the understanding of which non-specialised judges and adjudicators may otherwise lack. By contrast, the admissibility of amicus curiae briefs is much more challenging in international investment disputes. For instance, in the recent case *Odyssey Marine Exploration v Mexico*, an amicus curiae brief submitted by the Center for International Environmental law (CIEL) has been declared inadmissible by the tribunal.[9] The introduction of amicus curiae briefs can be particularly important in disputes concerning climate change, given the need to ensure that adjudicators develop a sound understanding of climate science. In a matter like climate change, where science is fundamental to the adoption of appropriate policy responses, an understanding by investment adjudicators of the relevant scientific background can ultimately lead to more climate-friendly outcomes. Therefore, in order to enhance consistency with climate goals, facilitating amicus curiae interventions in investment disputes should be a priority in the ongoing efforts to reform investor-State dispute settlement.

[6] See, respectively, *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22; R*WE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4.
[7] *Duarte Agostinho and others v Portugal and others*, European Court of Human Rights, ECHR Application No. 39371/20.
[8] *Future Generations v. Ministry of the Environment and Others,* Supreme Court of Colombia, Case n. STC4360-2018.
[9] *Odyssey Marine Exploration v Mexico*, ICSID Case No. UNCT/20/1.

Expanding regulatory space for climate policies

Over the last two decades, provisions ensuring regulatory space for environmental measures have found their way into more investment treaties. Although in several treaties references to the environment are not legally binding,[10] a number of agreements also contain substantive provisions that explicitly make room for a right to regulate to protect the environment. For example, Article 2.2. of the 2019 Dutch Model BIT provides that 'The provisions of this Agreement shall not affect the right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives such as the protection of public health, safety, environment […]'.[11] Yet, even in such cases, it is difficult for a State to justify normative measures adopted on climate grounds when they impact foreign investments. This is largely due to the fact that the Paris Agreement does not impose climate change mitigation targets for specific countries or specific sectors, despite the binding 2°C (aiming at 1.5°C) temperature goal.[12]

Hence, claims like those brought by the investors Uniper and RWE raise the important question of how States can justify the measures that they take as part of their coal phase-out policy. This question is independent of whether the agreement under which the disputes are raised, in those two cases the Energy Charter Treaty, confers the right to regulate for environmental purposes on states. In fact, analogous challenges would arise if claims were raised under an agreement explicitly providing for a similar right, such as the Dutch Model BIT under its Article 2.2. This is because of the lack of sufficiently precise obligations in international climate agreements, which undermines the possibility for host States to argue that a specific climate measure, which may impinges upon investors' rights, is required for compliance with international obligations.

Conversely, more specific obligations for climate change mitigation can be constructed on the basis of international human rights law. While the core international human rights treaties do not contain any provisions explicitly on climate change, human rights law has been undergoing a greening over the last two decades. As such, it is now well established that human rights law imposes obligations on states with respect to climate change. In particular, human rights litigation has been used to elaborate states' obligations to mitigate climate change. A prominent example is given by the *Urgenda* case, in which the Dutch Supreme Court found that the Dutch state was required to reduce its GHG emissions by at least 25% by 2020 compared to 1990 levels. Human rights turned out to be decisive in the Supreme Court's judgment, as it found that the rights to life and private and family life entailed an obligation on the State to take preventative mitigation measures to prevent interferences with those rights.

Given this use of human rights law to flesh out mitigation obligations, human rights provisions in investment treaties can play a pivotal role in climate-related investment arbitration. However, the current practice of investment arbitration tribunals indicates a widespread reluctance to take normative instruments beyond the applicable investment treaty, as well as

[10] See Kathryn Gordon and Joachim Pohl, 'Environmental Concerns in International Investment Agreements: A Survey', vol 2011/01 (OECD 2011) OECD Working Papers on International Investment 2011/01 11.
[11] Netherlands Model Investment Agreement (2019).
[12] Paris Agreement, Article 2.1(a).

decisions by domestic and international courts and tribunals, into consideration.[13] Consequently, when assessing possible options for investment treaty reform, it is key to ensure that international legal instruments beyond investment treaties, and particularly international and regional human rights treaties, can be taken into account to a greater extent in investment disputes.

Climate-related counterclaims

A final option to strengthen the consistency between climate change and investment law is by expanding the possibilities for States to bring counterclaims against investors, due to the harm caused by the GHG emissions of the latter. Indeed, this possibility is primarily exploratory at present, given that investors do not typically have any obligations to reduce or limit their GHG emissions. Nevertheless, human rights-based climate litigation again send encouraging signals. In *Milieudefensie v. Shell* a Dutch court found, for the first time and by relying on human rights arguments as interpretative aid, that specific GHG emissions targets can also be imposed on corporate actors.[14] While this decision is currently an outlier, it is plausible that similar climate lawsuits against private companies will be brought in coming years in other jurisdictions. Indeed, in light of the business and human rights movement, corporate human rights responsibilities have become increasingly accepted at the international level. Therefore, should it become more established in human rights jurisprudence that private investors have specific obligations with regard to climate change mitigation, it will be important to ensure that similar outcomes also be transposed into international investment disputes. This might enable States to raise counterclaims against investors.

In order to reach this objective, it will be important to expand the possibility for States to invoke investors' human rights obligations in their counterclaims. So far, this has rarely been the case in the jurisprudence of investment arbitration tribunals, with the notable exception of the dispute *Urbaser v. Argentina*, in which the arbitral tribunal admitted a counterclaim by the State, based on the investor's human rights responsibilities.[15] Therefore, further enabling States' counterclaims against investors is an important aspect, on which efforts to futureproof investment treaties should focus. Doing so would have a twofold set of advantages, also in the context of climate action. First, it might deter investors from challenging States' climate measures at all, in order not to be targeted by potential host State's counterclaims. Second, it would increase investors' accountability for GHG emissions that are not consistent with international and national climate policies.

[13] See, for instance, the dismissal of objections based on the European Court of Justice's *Achmea* and *Komstroy* decisions, for example in *Mainstream Renewable Power Ltd and others v. Federal Republic of Germany*, ICSID Case No. ARB/21/26, Decision on Respondent's Application under ICSID Arbitration Rule 41(5); *Cavalum SGPS, S.A. v. Kingdom of Spain*, ICSID Case No. ARB/15/34, Decision on the Kingdom of Spain's Request for Reconsideration.
[14] See Harro van Asselt et al, 'Shell-shocked: a watershed moment for climate litigation against fossil fuel companies', in CCEEL blog, 28 May 2021 <https://sites.uef.fi/cceel/shell-shocked-a-watershed-moment-for-climate-litigation-against-fossil-fuel-companies/>.
[15] *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic*, ICSID Case No. ARB/07/26, Award, para. 1155. However, it ought to be noted that the counterclaim was ultimately rejected by the tribunal, concluding that the relevant legal obligations under human rights law could not be construed as binding for the private investor.

Submission to OECD Public Consultation on Investment Treaties and Climate Change

Dr Joshua Paine

March 2022

1. I am a Senior Lecturer in Law at the University of Bristol. I teach and research in international investment law and international dispute settlement. Further information about my professional background and publications is available on my university profile.[1] I am making this submission in a personal capacity. This submission partly draws on a recent submission I made to an inquiry of the UK Parliament's International Trade Select Committee.[2]

Key proposal of this submission: Develop a carve-out that removes *bona fide* measures to address climate change from Investor–State Dispute Settlement (ISDS), the application of which is not controlled by ISDS tribunals

2. The key suggestion of this submission is that for those investment treaties that include ISDS, governments should develop a carve-out that removes *bona fide* measures to address climate change from the scope of ISDS. Importantly, this carve-out should not be controlled by ISDS tribunals, but by a joint determination of designated environmental authorities of the treaty Parties, or by another body with appropriate expertise (eg a State–State dispute settlement panel that includes individuals with climate-related expertise). This proposal is applicable both to the drafting of future treaties that include ISDS and to the reform of existing treaties that include ISDS. Once the contours of a carve-out have been decided upon, governments could agree on either a bilateral or multilateral opt-in basis to treaty amendments that replace ISDS provisions in existing treaties with an ISDS mechanism that includes the climate carve-out.[3]

3. It is important to emphasise that there are certain questions of treaty design that logically precede the issue of designing a carve-out from ISDS for climate change measures. These include:

a. Whether to include an ISDS mechanism in an investment treaty at all;
b. Whether to exclude fossil fuel investments from protection under investment treaties altogether, as proposed by some commentators.

This submission focuses only on the issue of a carve-out from ISDS for measures to address climate change, on the basis that it is unlikely that all future and existing investment treaties will (be reformed to) exclude ISDS or exclude fossil fuel investments from protection.

4. In short, there are two key challenges involved in designing a carve-out from ISDS for legitimate climate change measures:

a. Designing the scope of the carve-out so that it is sufficiently broad to cover the wide-range of measures that States may need to take to address the problem of climate change, but excludes measures that have some other dominant purpose (eg a protectionist purpose);[4]

[1] https://research-information.bris.ac.uk/en/persons/joshua-paine
[2] Joshua Paine, submission to International Trade Committee Inquiry on Trade and the Environment, 28 February 2022.
[3] See the proposal on this issue in Gus Van Harten, 'An ISDS Carve-out to Support Action on Climate Change' (2015) Osgoode Legal Studies Research Paper Series No 113, at pp. 1-5 https://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=1112&context=olsrps.
[4] Similarly: ibid 6-7.

b. Designing the process that governs the application of the carve-out to investor claims, so that it involves decision-makers with appropriate climate-related expertise – which is unlikely to include ISDS tribunals – and specifies a mechanism that applies in cases where the authorities of the treaty parties disagree on the application of the carve-out.

5. In summary, a climate carve-out could take the form of an initial provision that clarifies that no claim may be brought under a treaty's ISDS mechanism in relation to measures that are adopted in good faith for the purpose of climate change adaptation or mitigation. Subsequent provisions should then establish a process whereby the designated environmental authorities of the treaty Parties jointly, or some other body that includes individuals with climate-related expertise (eg a State–State dispute settlement tribunal), controls the application of the carve-out to specific investor claims. The carve-out should further provide that where the environmental authorities of the Parties jointly, or some other body, determine that the carve-out applies, the investor claim in question is automatically withdrawn and discontinued.

Suggestions on the wording of the initial provision excluding climate change measures from ISDS

6. In existing literature, commentators have made suggestions about the shape of a carve-out to insulate measures to address climate change from ISDS. For example, Van Harten has proposed a carve-out from ISDS covering:

> any measure adopted by a Party … relating to the objective of stabilizing greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system or relating to any of the principles or commitments contained in Articles 3 and 4 of the United Nations Framework Convention on Climate Change of 1992.[5]

A similar proposal from ClientEarth suggests a carve-out from ISDS that 'would require the dismissal of any claim that challenged a good-faith climate mitigation or adaptation measure', which 'would apply to any measure linked to the objective and principles of or commitment to the UNFCCC'.[6] Another example of language that has been proposed as a treaty exception but which could be used in a carve-out from ISDS is to exclude from ISDS 'non-discriminatory regulatory measures taken in good faith' by a Party, among other reasons, 'to protect the environment' and 'to achieve the objectives of the Paris Agreement and other climate change mitigation and adaptation objectives'.[7]

7. The wording used to specify the connection between a measure and the aim of addressing climate change in order for the measure to fall within a carve-out from ISDS is crucial. The term 'necessary' has often been interpreted in a strict manner in investor–State and World Trade Organization (WTO) jurisprudence and is best avoided. In contrast, requiring that measures are 'related to' or bear 'a reasonable relationship to' the aim of addressing climate change may strike a better balance between safeguarding measures that are aimed at addressing

[5] ibid 1.
[6] Amandine Van den Berghe and Kyla Tienhaara, 'Potential solutions for phase 3: aligning the objectives of UNCITRAL working group III with states' international obligations to combat climate change' (2019) p. 7 https://www.clientearth.org/media/h15fylit/july-clientearth-uncitral-aligning-phase-3-with-ciimate-change-efforts2.pdf.
[7] The Creative Disrupters, 'Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation', (2018) art 5.1(3)(d) and (j) https://stockholmtreatylab.org/wp-content/uploads/2018/07/Treaty-on-Sustainable-Investment-for-Climate-Change-Mitigation-and-Adaptation-1.pdf.

the problem of climate change but excluding measures that only have a tangential connection with this goal.[8] Other drafting options that could broaden the scope of a carve-out from ISDS include requiring that measures are 'adopted and maintained' or 'designed and applied' for the legitimate aim of addressing climate change. The latter phrases are already often used in investment treaties, inter alia to clarify the type of regulatory measures that do not ordinarily constitute indirect expropriations,[9] although they do not yet have an established technical meaning (unlike the term 'necessary' in WTO law).[10]

8. If governments decide to include a condition that measures must be non-discriminatory to fall within a climate carve-out, they should provide guidance on what is meant by this requirement. For example, an explicit clarification could be included that in determining whether the condition of non-discriminatory application has been complied with, the climate and environmental impacts of an investment must be considered,[11] as well as whether the measure 'distinguishes between investors or investments based on legitimate public welfare objectives'.[12]

<u>Suggestions on designing the process to govern the application of a climate carve-out</u>

9. As noted above, it is crucial that a climate carve-out from ISDS specifies a process to determine the application of the carve-out to specific investor claims, as otherwise this issue would the issue would be left for ISDS tribunals to determine in deciding on their own jurisdiction. ISDS tribunals are unlikely to be the appropriate body to decide on the application of the carve-out because:

a. They lack climate-specific subject matter expertise; and
b. The sensitivity of the issues to be determined – namely, whether a measure is a legitimate climate change measure that should not be subject to challenge via ISDS – is similar to other vital policy areas that States have often partly or entirely removed from ISDS (eg taxation, prudential or monetary policy measures, and sometimes public health measures).

10. Some commentators have suggested that a climate carve-out from ISDS should be controlled by a multilateral mechanism set up within the UN climate change framework,[13] or 'an independent panel of climate change experts'.[14] Achieving agreement at a multilateral level on the appropriate scope of a climate carve-out from ISDS, and a process to govern its application, is likely to be difficult in the short to medium term. Accordingly, this submission suggests that governments should begin by negotiating such a carve-out on a bilateral basis, although there would be nothing to prevent the carve-out being scaled up to a plurilateral or multilateral level (eg through an opt-in instrument similar to the UN Convention on Transparency in Treaty-based Investor-State Arbitration).

11. In terms of a process to govern the application of a climate carve-out from ISDS at a bilateral level, investment treaties could designate particular climate-related authorities from

[8] Van Harten (n 3) 7. Freya Baetens, 'Protecting Foreign Investment and Public Health Through Arbitral Balancing and Treaty Design' (2022) 71 International and Comparative Law Quarterly 139, 167-168, 175-177.
[9] Eg Canada Model BIT 2021 art 9(3); India Model BIT 2015 art 5.5; ASEAN Comprehensive Investment Agreement (2009) Annex 2.4.
[10] Baetens (n 8) 171-2.
[11] For examples along these lines see The Creative Disrupters, 'Treaty on Sustainable Investment' (n 7) art 3.2(3). India Model BIT 2015 art 4.1 fn 2. Draft Pan-African Investment Code (2016) art 9(3)(b).
[12] Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) art 9.4 fn 14.
[13] Van Harten (n 3) 2, 9.
[14] Van den Berghe and Tienhaara (n 6) 7.

each Party that are, as a first step, to consult on whether the carve-out applies if it is invoked by a Party as a defence to an investor claim. For example, numerous investment treaties designate particular authorities of each Party responsible for financial services or taxation policy that are, in the first instance, jointly in control of the application of carve-outs from ISDS for taxation, prudential or monetary policy measures.[15] A slightly different option is to put the application of the carve-out in the control of a standing committee established under the treaty, which includes representatives of authorities of the Parties with relevant subject-matter expertise (eg many Regional Trade Agreements (RTAs) give a financial services committee control over the application of relevant carve-outs from ISDS).[16] These examples could be adapted for the climate context and could draw upon existing frameworks for cooperation on trade or investment-related environmental issues. For example, the environment chapters of RTAs often require each Party to designate a 'contact point', which is an authority in charge of cooperation activities related to implementation of the environment chapter.[17] For instances where consultations between the contact points fail to resolve disagreements about matters arising under an RTA's environment chapter, there is typically provision for the issue to be elevated either to an environmental committee established under RTA, consisting of more senior officials, or to ministerial-level consultations.[18]

12. It is important to specify a further process that applies where the question of the application of a climate carve-out arises and the Parties' representatives cannot agree on whether the carve-out constitutes a valid defence to an investor claim. One option would be to allow ISDS tribunals to decide on the application of the carve-out where the Parties' authorities cannot agree on this issue within a specified period. For example, some carve-outs for financial policy or taxation measures in investment treaties adopt this approach.[19] Another approach, which may be more attractive to governments, is to provide that where the Parties' authorities cannot agree on whether the carve-out constitutes a valid defence to a specific investor claim, then either Party can refer this question to a State–State dispute settlement panel that is empowered to decide the issue. For example, some carve-outs for financial policy measures in investment treaties adopt this approach, thus effectively removing the issue of the application of the carve-out entirely from the control of ISDS tribunals.[20] This approach can be combined with a requirement that the State–State tribunal includes individuals with appropriate climate-related expertise.

13. Finally, governments should give careful thought to specifying the legal effect of a joint determination of the Parties' authorities, or of some other body (eg a State–State tribunal), that a climate carve-out applies to a specific investor claim. The drafting option that would make the carve-out most effective is to provide that where a determination is made that the carve-out applies, the investor is automatically deemed to have withdrawn its claim and the proceedings are discontinued with prejudice, to the extent they are covered by the carve-out. Such a carve-out should also provide that an ISDS tribunal must 'take note of the discontinuance of the claim [or part thereof] in an order' and to the extent the claim is covered by the joint determination,

[15] Regarding financial services see eg US–Uruguay BIT (2005) art 20(3)(a)-(b); Australia–Hong Kong Investment Agreement (2019) art 25(2)(a)-(b); CPTPP art 11.22(2)(a)-(b) and Annex 11-D. Regarding taxation see eg Australia–Hong Kong Investment Agreement art 13(1), (5); US–Uruguay BIT art 21(3).
[16] Eg Comprehensive Economic and Trade Agreement Between Canada and the European Union (CETA) arts 13.18, 13.21(3)-(4).
[17] Eg CPTPP art 20.12(3).
[18] Eg CPTPP arts 20.20-20.22; CETA arts 24.13-14, 26.1, 26.2(g).
[19] Eg US–Uruguay BIT 20(3)(c); CETA art 13.21(4)-(5); Australia–Hong Kong Investment Agreement art 13(5).
[20] Eg CPTPP art 11.22(2)(c)-(3); Singapore–Australia FTA ch 9 art 22(2)(c)-(3); Canada–Hong Kong BIT (2016) art 22(4)-(5).

the ISDS tribunal shall not have authority to proceed to hear the claim.[21] This approach is adapted from the process established within certain existing carve-outs from ISDS for financial policy measures.[22] In contrast, providing that a determination of the Parties' authorities (or another body) that the carve-out applies is binding on an ISDS tribunal, and that any decision or award the tribunal issues must be consistent with the determination,[23] may not be as effective. This is because the latter approach leaves greater discretion to an ISDS tribunal (eg in terms of what constitutes a decision 'consistent with' the Parties' joint determination).

[21] Canada Model BIT 2021 art 45(5)-(6).
[22] Canada Model BIT 2021 art 45(5)-(6); CETA art 13.21(4).
[23] Eg CPTPP art 11.22(2)(b) and (3). USMCA Annex 17-C (5)(e).

The future of investment treaties in the context of climate change: Lessons from aligning officially supported export finance with the Paris Agreement

22.03.2022

Authors: Philipp Censkowsky, Laila Darouich, Igor Shishlov (Perspectives Climate Research gGmbH)

Aligning financial flows with low-carbon and climate-resilient development is required by Article 2.1c of the Paris Agreement and decisive to limiting global warming to 1.5°C above pre-industrial levels. But what does this concretely mean for the future role and design of investment treaties? In the following, we briefly present our approach to 'Paris alignment' of Export Credit Agencies (ECAs) and outline climate change considerations in the OECD Arrangement – the main supranational policy framework regulating officially supported export finance (section 1). We then argue that the nature of products of ECAs and investment treaties are similar enough – both are public instruments to de-risk investments and support transboundary trade – to allow us to translate some recommendations from the Paris Alignment of ECAs to investment treaties (section 2). These recommendations for the future and role of investment treaties in the context of climate change are outlined at the end of this note (section 3).

1. Officially supported export finance in the context of climate change

At Perspectives Climate Research, we developed a dedicated methodology[1] to assess the alignment of ECAs with the Paris Agreement and to inform ongoing reform processes through targeted policy recommendations. Through a series of country case studies[2], we use this methodology to identify existing gaps and best practices of ECAs and respective government policies. Beyond individual countries and their officially supported export sectors, our work aims at aligning the global export finance system with the objectives of the Paris Agreement.

ECAs are either private companies that act on behalf of a government or public entities themselves and their *raison d´être* is the promotion of exports into riskier foreign markets. ECA products include state-backed guarantees and insurance covers, and in some countries also direct loans. Thus, ECAs can de-risk transactions and/or improve financing conditions for national exporters, banks or foreign importers. ECAs are regulated both nationally as well as at supranational level under the OECD Arrangement – a 'gentlemen's agreement' that aims to foster a 'level-playing field' among its Participants.[3] The OECD Arrangement provides common terms and conditions for tied aid and export credits, e.g., regarding concessionality, minimum interest or premium payment levels, as well as detailed sector understandings for specific sectors that are of high strategic and economic importance, such as shipping, civil aircraft, nuclear power or rail infrastructure. Such a policy framework helps to build trust and encourages the 'orderly use' of officially supported export credits among Participants.

Regarding climate change considerations, the OECD Arrangement features a sector understanding that restricts the support for coal-fired electricity generation, which was significantly extended in the run

[1] See here.

[2] See some case studies we conducted, e.g., on Canada or the Netherlands.

[3] Participants include Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland, Turkey, the United Kingdom and the United States. Access the OECD Arrangement here.

up to COP26 essentially banning export credit support for unabated coal-fired power plants.[4] Moreover, the OECD Arrangement contains a sector understanding that allows for more flexible terms and conditions for the provision of officially supported export credits relating to water projects, renewable energy projects, or climate change mitigation projects. Despite these important steps, a resolute reform of the OECD Arrangement in the context of climate change is still pending.

2. Parallels to investment treaties and their importance in the context of climate change

Investment treaties are important public policy frameworks that determine the conditions under which foreign investment takes place, notably with the aim of protecting investment security. Currently, more than 2,500 investment treaties are in force that essentially cover all investments from one country to another.[5] Investment treaties are similar to ECA support, inasmuch as they de-risk and support transboundary trade and investment flows as a public instrument. They differ from ECA support, however, since they represent quasi-public goods to investors that are covered without the requirement to pay any premium, fee or interest rate - which is the case with ECA support. Despite this, any investor can claim financial compensation for expropriation, discrimination and or exposure to other risks specified in the terms and conditions of an investment treaty. This can happen through Investor-State Dispute Settlements (ISDS) if trade partners agree to such an arbitration mechanism in international investment treaties. Functionally, and despite their far smaller degrees of specificity, investment treaties hence work similar to ECA guarantees or insurances – and are of particular importance to foreign investments in riskier sectors, such as the energy sector.

These similarities lead us to the conclusion that investment treaties – as public instruments by governments that bear responsibilities under the Paris Agreement - should be under the same scrutiny as ECAs and ultimately need to align with the 1.5°C temperature objective. Indeed, the importance of ISDS in the context of climate change is reflected in the steep rise of investment arbitrations claimed by the fossil fuel industry.[6] An investment arbitration can occur when investments into carbon-intensive assets are suddenly exposed to climate-related transitional or litigative risks, such as those induced through the introduction of carbon pricing or the political decision for coal phase-out, to just name a few. Next to incurring high public costs once disputes are settled, the fear of being sued by foreign investors can also obstruct host state governments from taking resolute climate action in the first place or urge large pre-emptive compensation payments. The latter has been the interpretation of some observers of the German coal-phase out, where Germany agreed to pay large compensation sums to lignite mine operators potentially avoiding even higher costs under ISDS arbitration claims against which Germany is now protected through an explicit exclusion clause.[7] Overall, ISDS can hence significantly augment the public costs of the energy transition (*ibid*.).

Contrarily to that, multinational companies can maximise profits and competitive advantages through ISDS. Indeed, current practice for arbitrators is to tactically structure their operations through subsidiaries based in 'home states' that negotiated the most favourable ISDS mechanisms. This incentivizes 'treaty shopping' which is why most claimants from the fossil fuel industry file their arbitrations from the United States, the United Kingdom or the Netherlands (see footnote 6).

[4] See here.

[5] See for instance the database ran by UNCTAD.

[6] See a recent report by the International Institute for Sustainable Development (IISD) and a database covering arbitration claims under the Energy Charter Treaty (ECT), the instrument under which most arbitration cases of the fossil fuel industry are filed.

[7] See the example and references in a recent report by the International Institute for Environment and Development (IIED).

3. Recommendations

Against this background, we identify the following strategic priority areas for governments to act on the future role and design of investment treaties in the context of climate change (Table 1):

Table 1: Recommendations for the role and future design of investment treaties in the context of climate change.

1. Start the conversation by updating investment treaties in the context of climate change with a carve-out for coal A carve-out, or in other words an exemption of cover, for foreign investments in coal-fired electricity generation needs to be introduced with high likelihood of political support. This should follow and go beyond the recent ban of official export finance support for unabated coal-fired electricity generation in the OECD Arrangement. A 'carve-out' would imply that affected investors are no longer protected by the treaties' ambit and could no longer bring up any claim under it.
2. Update investment treaties with 'carbon carve-outs' for all investments that are not in line with the Paris Agreement 'Carbon carve-outs' should at least include all new upstream development of coal, oil and gas as well as a majority of mid- and downstream activities alongside fossil fuel value chains unless proven that in justified exceptions no viable alternative exists. As a starting point, governments can take the International Energy Agency's Net Zero by 2050 roadmap as a reference for carbon carve-outs.[8]
3. Consider to terminate investment treaties that are difficult to modernize in the context of climate change If updating existing treaties through 'carve-outs' of carbon-intensive sectors is legally difficult to implement, governments should consider terminating treaties that cannot accommodate the urgency of climate change to the extent required by the latest climate science. Despite 'survival clauses' of many treaties, this can importantly underpin a political momentum.
4. Rally partners to coordinate the role and design of investment treaties in the context of climate change We suggest a higher degree of specificity in future investment treaties for all carbon-intensive sectors that do not fall under new upstream fossil fuel developments and fossil-fired electricity generation. This can help to resolve ISDS processes and provide additional incentives to decarbonize foreign direct investments.
5. Enhance the climate-related specificity of terminology used to describe investments We suggest a higher degree of specificity in future investment treaties for all carbon-intensive sectors that do not fall under new upstream fossil fuel developments and fossil-fired electricity generation. This can help to resolve ISDS processes and provide additional incentives to decarbonize foreign direct investments.
6. Understand the *remaining* carbon footprint covered by an investment treaty based on state-of-the art climate accountability We suggest measuring and disclosing the *remaining* carbon footprint that is covered by an investment treaty based on state-of-the art climate accountability. Importantly, this means to first carve-out the above-described fossil fuel sectors in investment treaties. In a parallel effort, the remaining 'carbon coverage' should be measured in accordance to and collaboration with leading standard setting entities, such as the GHG Protocol or the Partnership for Carbon Accounting Financials (PCAF). This can subsequently inform further climate-related action.

[8] See: https://www.iea.org/reports/net-zero-by-2050

Submission to the Organization for Economic Co-operation and Development on investment agreements and climate change by PowerShift[1]

1. High risk of fossil fuel claims

Investment treaties pose a serious risk for much needed climate action. Three factors make the fossil fuel sector particularly prone to resorting to investment arbitration:

a) Fossil fuel companies are already the prolific users of investment treaty arbitration. Research has shown that the fossil fuel sector resorts to ISDS more than any other economic sector. All carbon majors have initiated ISDS claims, making companies and their legal departments well aware of the powers and possibilities of investment treaty arbitration. Furthermore, awards in the fossil fuel sector are on average five times larger than in other economic areas. [2]

b) The fossil fuel sector is characterized by particularly large capital investments, often coupled with an investment horizon of several decades. Especially oil and gas extraction, transportation and processing are very capital intensive. *New* investments in fossil fuel extraction and power generation fluctuated between USD700 billion and USD1 trillion annually in 2019-2021.[3] The existing investment stock in fossil fuel infrastructure is thus extremely large and it has been estimated that up to USD9 trillion of fossil fuel investments could be at risk of litigation.[4] Even if only a very small fraction ended up as the subject of investment treaty arbitration, it could seriously endanger a swift transition away from fossil fuels.

c) The home states of large fossil fuel companies have signed a large number of mostly old investment treaties. For example, the Netherlands, France, the UK, the United States, China and Canada, home to some of the largest private fossil fuel companies, have all more than 50 investment treaties or treaties with investment provisions in force. Coupled with the global presence of many fossil fuel companies and the prevalence of treaty shopping, it is likely that a high percentage of fossil fuel investments are protected through investment treaties with ISDS. One study found that 75% of foreign-owned coal power plants were protected by an investment treaty with ISDS.[5]

The three factors above make it highly attractive for law firms working in investment arbitration to advertise the possibility of investment treaty arbitration against energy transition measures. The law

1 PowerShift is a non-governmental organisation based in Berlin, Germany. We critically analyse and intervene in EU trade and investment policy. We have worked on investment treaties and investor-state dispute settlement for the last decade. Over the last couple of years, we have focused on the intersection between climate policies and investment treaties, in particular the Energy Charter Treaty. This contribution has been written by Fabian Flues: fabian.flues@power-shift.de. More information about our work can be found on our website: https://power-shift.de/.

2 Lea di Salvatore (2021) Investor–State Disputes in the Fossil Fuel Industry, IISD, 31 December https://www.iisd.org/publications/investor-state-disputes-fossil-fuel-industry

3 See: IEA (2021) World Energy Investment 2021 and the corresponding dataset available at: https://www.iea.org/reports/world-energy-investment-2021.

4 AFP (2021) Governments risk 'trillions' in fossil fuel climate litigation, 11 December https://www.france24.com/en/live-news/20211112-governments-risk-trillions-in-fossil-fuel-climate-litigation

5 Kyla Tienhaara, Lorenzo Cotula (2020) Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuel assets, IEED, 20 October https://pubs.iied.org/17660iied

firm Jones Day, for examples, highlighted the opportunities for fossil fuel firms in pursuing climate related ISDS cases and counselled them to undergo corporate restructuring to enable the use of ISDS against climate change mitigation measures: “Climate change litigation is often viewed by companies as a risk. However, it is also an opportunity—if brought in the right forum—for companies exposed to certain climate-related government measures to vindicate their rights. [...] ISDS is therefore likely to be an increasingly important avenue for the resolution of climate change disputes. Companies in industries most affected by States' climate change obligations (e.g., fossil fuels, mining, etc.) should audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty. […] Notably, some treaties have superior investor protections than others. It is thus important to assess which treaty would best protect the company from any adverse climate-related government measures.”[6]

2. Systemic concerns

Investment treaties and investment arbitration are a conservative force in policy making. I.e. they structurally favour stability of the regulatory environment or at best incremental changes rather than rapid and far-reaching policy shifts such as those needed for a swift transition away from fossil fuels. At the same time hardly any investment treaties or tribunal awards acknowledge the need for climate change mitigation, let alone give it precedence over the broad property rights enshrined in investment treaties.[7]

Climate change poses a unique challenge in this regard as for the first time in recent history a major, economically viable sector of the economy has to be phased-out through public policy measures. Experience has shown that pure demand side measures, probably less prone to cause investment arbitration cases, are not sufficient to curb greenhouse gases emissions to the level necessary for a 1.5°C path and regulatory action needs to be taken at all points of the fossil fuel life cycle, in particular when we see uneven ambition across jurisdictions.

The particularities of the investment treaty regime make it especially dangerous for ambitious climate action. The vague wording of substantive rights, in particular in first generation treaties, leaves states (and investors) in continuous uncertainty as to whether certain climate mitigation measures infringe on those rights or not. This is compounded by (1) the lack of precedent and the fact that arbitration tribunals have taken different decisions in very similar situation in the past; (2) the lack of an appellate mechanism which leaves states (and investors) at the mercy of the particular tribunal ruling on the case.

3. Concrete risks

3.1 Reduction in ambition

Perhaps the most significant danger of investment treaties is a reduction in GHG mitigation ambition out of a fear of expensive and lengthy investment treaty claims. This can play out in two ways:

6 Michelle Bradfield et al (2022) Climate Change and Investor-State Dispute Settlement, Lexology, 1 March https://www.lexology.com/library/detail.aspx?g=086370ea-bd96-4c3d-9446-24ca72136151

7 See, for example, the new analysis of available ECT awards: Anja Ipp et al (2022) The Energy Charter Treaty, Climate Change and Clean Energy Transition: A Study of the Jurisprudence, Climate Change Counsel, 15 March https://www.climatechangecounsel.com/_files/ugd/f1e6f3_d184e02bff3d49ee8144328e6c45215f.pdf

First, explicit threats from investors to initiate an investment treaty claim if a particular GHG mitigation measure is going ahead. Such threats are usually only made public as a consequence of freedom of information requests, meaning that their number is probably vastly underestimated. An example is the letter sent on behalf of Vermilion to the French government, which led to less ambitious phase-out plans for fossil fuels.[8] The Dutch government has also publicly stated that they're not pursuing further initiatives on coal fired power generation to avoid the risk of litigation.[9]

Secondly, there is a risk of a reduction of ambition without explicit threats of investment arbitration claims. Internal risk assessment conducted by government civil servants, especially in countries that have been respondents in ISDS proceedings before, could lead to an avoidance of measures that are seen as potentially leading to ISDS claims.[10] Such regulatory chill, where regulators factor possible liabilities into their decision making without any actual (threat of) claims, has already been observed in environmental policy making and it would be surprising if climate change mitigation was not affected by this.[11]

One challenge is that a reduction in ambition because of actual or hypothetical threats of ISDS claims happens in internal deliberations of ministerial bureaucracies which is usually not made public.[12] This makes it not only difficult to assess how widespread this phenomenon is. It also gives little opportunity for public interest groups to push back through legal assessments that come to a different conclusion or other forms of outside interventions.

There is evidence that the fossil fuel industry sees investment arbitration as a lever against unwanted policy changes. When Chevron lobbied the European Commission on the investment provisions of the planned free trade agreement with the United States, the TTIP, it argued that "the mere existence of ISDS is important as it acts as a deterrent."[13] Similarly an ExxonMobil lobbyist highlighted the continuation of investment protection for oil and gas companies in the USMCA, the revamped NAFTA, as a significant lobbying success.[14]

3.2 Increasing costs of the energy transition

Investment treaties can also increase the costs of the energy transition. The obvious way is for ISDS cases to lead to high compensation payments from states to fossil fuel investors. Several cases are currently ongoing, such as the ECT claims by Uniper and RWE against the Dutch coal phase-out,

8 Friends of the Earth Europe et al (2019) Blocking Climate Change Laws with ISDS Threats: Vermilion vs France, https://10isdsstories.org/wp-content/uploads/2019/06/Vermilion-vs-France.pdf

9 See this response by the Dutch government to parliamentary questions: https://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2021Z19314&did=2021D41482

10 A recent example might be the decision of New Zealand not to join the Beyond oil and gas alliance. In this case there is no publicly known threat by an oil or gas producing company (which does not at all preclude the possibility that those threats have been made in private) https://www.energymonitor.ai/policy/international-treaties/why-investor-lawsuits-could-slow-the-energy-transition

11 Van Harten, Scott (2016) Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study from Canada, Osgoode Legal Studies Research Paper No. 26/2016, 19 April, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2700238.

12 PowerShift is currently involved in litigation with the German government for the release of documents relating to investment treaty arbitration and the German coal phase-out: https://power-shift.de/pm-zu-viel-kohle-fuer-den-kohleausstieg-klage-will-licht-ins-dunkel-bringen/

13 Arthur Neslen (2016) TTIP: Chevron lobbied for controversial legal right as 'environmental deterrent', The Guardian, 26 April https://www.theguardian.com/environment/2016/apr/26/ttip-chevron-lobbied-for-controversial-legal-right-as-environmental-deterrent

14 See fourth in this investigation by Greenpeace: https://unearthed.greenpeace.org/2021/06/30/exxon-climate-change-undercover/

reportedly suing for €2.4 billion in compensation, and the USD16.3 billion claims by TC Energy and the Province of Alberta against the United States for the cancellation of the Keystone XL pipeline permits. The calculation of compensation payments in ISDS cases, often done on the basis of the hypothetical income the asset could have generated, could lead to extraordinarily large liabilities for states, in particular for economically viable oil, gas and coal reserves.[15]

More indirectly, investment treaties can raise the costs is by increasing the bargaining power of fossil fuel companies in the energy transition. In cases where an early phase-out of fossil fuel infrastructure requires the payment of some kind of compensation to the owner, the existence of an investment treaty (and even more so the implicit or explicit threat of a treaty arbitration case) can be used to increase the compensation states are willing to pay if it allows them to avoid a costly and lengthy arbitration.

4. The example of the German coal phase out

The case of the German coal phase-out brings together a few of the elements described above. They will be briefly summarised here and are laid out in more detail in a recently published briefing.[16]

In 2020 Germany decided to phase-out power generation from coal by 2038. Environmental organisations had strongly advocated for mandating the closure of coal powerplants through a regulation, which would have brought environmental benefits. Instead, the German government chose to phase-out the burning of (imported) hard coal through an auctioning system for powerplants and end the burning of domestically mined lignite through a contract with the two main operators. An internal document obtained via a freedom of information request shows that the economics ministry had warned the chancellery of potential "costly and lengthy" investment treaty claims if the government pursued a phase-out through regulation only.[17]

In the contract, the companies and their main shareholders waive their right to pursue investment treaty claims against the German government in relation to the phase out. But this waiver came at a steep price. The negotiations gave the coal companies significant bargaining power, helping them to negotiate a contract in which the public shoulders the risks and uncertainties of the phase-out and that makes it harder for the government to bring the phase-out forward.[18]

In return for the waiver, the companies also demanded higher compensation payments from the German government for the phase-out. While the German government has publicly admitted that the

15 See for example: Jonathan Bonnitcha and Sarah Brewin (2021) Compensation Under Investment Treaties, IISD Best Practice Series, November https://www.iisd.org/system/files/publications/compensation-treaties-best-practicies-en.pdf

16 Fabian Flues (2022) Coal ransom: How the Energy Charter Treaty drove up the costs of the German coal phase-out, PowerShift and others, March https://power-shift.de/wp-content/uploads/2022/03/How-the-Energy-Charter-Treaty-drove-up-the-costs-of-the-German-coal-phase-out-web-22022022.pdf

17 See extract from the document "Bewertung Kohleausstieg durch Ordnungsrecht" sent by the Federal Ministry of Economics to the Chancellery on 31 October 2019. Available at the following link on p. 81, https://fragdenstaat.de/anfrage/dokumente-zum-energiecharta-vertrag-und-kohleausstieg/639279/anhang/211025-UIGBescheid-NAMEIIIFinal_geschwaerzt.pdf

18 See: Ida Westphal (2020), Stellungnahme zum Thema „Öffentlich-rechtliche Verträge der Bundesregierung mit den Braunkohlebetreibern", Öffentliche Anhörung im Ausschuss für Wirtschaft und Energie des Deutschen Bundestages, 7 September https://www.bundestag.de/resource/blob/711246/c8642c292aec135747bb2d312e0114c0/stgn-sv-westphal-data.pdf

waiver played a role in determining the level of compensation,[19] it is difficult to exactly quantify the level of additional compensation the coal companies received. In total, the two lignite companies are paid €4.35 billion in compensation. This amount is seen by independent experts as too high. The climate think tank Ember concludes in an analysis for Greenpeace Germany that a total compensation of €343 million for the two companies would have been adequate.[20] The European Commission has opened a state aid investigation into the payment, because it "doubts that the compensation is kept to the minimum required and that the amounts are proportionate."[21]

In short, in order to avoid investment treaty arbitration over its coal phase-out, the German government chose to negotiate a contract with the two leading coal companies. The conclusion of the contract led to a coal phase-out that is more favourable to the companies and costlier to the taxpayer than it would have been had a purely regulatory exit been pursued.

5. Options for reform

It is important to note that any reform option that addresses only climate-related aspects of investment treaties is partial, because issues similar to the ones described above arise in other areas of environmental and social concern such as mining, public health or infrastructure and construction all of which have seen high numbers of investment arbitration cases. It is therefore preferable that reform options tackle the underlying problems of the investment treaty regime rather than focusing solely on climate change.

The decentralised structure of the investment treaty regime makes it hard for any single approach to work. A case in point is the very slow and marginal progress of multilateral reforms, such as the negotiations at UNCITRAL. Therefore, a mix of different measures is likely to be needed to urgently address the issues identified. In our view, the following options should be considered, in descending order of desirability, and combined where possible.

a) Withdrawal of Consent to Arbitrate and Termination Treaty
   An international treaty by which states would withdraw their consent to arbitrate and would terminate investment treaties has been developed by leading investment law experts.[22] It would be the most comprehensive solution to problems identified and allow states to join over time. While some states are unlikely to join such an initiative at the moment, there is a successful precedent to such a treaty: The one developed by the European Union to end the application of intra-EU BITs, including the cancellation of sunset clauses.[23]

19 Nico Schmidt (2021) Wie Schiedsgerichte Europas Klimaziele bedrohen, BuzzFeed News, 23. February, https://www.buzzfeed.de/recherchen/energiecharta-vertrag-schiedsgerichte-europa-klimaziele-90214917.html

20 Greenpeace (2021) Strich durch die Rechnung, 4 June https://www.greenpeace.de/themen/energiewende-fossile-energien/kohle/strich-durch-die-rechnung

21 European Commission (2021) State Aid SA.53625 (2020/N) – Germany – Lignite phase-out, 2 March, https://ec.europa.eu/competition/state_aid/cases1/202117/292944_2268207_78_2.pdf

22 See CCSI, IEED, IISD (2019) Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements, 15 June https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/wgiii_withdrawalconsent_0.pdf

23 Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union (2020) https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22020A0529(01)&from=EN

b) Termination

In case where a joint termination of agreements is not possible, countries should consider terminating their investment agreements unilaterally. A number of countries have taken such action in the past, without negative impacts on their FDI inflows. Such termination would shield them from potentially enormous liabilities for new fossil fuel investments, which over the past years reached between USD1 trillion and USD700 billion globally.

c) Unilateral withdrawal of consent to fossil fuel investors

A third element in the toolbox should be for countries to unilaterally withdraw consent to arbitration for investors in fossil fuels, ideally as part of multi-country coalition to reduce the possibilities for treaty shopping. Such an approach would be similar to some of the measures suggested in a) but specifically targeted at fossil fuel investors only. It might help to overcome hesitation of countries that are unwilling or unable at this moment to exit the investment treaty regime in its entirety.

d) Replacement of existing investment treaties

Where countries are unable to terminate their investment treaties, another option might be to replace existing treaties with entirely new investment treaties that should categorically exclude fossil fuel investments and other carbon intensive sectors from their coverage, while providing protection only to investments that are sustainable and benefit the host state. In addition, such agreements would need to depart from the investor-state dispute settlement system, for example by replacing it with state-to-state dispute settlement or more conciliatory approaches such as mediation. Substantive investor rights should be limited to direct expropriation. Some elements have been already been developed in model or existing treaties.[24]

e) No contract-based arbitration in the fossil fuel sector

A serious challenge is the use of contract-based arbitration in the fossil fuel sector, especially against low-income countries.[25] There should be global guidance to all states to avoid including arbitration clauses in contracts with fossil fuel companies, especially in the upstream oil & gas sector. Such guidance should be issued and supported by all relevant multilateral development institutions, regional integration bodies and bilateral development agencies. Countries should be supported in re-negotiating existing contracts.

24 Southern African Development Community (2012) SADC Model Bilateral Investment Treaty Template https://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf, Creative Disrupters (2018) Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation https://www.iisd.org/publications/treaty-sustainable-investment-climate-change-mitigation-adaptation

25 Lea di Salvatore (2021) Investor–State Disputes in the Fossil Fuel Industry, IISD, 31 December https://www.iisd.org/publications/investor-state-disputes-fossil-fuel-industry

25 March 2022

Submission to the OECD Public Consultation on Investment Treaties and Climate Change

Dr Elizabeth Sheargold, University of Wollongong, Australia[1]

I. Introduction

1. I welcome the opportunity to make this submission to the OECD's work programme on The Future of Investment Treaties. This submission focuses on the first goal outlined in the consultation document, specifically considering how investment treaties can be designed to 'preserv[e] sufficient policy space' for states to implement measures to reduce greenhouse gas emissions and mitigate climate change.

2. Climate change mitigation policies, such as phase outs of coal-fired electricity generation, have already been the subject of investor-state dispute settlement (ISDS) cases,[2] and this submission proceeds from the assumption that in future more investors are likely to allege that climate change mitigation policies breach the protections found in investment treaties. If an investor is successful in an ISDS claim, the usual remedy provided is damages. While an award of damages may not directly prevent a state from regulating to reduce greenhouse gas emissions, it does 'affect the way the costs of public interest action are distributed between states and businesses.'[3] In addition to the actual cost of paying damages to a successful claimant, it has frequently been argued that the mere threat or potential for ISDS claims can cause 'regulatory chill' and deter states from adopting public interest regulations such as climate change mitigation policies.[4]

3. Thus, the extent to which states may wish to limit the potential for investors to bring successful ISDS claims is closely linked to questions of cost allocation – what proportion of the costs of transitioning to a lower-emissions economy should be borne by the state, and what losses should be borne by investors in fossil fuels or other emissions-intensive sectors? Different states may have different answers to this question, and each state needs to consider what balance is appropriate for their context. For states that are concerned about the potential impacts of investor claims with respect to climate change mitigation policies, this submission considers

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[1] Vice-Chancellor's Postdoctoral Research Fellow, University of Wollongong, researching interactions between international economic law, environmental protection and regulatory impact assessment. Completed a PhD at the University of Melbourne which examined the efficacy of different safeguards for regulatory autonomy that have been included in the drafting of contemporary investment treaties. Previous roles include Associate Director of the Center for Climate Change Law at Columbia University, New York, USA. Further biographical information is available at: https://scholars.uow.edu.au/display/elizabeth_sheargold.

[2] See, eg, the complaint made by Westmoreland Coal against Canada: *Westmoreland Minig Holdings LLC v Canada*, Final Award, ICSID Case No UNCT/20/3 (31 January 2022) and the claim threatened by Uniper against The Netherlands: Dr Pekka Niemelä, 'Risky Business: Uniper's Potential Investor-State Dispute against the Dutch Coal Ban', *EJIL: Talk!* (18 March 2020) <https://www.ejiltalk.org/risky-business-unipers-potential-investor-state-dispute-against-the-dutch-coal-ban/>.

[3] Kyla Tienhaara and Lorenzo Cotula, *Raising the Cost of Climate Action?: Investor-State Dispute Settlement and Compensation for Stranded Fossil Fuel Assets* (IIED, September 2020) 19–20.

[4] See generally Jonathan Bonnitcha, *Substantive Protection under Investment Treaties: A Legal and Economic Analysis* (Cambridge University Press, 2014) Chp 3; Kyla Tienhaara, 'Regulatory Chill and the Threat of Arbitration: A View from Political Science' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011) 606; Lorenzo Cotula, 'Do Investment Treaties Unduly Constrain Regulatory Space?' (2014) 9 *Questions of International Law* 19.

tools that could be incorporated in future investment treaties to preserve host state policy space.[5] Section II briefly considers the drafting of substantive obligations, noting that even with the refinements typically found in modern investment treaties there is still a risk that climate change mitigation policies could breach investor protections. Section III then argues for the careful use of carve-outs for climate change mitigation policies, as these can be a highly effective tool for safeguarding policy space. Section IV considers how the drafting of general exceptions can be refined to reduce ambiguity and ensure that they can accommodate climate change policies.

II. The potential for climate change mitigation measures to breach investment treaty standards

4. The first line of defence to preserve host state policy space under investment treaties has been to refine the drafting of substantive obligations, to better define the government conduct that will breach a treaty standard (and conversely, to better define government conduct that does not breach the relevant treaty standard). Careful drafting of the substantive obligations included in investment treaties is an important step in minimising the risk of ISDS claims successfully challenging climate change mitigation measures.

5. Drafting which directs arbitral tribunals to look at regulatory purpose in the assessment of whether a substantive obligation has been breached is particularly important. For example, a provision clarifying that non-discriminatory regulatory measures which are designed and applied for a legitimate public purpose will not usually constitute indirect expropriation should assist host states responding to claims that phase-outs of coal fired electricity generation or similar measures are expropriations of the relevant generation assets. Similarly, by specifying that whether two investors / investments are in 'like circumstances' requires a consideration of whether 'the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives',[6] states can minimise the chances that policies which distinguish on the basis of greenhouse gas emissions will be found to be discriminatory (such as providing incentives for renewable energy generation which are not available to fossil-fuel based generators).

6. However, even under the refined standards found in most contemporary investment treaties, measures do not need to be adopted in bad faith, or be 'arbitrary, opportunistic or discriminatory' to fall foul of investment treaty standards.[7] A measure may be well-designed to achieve a legitimate public purpose and still be found to violate the rights of an investor.[8] Moreover, the obligations contained in investment treaties are standards which give significant discretion to arbitrators in their interpretation and application. Thus, even with modern drafting, there is a real risk that some climate change mitigation measures may still be found to breach host state obligations under investment treaties.

III. Carve-outs

7. A powerful tool that states can employ to safeguard their policy space are carve-outs or reservations for non-conforming measures. These are provisions which exempt certain measures from the scope of the

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[5] It is noted that a separate track of the OECD's work programme on The Future of Investment Treaties will be examining whether the substantive provisions of older investment treaties should be made more similar to those now commonly adopted in newer treaties. Given the scope of the current track of the work program, this submission does not discuss the merits of updating older-style investment treaties.

[6] See, eg, Singapore - Australia FTA (as amended in 2016), chp 8, fn 8.

[7] Tienhaara and Cotula (n 3) 13–14.

[8] Lise Johnson, Lisa Sachs and Nathan Lobel, 'Aligning International Investment Agreements with the Sustainable Development Goals' (2019) 58(1) *Columbia Journal of Transnational Law* 58, 99.

investment treaty as a whole, or from the scope of specific provisions. Typically, carve-outs and non-conforming measures provisions state that the treaty / obligation 'shall not apply to' the relevant measures.

A. Forms of carve-out

8. There are three main kinds of carve-outs or reservations found in contemporary investment treaties:

- *Treaty-wide carve-outs*: Treaty-wide carve-outs are frequently used to exclude government procurement, subsidies and taxation measures from the scope of investment agreements.[9] Although not common, there are also some examples of treaty-wide carve-outs being used to safeguard certain categories of public interest regulation or sensitive industries. For example, Canadian investment treaties usually include a clause stating that '[t]his Agreement does not apply to a measure adopted or maintained by a Party with respect to a person engaged in a cultural industry'.[10]

- *Obligation-specific reservations:* Most contemporary investment treaties exclude existing non-conforming measures or future measures in specified sectors from the scope of particular obligations, such as non-discrimination requirements or prohibitions on performance requirements. Typically, an annex or schedule lists each party's existing measures, and describes the sectors in which non-conforming measures may be introduced in the future. Where policy space is reserved for future measures, the relevant sectors are often described in great detail. For example, in its BIT with Kuwait, 'Japan reserves the right to adopt or maintain any measure relating to investment in fisheries', and defines "fisheries" as the 'taking and cultivation of aquatic resources, including the following fisheries related activities: (a) investigation of aquatic resources without taking such resources; (b) luring of aquatic resources; (c) preservation and processing of fish catches; (d) transportation of fish catches and fish products; and (e) provision of supplies to other vessels used for fisheries.'[11]

- *Carve-outs from the scope of ISDS*: A more novel form of carve-out, these provisions do not limit the scope of a treaty or of substantive obligations, but safeguard policy space by barring investors from challenging certain kinds of measures through ISDS. For example, several Australian investment agreements exclude ISDS claims relating to tobacco control measures.[12] Although a tobacco control measure would still be covered by the obligations in the investment treaties (and could potentially be in breach of those obligations), these carve-outs from ISDS remove the risk of a successful challenge and award of damages to an investor (although where a treaty allows state-state dispute settlement, this may still be available).

B. Benefits of using carve-outs for climate change mitigation measures

9. As shown by the examples given above, carve-outs and reservations are already used in many investment treaties, in different forms. Although they have not been framed to directly safeguard space for climate change policies, some of the carve-outs which have already been adopted in investment treaties are

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[9] See, eg, ASEAN – India Investment Agreement (2014), art 1.2.
[10] Canada – Serbia BIT (2014), art 18.7.
[11] Japan – Kuwait BIT (2012), Annex II, Schedule of Japan, item 7.
[12] Singapore - Australia FTA (SAFTA) (as amended in 2016) chp 8, art 22; Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) art 29.5 (note that the CPTPP exclusion operates as a denial of benefits provision which must be utilised by each treaty party); Australia - Hong Kong FTA Investment Agreement (2019), sec C, fn 14.

relevant to climate and energy policy. The United Arab Emirates has carved out the natural resources sector from the definition of an 'investment' under some of its investment treaties,[13] which effectively excludes fossil fuel extraction activities from the scope of investor protections. Canada has successfully defended a claim by an investor under NAFTA that a feed-in tariff scheme for renewable energy was discriminatory and included prohibited performance requirements, by relying on a clause excluding government procurement from the scope of the relevant obligations.[14]

10. Three features make carve-outs a particularly effective tool for protecting regulatory space:

- *Specificity of drafting*: While the scope of general exceptions is defined by the purpose of a measure, such as the protection of public health or the environment, carve-outs are usually described by reference to a particular industry (e.g. tobacco or cultural industries), or category of measure (e.g. subsidies or government procurement). This makes carve-outs narrower in scope than general exceptions, but it also provides host states and investors with greater certainty about what measures are excluded from the treaty or from the scope of particularly obligations.

- *No 'necessity' tests:* carve-outs do not usually require an examination of whether the measure is 'necessary' or 'designed and applied' to achieve a legitimate public purpose. If the measure is within the category which is excluded, no further consideration of the merits of the measure is required.

- *Consideration as a preliminary matter in disputes:* tribunals have generally been willing to consider the application of a carve-out as a preliminary matter, or at least before considering the merits of an investor's claim of breach of the relevant obligations, which can enable disputes to be resolved more quickly if the carve-out does apply.[15]

11. In future investment treaty negotiations, states that are particularly concerned about the potential for ISDS claims against climate change policies could consider using specifically designed carve-outs. States may be reluctant to exclude large or significant sectors of the economy, such as energy production, from the scope of all investor protections. However, carefully drafted and targeted carve-outs could be used to safeguard policy space in relation to the most sensitive or significant sectors, or in relation to specific obligations if there is a particular risk of climate mitigation policies breaching those standards. For example, coal-fired electricity generation could be excluded from the scope of application of an investment treaty, or from being the subject of ISDS claims. If states are using (or may in future use) incentives to encourage the development of renewable energy capacity, but are worried that these policies could be alleged to be discriminatory against fossil fuel-based power plants or could violate prohibitions on performance requirements (e.g. through the imposition of domestic content requirements), then they could carve-out the electricity generation sector and/or subsidies schemes and government procurement from the scope of obligations concerning non-discrimination and performance requirements.

IV. Refined use of general exceptions

12. One of the most common protections of regulatory space found in contemporary investment treaties are general exceptions clauses. Typically, investment treaties either incorporate, *mutatis mutandis*, or reproduce

[13] See, eg, UAE – Greece BIT (2014), art 1.1(e).
[14] See *Mesa Power Group LLC v Canada*, Award, PCA Case No. 2012-17 (24 March 2016), [465]–[466].]
[15] See, eg, *Mesa Power Group LLC v Canada*, Award, PCA Case No. 2012-17 (24 March 2016); *Global Telecom Holdings S.A.E. v Canada*, Award, ICSID Case No. ARB/16/16 (27 March 2020).

with little variation, the general exceptions clauses which are found in the World Trade Organization (WTO) Agreements: article XX of the General Agreement on Tariffs and Trade 1994 (GATT) and/or article XIV of the General Agreement on Trade in Services (GATS).

13. In my view, while these exceptions could potentially be used to defend some climate change mitigation measures, it should not be assumed that they can be relied upon as a defence to liability. For the reasons outlined at paragraph 10 above, carve-outs provide greater certainty and are a more effective tool for safeguarding policy space in areas where states are particularly aware of the potential for ISDS claims. However, general exceptions are likely to remain a common feature of investment treaties, and their broader scope means that they could prove useful to defend measures which had not been envisaged at the time of the treaty negotiation (and therefore were not covered by a carve-out). Considering this, this section discusses some clarifications and improvements in drafting which may enhance the utility of general exceptions in investment treaties, particularly with respect to climate change mitigation policies.

A. Is climate change mitigation covered by WTO-style general exceptions?

14. WTO-style general exceptions safeguard policy space in relation to an exhaustive list of permissible public interests, which includes 'measures to protect human, animal or plant life or health' (GATT article XX(b) and GATS article XIV(b)) and measures for the 'conservation of exhaustible natural resources' (GATT article XX(g)). In my view, either of these objectives could (and should) be interpreted as covering the mitigation of climate change. Moreover, many contemporary investment treaties clarify, either in the exceptions provision itself or in a footnote, that the 'protection of human, animal or plant life or health' covers 'environmental measures necessary for the protection of human, animal or plant life or health'.[16] However, in future investment treaties any potential ambiguity on this point should be removed by adding a specific reference to the protection of the environment and / or transition to a low carbon economy among the permissible objectives covered by the exceptions.

B. Exceptions and the requirement to compensate

15. Few arbitral tribunals have yet had to consider the invocation of a general exceptions clause in an investment treaty, but two tribunals have reached the problematic conclusion that the application of the exception does not relieve the host state from the requirement to pay compensation to an investor.[17] General exceptions which are based on their counterparts from the WTO agreements state that '[n]othing in this agreement shall be construed to prevent the adoption or enforcement' of covered measures. The tribunal in *Bear Creek Mining v Peru* held that a general exceptions clause drafted along these lines did not 'offer any waiver from the obligation in [the expropriation provision] to compensate.'[18] It is unclear if this finding from *Bear Creek* would apply for breaches of other investment treaty obligations, since it specifically refers to the obligation for expropriations to be compensated. The majority in *Eco Oro v Colombia* made a broader finding which applied in relation to the fair and equitable treatment obligation, holding that:

[16] See, eg, Canada – Korea FTA (2014), art 22.1.

[17] *Eco Oro Minerals Corp. v Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum, ICSID Case No. ARB/16/41 (9 September 2021), [830] ('*Eco Oro v Colombia)*

[18] *Bear Creek Mining Corp. v Peru*, Award, ICSID Case No. ARB/14/21 (30 November 2017), [477].

whilst a State may adopt or enforce a measure pursuant to the stated objectives in [the general exceptions] without finding itself in breach of the FTA, this does not prevent an investor claiming … that such a measure entitles it to the payment of compensation.[19]

The *Eco Oro* tribunal reached this conclusion despite both state parties to the relevant investment treaty arguing that, if the requirements of the general exception were met, that there would be no violation of the treaty and no payment of compensation would be required.[20]

16. *Eco Oro* and *Bear Creek* are only two arbitral decisions — both made by majority — and their approach to general exceptions may not be followed in future ISDS cases. However, these decisions demonstrate that there is ambiguity in the drafting of the general exceptions clauses which have been included in investment treaties to date. Given that awards of damages are the main remedy in ISDS disputes, if exceptions clauses do not preclude the requirement to compensate then they serve little purpose in safeguarding policy space, particularly in relation to areas such as climate change mitigation, where investors could potentially seek large damages payments for early retirement of fossil fuel assets.

17. For this reason, it is suggested that the language of GATT Article XX — that '[n]othing in this agreement shall be construed to prevent the adoption or enforcement' of covered measures — should not be used in the exceptions clauses of investment treaties. Instead, investment treaty exceptions clauses should state that the obligations in the treaty do not apply to the covered measures or clarify that no compensation is payable to an investor for a measure which is covered by the exception. If states do not intend for general exceptions to have the effect of removing the requirement to pay compensation for expropriations, then the agreement can be drafted so that the exception does not apply to the expropriation obligation.[21]

C. Necessity tests and the examination of alternative 'less-restrictive' measures

18. Several paragraphs of GATT article XX and GATS article XIV, and similarly phrased general exceptions in investment treaties, require that a measure be 'necessary' for the achievement of its purpose. Part of the necessity test, as it has been interpreted by the WTO Appellate Body, is an examination of whether there is a less trade restrictive alternative that could have achieved the measure's purpose.[22] The consideration of alternative measures could be problematic in relation to a complex and multifaceted problem such as climate change, where the reduction of greenhouse gases could be achieved through a wide range of different policies targeting different sectors of the economy. To take a simple example, an investor challenging the phase out of coal fired electricity generation may argue that the policy was not necessary, because a similar level of emissions reduction could have been achieved through other climate change mitigation policies, such as stringent vehicle emissions standards.

19. The WTO Appellate Body has addressed this problem by holding that where a 'comprehensive strategy' is taken to protect a public interest, complementary policies or measures that are already a part of that

[19] *Eco Oro v Colombia*, [830].
[20] Canada's views, as the non-disputing state party, are restated in paragraph 836.
[21] For examples of general exceptions that do not apply in relation to expropriation obligations, see Japan – Australia EPA (2014), art 14.15; CETA (2016), art 28.3.1; ANCERTA Investment Protocol (2011), art 19.
[22] See Appellate Body Report, *India – Solar Cells*, [5.59]; Appellate Body Report, *Colombia – Textiles*, [5.71]–[5.73], [5.77]; Appellate Body Reports, *EC – Seal Products*, [5.169].

strategy should not be treated as alternatives when assessing the necessity of a challenged measure.[23] To avoid claimants arguing that a wide range of alternatives may exist to any given climate change mitigation policy, states may wish to clarify in the treaty text that in considering whether a measure is necessary, any examination of alternative measures should be limited to the same sector of the economy, and complementary elements of a comprehensive regulatory strategy should not be viewed as alternatives.

V. Conclusions and recommendations

20. Even carefully drafted substantive obligations may not be sufficient to ensure that host states can successfully defend climate change mitigation measures which are challenged through ISDS, and therefore states should consider the use carve-outs or exceptions to safeguard policy space.

21. Carve-outs or reservations are a particularly effective tool for safeguarding policy space because they exclude certain measures from the scope of an investment treaty or from the scope of particular obligations. States could use carve-outs to remove particularly sensitive or significant industries from the scope of investment treaties (e.g. coal-fired electricity generation), or to exclude climate change mitigation policies from specific obligations if there is a particular risk of breaching those standards (e.g. excluding feed-in tariffs or other incentives for renewable energy production from non-discrimination obligations and prohibitions on performance requirements).

22. States should be cautious about adopting the language of WTO general exceptions in their investment treaties. Instead, general exceptions should be drafted in a way which clarifies that: (a) protection of the environment and / or energy transition are permissible objectives; (b) no compensation is payable in relation to measures covered by the exception; and (c) when considering whether a measure is 'necessary', examination of alternative measures should be limited to the same economic sector as the challenged measure, and that complementary aspects of a broad regulatory strategy are not alternatives.

I am happy to provide further information on any aspect of this submission, or to discuss these issues with members of the OECD Investment Committee and Secretariat.

Yours faithfully,

Dr Elizabeth Sheargold
Email: elizabeth_sheargold@uow.edu.au

[23] Appellate Body Report, *Brazil – Retreaded Tyres*, [172]. However, in a recent case under art 2.2 of the WTO Agreement on Technical Barriers to Trade, the Appellate Body suggested that 'strengthened variations of … existing measures' that are part of a comprehensive policy response may qualify as reasonably available alternatives. See Appellate Body Reports, *Australia – Tobacco Plain Packaging*, [6.501].

Contribution to the Public Consultation on Investment Treaties and Climate Change, organized by the Organization for Economic Cooperation and Development (OECD) Investment Committee, submitted by the Centre for Research on Multinational Corporations (SOMO)[1]

25 March 2022

A. Introduction

1. In 2015, 197 countries signed up to the Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC), which sets out to limit global warming to 2°C above pre-industrial levels and to pursue efforts to limit warming to 1.5°C, with the purpose to "significantly reduce the risks and impact of climate change".[2] The latest report by the Intergovernmental Panel on Climate Change shows how human-induced climate change is already causing dangerous and widespread disruption in nature and affecting the lives of billions of people around the world. The report's findings underline the urgency for climate action, stressing that "any further delay in concerted global action will miss a brief and rapidly closing window to secure a liveable future".[3]
2. In order to have a reasonable chance of meeting the Paris Agreement' objectives and to prevent dangerous climate change, governments must rapidly boost clean energy and reduce fossil fuel use to bring global energy-related carbon dioxide emissions to net zero by 2050. This requires nothing less than "a complete transformation of how we produce, transport and consume energy", including phasing out or retrofitting high-emitting infrastructure and no investments in new fossil fuel supply.[4] In line with the UNFCCC's equity principle of 'common but differentiated responsibility', wealthy and high-emitting

[1] SOMO is an independent, non-profit research and network organization that promotes sustainable and fair global economic development and the elimination of the structural causes of poverty, environmental problems, exploitation and inequality. SOMO works together with partner organizations across the world to advocate for responsible and sustainable investment policies and practices. SOMO actively participates in various domestic and international fora on investment policy and ISDS reform, including at UNCITRAL Working Group III, as well as the UN negotiations on a binding treaty on business and human rights. SOMO supports workers, communities, individuals and civil society organizations in submitting amicus curiae briefs in ISDS proceedings as well as in their complaints to various non-judicial grievance mechanisms, including under the OECD Guidelines for Multinational Enterprises. SOMO is both a member and host of OECD Watch, which is the official representative of civil society at the OECD Investment Committee.
[2] Article 2(1)(a) of the Paris Agreement on Climate Change, United Nations, 2015, available at: https://unfccc.int/sites/default/files/english_paris_agreement.pdf
[3] IPCC Sixth Assessment Report, Press Release, 28 February 2022, available at: https://www.ipcc.ch/report/ar6/wg2/resources/press/press-release/. See also: IPCC Working Group II Sixth Assessment Report, "Climate Change 2022: Impacts, Adaptation and Vulnerability: Summary for Policymakers", available at: https://www.ipcc.ch/report/ar6/wg2/downloads/report/IPCC_AR6_WGII_SummaryForPolicymakers.pdf.
[4] IEA, "Net Zero by 2050: A Roadmap for the Global Energy Sector", October 2021, available at: https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf.

countries need to phase out all oil and gas production already by 2034, with extended time frames to 2050 for less wealthier countries.[5]

3. Necessary climate action will inevitably impact the profitability, and sometimes even the viability, of carbon-intensive investments, and almost certainly will create billions or even trillions of dollars in unprofitable assets. Such 'stranded assets' are commonly defined as "assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities".[6] A recent study warns that about half of the world's fossil fuel assets - estimated between US$11-14 trillion in infrastructure, property and investments - will be worthless by 2036 under a net zero transition.[7]
4. To ensure a just low-carbon energy transition, it is key to prevent fossil fuel investors from offloading the costs of the transition, and the financial risks of their stranded assets, onto society at large. In the first place, investors must ensure that when they exit from fossil fuel projects, they do so responsibly; secondly, governments need to ensure that their investment policies and treaties are consistent with climate change objectives; and thirdly, governments must retain sufficient flexibilities to manage capital flows and policy space for sustainable finance.

B. Responsible Disengagement from Fossil Fuels

5. The potentially devastating negative impact of climate change necessitates that companies quickly disengage from business activities extracting and using fossil fuels. However, disengagement has serious consequences for workers, their families and local communities that depend on the income from the economic activity generated by fossil fuel extraction and that may have little or no safety net or social protection. This is particularly problematic in countries with absent or weak state governance such as conflict-affected areas. In post-conflict regions, irresponsible disengagement may unwittingly reignite conflict and tensions, potentially leading to more violence and the re-victimization of local communities and populations. Abandoning these workers and communities, many of whom have borne the brunt of the negative human rights and environmental impacts of fossil fuel extraction for decades, without remediating these impacts would be unjust and irresponsible. Disengagement from fossil fuels is necessary, but it must be done in a manner that is just and responsible in order to avoid causing additional negative human rights and environmental impacts.[8]
6. In order to disengage responsibly, the disengaging company must remediate all previous adverse impacts it caused or to which it contributed, even if the company disengages from

[5] D. Calverley and K. Anderson, "Phaseout Pathways for Fossil Fuel Production within Paris-Compliant Carbon Budgets", 22 March 2022, available at: https://www.research.manchester.ac.uk/portal/files/213256008/Tyndall_Production_Phaseout_Report_final_text_3_.pdf.
[6] B. Caldecott, N. Howarths & P. McSharry, "Stranded Assets in Agriculture: Protecting Value from Environment-Related Risks", Smith School of Enterprise and the Environment and University of Oxford, August 2013, available at: https://www.smithschool.ox.ac.uk/publications/reports/stranded-assets-agriculture-report-final.pdf.
[7] J.F. Mercure, P. Salas, P. Vercoulen *et al.*, "Reframing incentives for climate policy action, *Nature Energy* 6, 1133-1143 (2021), available at: https://doi.org/10.1038/s41560-021-00934-2.
[8] SOMO, "Responsible Disengagement from Coal as Part of a Just Transition", 12 July 2021, available at: https://www.somo.nl/responsible-disengagement-from-coal-as-part-of-a-just-transition/

the business relationship through which it contributed to the impact.[9] Thus, energy companies that disengage from fossil fuel suppliers continue to be responsible for addressing the impacts to which they contributed to during their relationship – even after they have disengaged. Similarly, fossil fuel companies disengaging from fossil fuel extraction continue to bear responsibility for impacts that they caused or contributed to during the extraction.

7. The significant contribution of fossil fuels to climate change means that all mining and energy companies should develop ambitious and just plans to responsibly disengage from fossil fuels completely. Companies should prioritize disengaging from fossil fuel relationships and projects that are associated with severe human rights abuses as the first from which to disengage, and do so in the short term. In all cases, companies should use their leverage to mitigate negative impacts to workers and local communities as they disengage. Finally, the OECD Guidelines are clear that disengagement should not occur without responsible exit strategies or just transition plans, developed through meaningful, good-faith bargaining with workers, trade unions and local civil society organizations.[10]

C. Responsible and Climate-friendly Investment Policies and Treaties

I The Misalignment between Investment Treaties and Climate Objectives

8. Currently existing investment treaties and the system of investor-to-state dispute settlement (ISDS) are ill-equipped to enhance the climate objectives. Up to 3,000 bilateral investment treaties and free trade agreements with provisions on investment provide foreign investors with extensive protections against government measures that might damage their investments. Under the ISDS mechanism, foreign investors can directly sue governments outside of their national courts and claim monetary compensation before private arbitration tribunals.

9. Investment treaties grant foreign investors, irrespective of their climate impact, substantive and procedural rights that extend beyond those found in many domestic legal systems, consisting of broad and vaguely-worded standards that are generally open to wide interpretation.[11] Among other things, investment treaties oblige governments to provide foreign investors fair and equitable treatment (FET), which has been interpreted as protecting investors' legitimate expectations regarding their business plans and future government conduct.[12] They also set out conditions for both direct and indirect expropriation to be lawful, the latter being a catch-all standard that may cover a wide variety of regulatory measures that severely affect the use of an asset. Both standards have been most frequently invoked by foreign investors to challenge a wide range of

[9] OECD, OECD Due Diligence Guidance for Responsible Business Conduct, 2018, available at: http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf
[10] OECD, OECD Guidelines for Multinational Enterprises, 2011, available at: https://www.oecd.org/daf/inv/mne/48004323.pdf
[11] SOMO, "Super-Protections for Corporations: How Investment Treaties and Investor-to-State Dispute Settlement Grant Foreign Investors Greater Rights than Dutch and EU Law", Fact Sheet, 16 March 2021, available at: https://www.somo.nl/wp-content/uploads/2021/03/SOMO-Factsheet-Greater-rights.pdf.
[12] L. Johnson (2018), "A Fundamental Shift in Power: Permitting International Investors to Convert their Economic Expectations into Rights", UCLA Law Review, available at: https://www.uclalawreview.org/fundamental-shift-in-power/#_ftnref1.

regulatory measures, including non-discriminatory and legitimate measures to advance public policy objectives.[13]

10. Investment treaties typically order governments to pay the *fair market value* in case of expropriation, but they generally do not further specify how to determine that value nor what methods to use for breaches of other investment protection standards. Compensation amounts can expand to billions of euros, particularly when arbitrators apply speculative and highly-controversial income-based approaches incorporating expected future earnings to assess the value of an affected asset.[14] This could potentially lead to situations of overcompensation in the case of fossil fuel assets that are likely to become stranded.[15]

11. These financial awards can be a significant burden on public budgets, particularly in less wealthier countries. Governments could feel compelled to drop or water down climate policy measures in fear of expensive and unpredictable ISDS arbitration, or they could end up paying more compensation than anticipated because of negotiations taking place under the shadow of ISDS. While it remains difficult to establish the precise effects of such (perceived) threats, the existence of such 'regulatory chill' effect has been widely recognized by governments[16], international institutions[17], academics[18], and even among arbitrators themselves.[19]

12. According to ICSID's latest case statistics, 25% of all cases relate to oil, gas and mining, and another 17% relate to electric power and other energy, making them the most litigated economic sectors.[20] Some of the largest fossil fuel companies have been successful in

[13] Out of 657 cases of which details are known, 555 cases involve allegations of a breach of FET and 450 cases involve allegations of a breach of indirect expropriation. Out of 234 awards of which details are known, 154 involve breach of FET and 65 breach of indirect expropriation. UNCTAD, Investment Dispute Settlement Navigator, last accessed at 24 March 2022, available at: https://investmentpolicy.unctad.org/investment-dispute-settlement?id=800&name=rockhopper-v-italy.

[14] J. Bonnitcha & S. Brewin, "Compensation Under Investment Treaties: What are the problems and what can be done?", IISD Policy Brief, December 2020, available at: https://www.iisd.org/system/files/2020-12/compensation-investment-treaties-en.pdf.

[15] K. Tienhaara, L. Johnson and M. Burger, "Valuing Fossil Fuel Assets in an Era of Climate Disruption", IISD Investment Treaty News, 20 June 2020, available at: https://www.iisd.org/itn/en/2020/06/20/valuing-fossil-fuel-assets-in-an-era-of-climate-disruption/#_ftn20.

[16] UNCITRAL Working Group III Report, 36th Session, A/CN.9/964 para 111, available at: https://documents-dds-ny.un.org/doc/UNDOC/GEN/V18/075/12/PDF/V1807512.pdf?OpenElement; UNCITRAL Working Group III, Comments from the Government of Indonesia, A/CN.9/WG.III/WP.156, para 10, available at: https://documents-dds-ny.un.org/doc/UNDOC/LTD/V18/075/93/PDF/V1807593.pdf?OpenElement; UNCITRAL Working Group III, Submission from the Government of South Africa, A/CN.9/WG.III/WP.176, para 63, available at: https://documents-dds-ny.un.org/doc/UNDOC/LTD/V19/072/51/PDF/V1907251.pdf?OpenElement.

[17] UNCTAD, World Investment Report 2018, p.112, available at: https://unctad.org/system/files/official-document/wir2018_en.pdf; D. Gaukrodger, "The balance between investor protection and the right to regulate in investment treaties: A scoping paper", *OECD Working Papers on International Investment*, No. 2017/02, OECD Publishing, Paris, https://doi.org/10.1787/82786801-en.

[18] K. Tienhaara (2018), "Regulatory chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement", Transnational Environmental Law 7(2), 229-250; J. Kelsey (2017), "Regulatory chill: learnings from New Zealand's plain packaging tobacco law", QUT Law Review 17(2), 21-45; G. Van Harten & D. Nadine Scott (2016), "Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study from Canada", Osgoode Legal Studies Research Paper Series 12(6).

[19] Odyssey Marine Exploration, Inc. v. United Mexican States, ICSID Case No. UNCT/20/1, Procedural Order No. 6, 20 December 2021, Professor Sands' Dissenting Opinion, para 2, available at: http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C8573/DS17216_En.pdf; Clayton and Bilcon of Delaware Inc. v. Government of Canada, PCA Case No. 2009-04, 14 May 2015, Dissenting Opinion of Professor Donald McRae, para 51, available at: https://www.italaw.com/sites/default/files/case-documents/italaw4213.pdf; T. Landau in J. Hill, "ISDS: The Devil in the Trade Deal", Australian Broadcasting Corporation, Background Briefing, 26 July 2015, available at: https://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/6634538.

[20] ICSID, The ICSID Caseload - Statistics, Issue 2022-1, available at: https://icsid.worldbank.org/sites/default/files/documents/The_ICSID_Caseload_Statistics.1_Edition_ENG.pdf

ISDS cases, with eight out of the eleven largest known awards (all over US$1 billion) involving fossil fuel companies or shareholders.[21]

13. A number of cases have already been threatened or initiated, which could set an alarming precedent for future climate action. Most notably, German energy companies RWE and Uniper are suing the Netherlands for EUR 2.4 billion in damages under the Energy Charter Treaty over the country's decision to prohibit coal-fired energy production by 2030 in order to reduce emissions by 49% from 1990s level before 2030 and to meet its climate targets under the Paris Agreement.[22]

14. In 2011, a local government in Germany decided to water down environmental restrictions imposed on a coal-fired power plant after the Swedish owner, Vattenfall, sued Germany for €1.4bn.[23] In 2017, the British oil and gas company Rockhopper sued Italy for €350m following its decision not to grant a concession for oil drilling in the Adriatic Sea because of concerns over earthquake risks and environmental damage.[24] In the same year, Canadian oil and gas company, Vermilion, threatened to file a claim against the French government over a proposed law to ban fossil fuel extraction on French territory by 2040.[25] In 2020, UK gas company Ascent Resources notified the government of Slovenia that it has begun procedures to start an ISDS case for requiring the company to conduct an environmental impact assessment in relation to its fracking project.[26] And in 2021, Canadian energy company TC Energy lodged a claim against the United States in which it is seeking US$15 billion in compensation for the cancellation of the Keystone XL pipeline as part of US President Biden's climate commitments.[27]

15. These developments show that existing investment treaties (potentially) enable fossil fuel investors to largely offload the risks and costs associated with regulatory changes onto the society at large. The broad scope of potential liability puts greater pressure on governments to refrain from taking climate action. Foreign investors could also be less inclined to anticipate possible future climate measures and to divest from fossil fuels, and instead try to recover the losses through compensations under ISDS.

II Realigning Investment Policy with Climate Objectives

16. OECD members should consider the following, non-exhaustive and not mutually exclusive suggestions:

[21] UNCTAD, Investment Dispute Settlement Navigator, last accessed at 24 March 2022, available at: https://investmentpolicy.unctad.org/investment-dispute-settlement.
[22] RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands, ICSID Case No. ARB/21/4. Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands (ICSID Case No. ARB/21/22). See also, SOMO, Ember and IEEFA, "Compensation for Stranded Assets? German energy giants claim billions in public funds for loss-making Dutch coal-fired power plants", 28 April 2021, available at: https://www.somo.nl/compensation-for-stranded-assets/.
[23] Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6, Award, 11 March 2011.
[24] Rockhopper Exploration Plc, Rockhopper Italia S.p.A. and Rockhopper Mediterranean Ltd v. Italian Republic, ICSID Case No. ARB/17/14, Pending.
[25] The French government ultimately decided to water down the law by allowing exploitation permits to be renewed after that period. Corporate Europe Observatory, Transnational Institute, Friends of the Earth Europe/International, "Blocking Climate Change Laws with ISDS Threats: Vermilion v. France", 2019, available at: https://10isdsstories.org/cases/case5/.
[26] Ascent Resources Plc and Ascent Slovenia Ltd. v. Republic of Slovenia, Notice of Intent, 23 July 2020, available at: https://www.italaw.com/sites/default/files/case-documents/italaw11654.pdf.
[27] TC Energy Corporation and TransCanada Pipelines Limited v. United States of America, ICSID Case No. ARB/21/63.

17. Ensure greater coherence between investment policies and climate commitments at national, regional and international levels. This means also greater coordination and cooperation between investment and environment departments within governments and state institutions, and promoting discussion and awareness on the tension between investment law and climate policy in other international fora, most notably within the framework of the UNFCCC.[28] Governments should take a coordinated approach to reforming investment policy and ISDS in relation to ongoing efforts at national, regional and multilateral level, for example at UNCTAD, UNCITRAL Working Group III, the WTO, OHCHR, OECD, and ECT modernization, to enhance greater consistency and efficiency.
18. Take stock of existing investment treaties, evaluate them on their climate impact, and reconsider the costs and benefits of investment treaties and ISDS. A burgeoning body of empirical evidence already shows that existing investment treaties and ISDS are hardly determining factors in attracting increased volumes of investment, including in renewable energy.[29] Moreover, they do not necessarily contribute to the depoliticization of investment disputes or the promotion of the rule of law and good governance in host states.[30]
19. Terminate or withdraw from existing investment treaties that are not in line with climate and sustainable development objectives. As governments are engaged in various ongoing reform processes, foreign investors can still rely on these existing treaties and challenge climate measures. Governments could consider preparing and adopting a multilateral agreement to terminate existing treaties and to neutralize applicable ‘sunset’ clauses under which existing investments may continue to be protected for extensive periods.[31] Conversely, governments could also consider developing a multilateral instrument to withdraw consent to ISDS under existing treaties[32], or adopting a moratorium or waiver on all ISDS claims related to climate policy measures.[33]
20. Move away from the current treaty models that focus on strong investment protection and arbitration and develop new models for investment governance conducive to advancing climate and sustainable development objectives. Such new models should focus on

[28] UNCTAD’s 2015 Investment Policy Framework for Sustainable Development offers a useful point of reference for policymakers in formulating national investment policies, in negotiating and reviewing investment treaties, and in designing concrete policy initiatives to promote investment in priority sectors for sustainable development and the energy transition. Available at: https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf.
[29] J. Pohl (2018), "Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence", *OECD Working Papers on International Investment*, No. 2018/01, OECD Publishing, Paris, https://doi.org/10.1787/e5f85c3d-en.
[30] L. Johnson, L. Sachs, B. Güven, J. Coleman, “Costs and Benefits of Investment Treaties: Practical Considerations for States”, CCSI Policy Paper, March 2018, available at: https://ccsi.columbia.edu/sites/default/files/content/docs/publications/07-Columbia-IIA-investor-policy-briefing-ENG-mr.pdf; J. Bonnitcha, “Assessing the Impacts of Investment Treaties: Overview of the Evidence”, IISD Report, September 2017, available at: https://www.iisd.org/system/files/publications/assessing-impacts-investment-treaties.pdf.
[31] This agreement could be modeled after the Agreement for the Termination of Bilateral Investment Treaties between the Member States of the European Union, 29 May 2020, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22020A0529(01)&from=EN.
[32] CCSI, IIED and IISD, “Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements”, submission to UNCITRAL Working Group III on ISDS reform, 15 July 2019, available at: https://ccsi.columbia.edu/sites/default/files/content/docs/publications/UNCITRAL-submission-Withdrawal-of-Consent-and-Termination.pdf.
[33] See for example CCSI, “Call for ISDS Moratorium During COVID-19 Crisis and Response”, 6 May 2020, available at: https://ccsi.columbia.edu/content/call-isds-moratorium-during-covid-19-crisis-and-response. In the second part of its Trade and Development Report 2021, UNCTAD proposes a limited climate waiver of WTO trade and environment rules combined with a ‘peace clause’ for disputes on trade-related environmental measures as one possible route forward. Similar climate waivers and peace clauses for ISDS claims could be developed to give countries the assurance that they will not face disputes for climate and development-friendly initiatives that could be challenged under ISDS. UNCTAD, “Trade and Development Report 2021. From Recovery to Resilience: The Development Dimension”, United Nations, 28 October 2021, p.141, available at: https://unctad.org/system/files/official-document/tdr2021_part2_en.pdf.

discouraging climate-unfriendly investments, promoting climate-friendly investments, and supporting a just transition to low-carbon societies. The proposed *Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation* developed by a group of lawyers and economists could serve as a point of reference.[34] Such new models should incorporate the following elements:

a. Exclusion of fossil fuel and other high-emitting investments from the scope of the treaty. Likewise, governments should carefully (re)draft definitions on investments to ensure that only responsible, sustainable and climate-friendly investments that materially contribute to greening the economy of the host state are covered. Inspiration could be drawn from the EU Taxonomy for Sustainable Activities and the OECD's FDI Qualities Policy Toolkit on how to harness investment for sustainable development and climate policy in line with the objectives of the Paris Agreement.[35] As a practical example, the EU is already proposing such an approach in the context of the ECT modernization and seeks to phase out protection for existing fossil fuel investments, while excluding new fossil fuel investments from treaty coverage (except for certain gas projects).[36]
b. Better safeguarding the policy space for governments to regulate and implement ambitious climate policy measures by significantly narrowing down the scope of substantive protection standards. New models should ensure and define what governments are prohibited from doing (e.g. discriminatory conduct, breach of due process, physical abuse, direct expropriation without compensation) and omit vaguely worded standards such as fair and equitable treatment, full protection and security, and indirect expropriation that could be invoked by foreign investors to challenge good faith and legitimate public interest measures. As governments have a duty to protect individuals from environmental degradation[37], incorporating new provisions on the right to regulate and exceptions on environment and other public interests are not the right way forward as they generally do not preclude compensation claims following the exercising of that duty.[38]
c. OECD members could work towards an instrument, a joint declaration, or draft treaty text that provides for a cut-off date after which fossil fuel investors can no

[34] N. Bernasconi-Osterwalder *et al.* (2018), "Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation: Aligning International Investment Law with the Urgent Need for Climate Change Action", *Journal of International Arbitration 6*(1), pp. 7-35. See also, M. Brauch (2020), "Reforming International Investment Law for Climate Change Goals", in M. Mehling & H. van Asselt (Eds.) *Research Handbook on Climate Finance and Investment Law*. Edward Elgar Publishing. Available at: https://academiccommons.columbia.edu/doi/10.7916/d8-5h9r-4r38/download.

[35] European Commission, "EU Taxonomy for Sustainable Activities: What the EU is doing to create an EU-wide classification system for sustainable activities", available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en; OECD, "FDI Qualities Policy Toolkit: Policies for improving the sustainable development impacts of investment", Consultation Paper for 6th FDI Qualities Policy Network Meeting, 16 November 2021, available at: https://www.oecd.org/investment/investment-policy/FDI-Qualities-Policy-Toolkit-Consultation-Paper-2021.pdf.

[36] European Union additional submission to its text proposal for the modernization of the Energy Charter Treaty, 19 May 2020, available at: https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159436.pdf. Although a step in the right direction, this proposal still suffers from several shortcomings. See for example: CAN Europe *et al.*, "Energy Charter Treaty (ECT) Reform: Why it has failed to deliver on the EU's own objectives", Briefing Paper, March 2022, available at: https://caneurope.org/content/uploads/2022/03/ECT-reform-briefing-March-2022.pdf.

[37] G. Reeh, "Human Rights and the Environment: The UN Human Rights Committee Affirms the Duty to Protect", EJIL: Talk! Blog of the European Journal of International Law, 9 September 2019, available at: https://www.ejiltalk.org/human-rights-and-the-environment-the-un-human-rights-committee-affirms-the-duty-to-protect/.

[38] Eco Oro Minerals Corp. v. The Republic of Colombia, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, para. 829, available at: https://www.italaw.com/sites/default/files/case-documents/italaw16212.pdf.

longer claim damages resulting from climate measures. This cut-off date should preferably be in the past. The adoption of the UNFCCC in 1992 already showcased the global commitment to reduce emissions to prevent dangerous anthropogenic interference with the climate system; subsequent international action only further underscored this commitment. As a result, the only legitimate expectations foreign investors could have is that governments would progressively adopt more stringent measures aimed at phasing out fossil fuels.[39]

d. Greater policy coherence on investment policy and responsible business conduct. Governments should for example require in their treaties compliance with the UNGPs, OECD Guidelines and other due diligence legislation, in order to mitigate adverse impacts from corporate activities and prevent irresponsible investors from challenging government action to advance human rights, environmental protection and social justice.[40] Governments should in their treaties give supremacy to their international obligations in the area of human rights and environmental law (including the UNFCCC) vis-à-vis their obligations under investment treaties.[41]
e. Development of more precise textual guidance for determining compensation to avoid overly large awards, based on speculative and controversial valuation techniques, that run the risk of overcompensation and disrupting public budgets. Much can be learned from how other international and domestic courts and tribunals deal with the issue of damages. A number of mitigating and contextual factors could be weighed in, such as whether the disputed measure was legal or not, whether losses exceed normal company risk, whether the measure was foreseeable and serving a public interest, whether there was a situation of investor misconduct, and whether the host state is able to pay.[42]
f. Abolish the ISDS mechanism and explore alternative avenues for dispute resolution, including: strengthening domestic legal systems; the use of risk insurance by investors; dispute prevention through inclusive and transparent national and state-state dialogues and contact points; using state-to-state dispute settlement mechanisms; and using existing human rights mechanisms for certain types of redress.[43]

[39] Prime examples here are the RWE and Uniper cases against the Netherlands. The companies opened their coal-fired power plants in the Netherlands respectively in 2015 and 2016 with the expectancy to operate them for the full life cycle of forty years. Both companies are now seeking EUR 2.4 billion in compensation for lost expected revenues beyond 2030 when the Dutch ban on coal-fired power generation becomes effective. For more analysis on these cases, see: SOMO, Ember and IEEFA, “Compensation for Stranded Assets? German energy giants claim billions in public funds for loss-making Dutch coal-fired power plants”, 28 April 2021, available at: https://www.somo.nl/compensation-for-stranded-assets/.
[40] For a broader discussion, see D. Gaukrodger (2021), "Business responsibilities and investment treaties", *OECD Working Papers on International Investment*, No. 2021/02, OECD Publishing, Paris, https://doi.org/10.1787/4a6f4f17-en; United Nations General Assembly, “Report from the Working Group on the Issue of Human Rights and Transnational Corporations and other Business Enterprises”, A/76/238, 27 July 2021, available at: https://documents-dds-ny.un.org/doc/UNDOC/GEN/N21/208/09/PDF/N2120809.pdf?OpenElement.
[41] Essex Business and Human Rights Project, Submission to the OEIWG, 28 February 2018, available at: https://www1.essex.ac.uk/ebhr/documents/Submission%20of%20the%20Essex%20Business%20and%20Human%20Rights%20Project.pdf
[42] J. Bonnitcha & S. Brewin, “Compensation Under Investment Treaties: What are the problems and what can be done?”, IISD Policy Brief, December 2020, available at: https://www.iisd.org/system/files/2020-12/compensation-investment-treaties-en.pdf; SOMO, “Super-Protections for Corporations: How Investment Treaties and Investor-to-State Dispute Settlement Grant Foreign Investors Greater Rights than Dutch and EU Law”, Fact Sheet, 16 March 2021, available at: https://www.somo.nl/wp-content/uploads/2021/03/SOMO-Factsheet-Greater-rights.pdf..
[43] L. Johnson, J. Coleman, B. Güven, L. Sachs, “Alternatives to Investor-State Dispute Settlement”, CCSI Working Paper, April 2019, available at: https://ccsi.columbia.edu/sites/default/files/content/docs/blog/Alternatives-to-ISDS-11-April-2019_0.pdf; J. Kelsey,

D. Flexibilities to Manage Capital Flows and Policy Space for Sustainable Finance

I Managing Capital Flows for Climate Mitigation and Adaptation

21. Free capital movements have resulted in very volatile capital and (portfolio) investment, and FDI flows. Quantitative easing (QE) by Western countries have had negative impacts on (low-to-middle income) countries' exchange rates and related attractiveness for FDI profitability and debt repayment capacity, as well as portfolio investments. While countries might be implementing policies to attract foreign investment to achieve the Paris climate goals, they now see more money flowing out of their countries, or are faced with sudden very volatile short-term capital flows while longer term dedicated (financial) investments are needed.

22. The IMF is reviewing its Institutional View on the Liberalization and Management of Capital Flows of 2012, following an evaluation concluding that IMF advice on capital flows has been too restrictive, and that more pre-emptive, ex-ante and more long-lasting use of capital flow measures are needed in some circumstances.[44] Such circumstances include spill-overs from external (monetary) policies and exogenous shocks, such as changes in QE and unexpected shocks such as pandemics or swift changes in regulation to orient capital flows and investments towards climate change goals.[45]

23. Investment treaty provisions on capital transfers tend to restrict the policy space for necessary capital flow management, including for orientating investment for climate goals and avoiding negative impacts on climate mitigation and adaptation (e.g. more debt repayment outflows than sustainable investment inflows).[46]

24. Consequently, governments should thoroughly rewrite provisions on financial transaction, capital flows and balance of payment restrictions in their investment treaties (as well as in the OECD Code of Liberalization of Capital Movements). Treaty parties could also opt to conclude a memorandum of understanding or a joint interpretative statement to allow for more flexibility to smartly manage financial transactions, capital flows and balance of payments problems.

II Policy Space for Corporate and Sustainable Finance Requirements and Regulation

25. In order to direct more private investment and capital towards achieving the Paris climate goals, many governments are undertaking 'sustainable finance' policies, with various

"UNCITRAL Working Group III: Promoting Alternatives to Investor-State Arbitration as ISDS Reform", IISD Investment Treaty News, 2 October 2019, available at: https://www.iisd.org/itn/en/2019/10/02/uncitral-working-group-iii-promoting-alternatives-to-investor-state-arbitration-as-isds-reform-jane-kelsey/; A. Arcuri & F. Montanaro (2018), "Justice for All? Protecting the Public Interest in Investment Treaties", *Boston College Law Review 59*(8), 2791-2824.

[44] IEO, "IMF Advice on Capital Flows", Evaluation Report 2020, available at: https://ieo.imf.org/-/media/IEO/Files/evaluations/completed/09-30-2020-imf-advice-on-capital-flows/cfm-report-final.ashx.

[45] M. Das, G. Gopinath and Ş. Kalemli-Özcan, "Preemptive Policies and Risk-Off Shocks in Emerging Markets." *IMF Working Paper*, no. 22/3., January 2022; K. Bergant and K. Forbes, "Macroprudential Policy During COVID-19." *NBER Working Paper*, no. 29346, October 2021.

[46] M. Vander Stichele & B.J. Verbeek, The Impact of the EU-Singapore Investment Protection Agreement on Managing Government Bonds and Capital Flows, SOMO Briefing paper, 11 February 2019, https://www.somo.nl/wp-content/uploads/2019/02/The-impact-of-EUSIPA-on-managing-government-bonds-and-capital-flows-1.pdf

voluntary or mandatory measures subjecting financial investors as well as mostly large internationally operating companies to various climate related requirements. One of the core requirements for financing Paris-aligned corporations, projects and activities is (financial) corporate disclosure and reporting on climate and environmental, social and governance (ESG) risks and impacts, which are very different per country.[47]

26. Another requirement might be to align green direct investments or portfolio investments according to a taxonomy, which has different definitions of climate mitigation and adaptation per jurisdiction (see also para 20(a) above). In the future, more mandatory obligations to align with the Paris agreement are expected, given the alarming figures on climate change, and related environmental and social aspects. The recent COP26 saw the establishment of the Glasgow Financial Alliance for Net Zero, a forum for leading financial institutions to accelerate the energy transition, and a new International Sustainability Standards Board to develop ESG disclosure standards for companies. Law firms are expecting ISDS cases to arise as a result of domestic ESG regulations, impairing the value of investor assets.[48]

27. Investment treaties and services agreements (especially related to mode 3) will have to ensure sufficient policy space to align with different policies and regulations to achieve the Paris climate goals and national indicative programmes. In order to avoid undue disputes and uncertainties, treaty provisions will need to be reviewed related to national treatment and other non-discrimination measures such as most-favoured nation, domestic regulation, market access, financial services, government procurement, subsidies, and modification of schedules.

[47] International Platform on Sustainable Finance, State and trends of ESG disclosure policy measures across IPFS jurisdictions, Brazil, and the US, November 2021, https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-esg-disclosure-report_en.pdf .

[48] Freshfields Bruckhaus Deringer, "The Rising Significance of ESG and the Role of International Arbitration", International Arbitration Trends 2022, available at: https://www.freshfields.com/en-gb/our-thinking/campaigns/international-arbitration-in-2022/the-rising-significance-of-esg-and-the-role-of-international-arbitration/.

25 March 2022

Contribution to the OECD
Public Consultation on Investment Treaties and Climate Change

- Matthew Stephenson, Head, Investment Policy and Practice, World Economic Forum
- José Henrique Vieira Martins, Graduate Institute of International and Development Studies, Geneva (Currently on leave from the Brazilian Ministry of the Economy)

Overview

Tackling climate change has become a shared imperative. While there is growing awareness and action on how trade can help diminishing carbon emissions and mitigate climate change, the role that investment policy and practice can play is less properly understood or explored.

For this reason, we are working on an inventory of measures to promote and facilitate foreign direct investment (FDI) that contributes to environmental goals ('green FDI') as well as a subset of these measures that contribute directly to climate goals ('climate FDI'). We plan to publish these measures by the end of 2022, and hope this will serve as an additional resource for efforts to tap investment flows[1] in support of climate goals.

The rest of this contribution is thus structured as follows: (a) presenting a question of scope that we suggest the OECD may wish to consider in carrying out this exercise; (b) providing suggestions for how to include climate considerations at a high level in international investment agreements (IIAs), (c) suggesting model language for IIAs, per the invitation to do so, (d) proposing additional provisions that could be considered in IIAs in support of climate goals, and (e) proposing complementary policy options, per the invitation to do so.

(a) Question of scope

An important conceptual question is whether investment treaties should include language that requires standards or encourages investment that help achieve environmental goals, climate goals, or both. Climate FDI generally contribute to environmental goals, but not all green FDI contributes to climate goals. Think of a factory that is required to clean effluent before it is released into a river: this is clearly an environmental goal, but not necessarily a climate goal. Given the importance of both environmental goals and climate goals, it may be worth including provisions in investment treaties that seek to achieve *both* environmental and climate objectives (as "co-benefits"), and not only climate objectives.

(b) Climate considerations in IIAs

[1] The private sector represents close to 75% of global climate finance flows. See Climate Action Network, "Climate change adaptation and the role of the private sector: creating effective tools for private sector engagement", April 2013. Available at: https://europa.eu/capacity4dev/file/14313/download?token=1waP-Q5z&usg=AOvVaw1Mw90jEupF2bCAieJRr2pB

There are useful precedents in trade agreements on possible ways to include climate clauses, and these could be emulated in IIAs. See, for example, Article 6 of the Trade and Development Chapter of the EU-MERCOSUR FTA, signed in 2019.[2] Although there has been political resistance regarding the ratification of the FTA in some European countries with significant agricultural sectors, questioning whether the agreement could contribute to reducing deforestation, the climate clause itself is a positive innovation, which has been replicated by the EU in other negotiations. The same, or very similar, language could be included in IIAs to either require or encourage the parties to carry out investment activities in ways that are consistent with, and further the goal, of, the Paris Agreement and Nationally Determined Contributions (NDCs). Other initiatives still in negotiation, such as the Agreement on Climate Change, Trade and Sustainability (ACCTS), try to bring even more advanced language on climate. Although with limited economic reach, such text could be seen as a future model for stimulating environmental and climate action through trade, including elements focused on eliminating fossil fuel subsidies and voluntary environmental standards.[3]

(c) Model language for Climate FDI in IIAs

In addition, IIAs could include specific language to protect, promote, facilitate, or otherwise encourage FDI that helps achieve climate goals (climate FDI). This can be defined as FDI that helps lower carbon, is carbon-neutral, or is carbon-positive (in other words produces a net downturn in the level of carbon in the economy),[4] hence focusing

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[2] *1. The Parties recognise the importance of pursuing the ultimate objective of the United Nations Framework Convention on Climate Change (UNFCCC) in order to address the urgent threat of climate change and the role of trade to this end.*

2. Pursuant to paragraph 1, each Party shall:
(a) effectively implement the UNFCCC and the Paris Agreement established thereunder;
(b) consistent with article 2 of the Paris Agreement, promote the positive contribution of trade to a pathway towards low greenhouse gas emissions and climate-resilient development and to increasing the ability to adapt to the adverse impacts of climate change in a manner that does not threaten food production.

3. The Parties shall also cooperate, as appropriate, on trade-related climate change issues bilaterally, regionally and in international fora, particularly in the UNFCCC.

The EU-MERCOSUR FTA text for the Trade and Development Chapter is available at: https://trade.ec.europa.eu/doclib/docs/2019/july/tradoc_158166.%20Trade%20and%20Sustainable%20Development.pdf

[3] The New Zealand Ministry of Foreign Affairs and Trade defines this initiative, which also includes Costa Rica, Fiji, Iceland, Norway and Switzerland as one led by "small, trade-dependent countries who believe trade measures and disciplines can contribute to helping to address the urgent challenge we face for sustainable development in general and on climate change in particular." Information available at: https://www.mfat.govt.nz/en/trade/free-trade-agreements/trade-and-climate/agreement-on-climate-change-trade-and-sustainability-accts-negotiations/

[4] The focus on carbon (CO_2) is due to the greater relevance of CO_2 to global warming, when compared to other greenhouse gases (GHG), corresponding to more than 3/4 of total emissions. The language for eventual clauses in Investment Agreements, however, can adopt a broader approach, including all GHG, as in the MERCOSUR-EU FTA example.

notably on climate mitigation. IIAs could encourage all of the above, perhaps with the greatest emphasis on carbon-positive climate FDI, followed by carbon-neutral climate FDI, and followed by carbon-abating climate FDI.

The following model language may be useful to consider including or adapting in IIAs:

> *Each Party shall encourage the facilitation of green foreign direct investment that assists the Parties to become carbon neutral, including by promoting renewable energy, energy efficient investments and appropriate technologies, and taking other measures that help the transition to a carbon-neutral, sustainable and climate-resilient economy.*[5]

Here again, it would be important to decide whether the provision should cover all environmental goals or specifically climate goals, and if the latter, carbon neutrality or another carbon-related objective.

(d) Additional potential provisions in IIAs

There are a number of additional provisions that could be included in IIAs in support of climate goals. For instance:

- The inclusion of carve-outs for climate-related public policies when it comes to Investor-State Dispute Settlement (or exemptions to specific provisions, such as exemption for climate-related public policies from provisions on Indirect Expropriation or Fair and Equitable Treatment)
- The inclusion of Corporate Social Responsibility Clauses mentioning the need for investors to pursue climate goals in their activities (due diligence requirements)
- The inclusion of provisions encouraging the adoption of measures to promote and facilitate climate FDI

For this last point, IIAs could provide examples of measures but mention these examples are non-exhaustive, given that our understanding and identification of climate FDI measures is still nascent and growing.

(e) Complementary policy option: Climate FDI measures to be included in or encouraged by IIAs, or adopted unilaterally

As mentioned, we are currently undertaking an inventory of climate FDI measures, which can serve as a resource for both national, regional, and multilateral efforts to grow investment in support of climate goals.

Illustrative examples of climate FDI measures include[6]:

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[5] Karl P. Sauvant, Matthew Stephenson and Yardenne Kagan, "Green FDI: Encouraging carbon-neutral investment," Columbia FDI Perspectives, No. 316, October 18, 2021, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3943705

[6] This list is drawn from Sauvant et al., *op cit.*

- Incentivizing foreign affiliates to become carbon neutral, both through financial and non-financial incentives
- Requiring reporting on foreign affiliates' emissions equivalent to any financial and non-financial disclosure requirements on emissions in place for domestic firms
- Linking taxes to the level of carbon emissions in investment projects: the lower the emissions, the lower the taxes
- Creating a pipeline of carbon-neutral projects, promoted through a platform that helps connect capital to investment opportunities, and investment authorities to cooperate on two-way climate FDI flows
- Linking outward FDI support to the observance of home-country climate standards, combined with requiring their outward investors to publish the carbon content of large-scale FDI projects (linked to financial climate risk disclosure)

Once the initial inventory is complete, we will be discussing each measures' effectiveness and importance through multistakeholder consultations, and look forward to sharing the outcome.

In conclusion, it is worth mentioning that support for the adoption of climate FDI measures can take place in at least three different ways:

- Inclusion in IIAs of specific measures *per se*
- Inclusion in IIAs of language requiring/suggesting to adopt measures, but not mentioning these *per se*
- Adoption of climate FDI measures unilaterally by policymakers without mention or inclusion in IIAs

In other words, while investment treaties can help with growing climate FDI, governments have the opportunity to also protect, promote, and facilitate such investment unilaterally, without having to rely on a treaty to do so.

Boston University Global Development Policy Center

Global Development Policy Center
53 Bay State Road
Boston, Massachusetts 02215
bu.edu/gdp | gdp@bu.edu | @GDP_Center

Submission to the OECD public consultation on investment treaties and climate change

Kyla Tienhaara[1,2], Rachel Thrasher[2], B. Alexander Simmons[2,3], Kevin P. Gallagher[2]

Climate Change and Fossil Fuel Production

1. Keeping global warming to below 1.5ºC or even 2ºC requires a "rapid, just, and equitable wind-down of fossil fuel production" (SEI et al. 2021). In 2021, the International Energy Agency (IEA) modelled an energy pathway consistent with limiting global warming to 1.5ºC. Under the Net-Zero Emissions by 2050 (NZE) scenario, "no new" oil and gas fields or coal mines would be approved for development (IEA 2021). In another 1.5ºC scenario, Welsby et al. (2021) estimate that by 2050 nearly 60% of oil and fossil methane gas and 90% of coal must remain unextracted, which suggests that even some existing operations are not viable and more aggressive action than the NZE is required.

2. The IEA's NZE involves no development of new fossil fuel projects where a final investment decision had not been made as of the close of 2021. The intention was to minimize the stranding of upstream production assets by avoiding the early closure of fields where significant capital has already been invested (Greenpeace et al. 2022). The NZE also, therefore, minimizes the potential for investor claims for compensation. Nevertheless, if firms have been awarded permits, even if they were only for exploration, they have an "investment" under the definition of most investment treaties and could take claims to investor-state dispute settlement (ISDS) if governments acted to limit production in line with this pathway.

3. Although current government plans for fossil fuel production do not align with the NZE and certainly not with a more aggressive phase-down of fossil fuels, the tide may be (slowly) turning. At the 26th Conference of the Parties (COP) to the United Nations Convention on Climate Change (UNFCCC) in Glasgow, eleven national and subnational governments launched the Beyond Oil and Gas Alliance (BOGA) - an international coalition led by Denmark and Costa Rica working to facilitate the managed phase-out of oil and gas production (BOGA 2021). This is the first international initiative to combat climate change that explicitly focuses on cutting the supply of fossil fuels.

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[1] School of Environmental Studies and Department of Global Development Studies, Queen's University, Kingston, Ontario K7L 3N6, Canada. kyla.tienhaara@queensu.ca
[2] Global Development Policy Center, Boston University, Boston, Massachusetts 02215, USA.
[3] Department of Human Dimensions of Natural Resources, Colorado State University, Fort Collins, Colorado 80523, USA.

Global Development Policy Center
53 Bay State Road
Boston, Massachusetts 02215
bu.edu/gdp | gdp@bu.edu | @GDP_Center

ISDS and Supply-Side Climate Policy

4. Climate policy has been dominated in recent years by demand-side policy approaches, such as carbon taxes targeted at consumers and incentive programs to encourage energy efficiency and increased deployment of renewables. It is possible for demand-side policies to be challenged by investors in ISDS, particularly if the measures target specific businesses (e.g., phase-out of coal power) rather than being economy-wide. Nevertheless, there is a much higher risk of ISDS cases arising from supply-side measures, which by their nature always target and directly impact the fossil fuel industry.

5. Bans and moratoria on fossil fuel extraction are the bluntest form of supply-side climate policy, but there are other forms. Emissions trading schemes, for example, allow firms to trade permits for emissions under a fixed "cap" on maximum carbon emissions for a given industry. This results in a market-based price on carbon emissions and forces firms to internalize some of the costs of their own emissions. Other more direct policies include taxing carbon emissions directly at the source or removing existing support for the fossil fuel industry such as subsidies and tax breaks (see further Gaulin and Le Billon 2020). A more piecemeal approach is to deny the approval of new (or revoke existing) permits on a project by project basis (including for midstream projects such as pipelines). Figure 1 summarizes how various supply-side policies may come into conflict with investor protections.

6. As of 1 March 2022, there had been at least nine ISDS cases involving fossil fuel companies that directly or indirectly relate to climate policies, four of which can be considered "supply-side" cases (*Lone Pine* v *Canada*, *Rockhopper* v *Italy*, *TC Energy* v *United States*, *Alberta Petroleum Marketing Commission* v *United States*). In these cases, government policy has been informed by the political will of their citizens. As citizens have become more aware of the threat of climate change, and the specific health and environmental threats of fossil fuel extraction in their own communities, they have increasingly engaged in large-scale protests, physical blockades and domestic litigation to challenge the power of the fossil fuel industry (Le Billon and Kristofersenn 2020). In some instances, these actions can directly interfere with the operation of an investment; however, most often it is the subsequent government response that sparks investor claims. The existence of public pressure to act on climate change is most likely to be used by investors as evidence that government decisions are "politically motivated" and thus illegitimate. For example, in *Alberta Petroleum Marketing Commission* the claimant is arguing that the cancellation of the Keystone XL Pipeline was "performative policymaking".

7. States have strong grounds to argue in these cases, and any future ones, that fossil fuel investors could not have had a "legitimate expectation" that their investments would not be directly impacted by climate policies, considering international agreements on climate date back to 1992. Furthermore, it is now well documented that oil and gas firms like Exxon have long been engaged in strategic efforts to misinform the public and obstruct government

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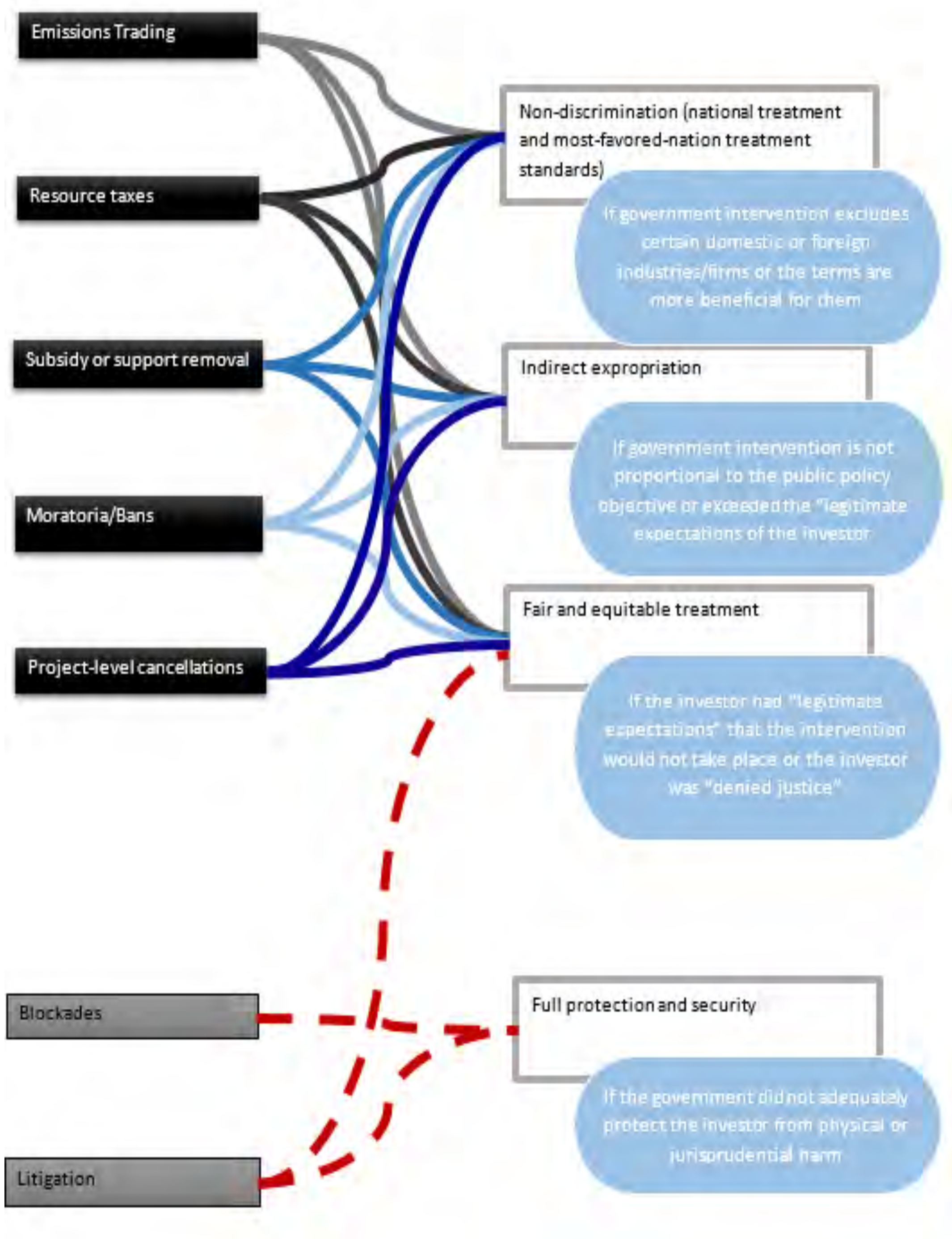

Figure 1: Supply-side climate policies and investor protections

Source: Authors. For definitions of supply-side initiatives see Gaulin and Le Billon 2020. We use the term "resource taxes" instead of "carbon taxes" to distinguish between taxes aimed at curbing supply from those aimed at curbing demand

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action on climate change (Oreskes and Conway 2011; Franta 2021; Supran and Oreskes 2021). Thus, any "expectation" that investors had that business as usual in the industry would be able to continue indefinitely is based on their own obstructionism and should not be considered "legitimate".

8. The problem is that it is unclear, and it is likely to remain unclear for some time (given the average duration of cases), whether arbitral tribunals will accept these lines of defence. In the interim, there is a risk of regulatory chill, particularly in countries with limited capacity to defend policies in arbitration and pay awards (Tienhaara 2018). Although it is difficult to definitively prove that threats of arbitration have led to delay or weakening of climate policies, there is some preliminary evidence to this effect. In 2017, the Canadian oil firm Vermillion threatened the French government with a ISDS case over its fossil fuel phase-out plan. The law was subsequently weakened (Vaudano 2018). Earlier this year, it was reported that both Denmark, one of the initiators of BOGA, and New Zealand had designed their oil and gas phase-out plans, at least in part, to minimize the impact on leaseholders that are protected by investment treaties (Meager 2022).

ISDS is a Support Measure for the Fossil Fuel Industry

9. ISDS should be viewed as a form of "free risk insurance" akin to a subsidy (Sachs et al. 2020). By insulating investors from the risk associated with further investments in fossil fuel production while the world is undergoing an energy transition, ISDS creates moral hazard. As Bonnitcha (2011) argues "risk plays an important role in discouraging investors from initiating socially undesirable investment."

10. Muttitt and Kartha (2020) note that it is "ironic" that fossil fuel investments are legally protected from the energy transition given that the large private profits that fossil fuel companies have generated are "generally rationalized as a reward for risk-taking." Even the editorial board of the *Financial Times* (2022) has taken the position on this issue that "If profits are to be private, so too should losses" because this is both the "heart of the capitalist social contract" and "fundamental to the ability of markets to deal adequately with the challenge of climate change."

11. While governments may decide, for many reasons, to pay fossil fuel businesses some level of compensation to strand their assets, experts have argued that "offering less-than-full compensation is fair, reasonable, and pragmatic" (Caldecott and Mitchell 2014; see also Moon 2021). Unfortunately, it cannot be assumed that arbitrators will agree with this approach, and thus, even governments that are willing at the outset to offer compensation may find themselves in arbitration if the amounts are considered inadequate by investors. For example, the Dutch government developed a mechanism to calculate compensation for investors impacted by the phase-out of coal-fired power in the country. One company agreed

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to this process and was paid US$241.8 million in compensation ("Onyx coal-fired power plant to shut with Dutch government support"). However, the maximum compensation for RWE (€512 million) and Uniper (€351 million) was deemed insufficient by these firms, with each choosing instead to launch claims of over €1 billion in arbitration (Verbeek 2021). Independent economic analysis suggests both plants were already loss-making before the phase-out was announced, which indicates that a win in ISDS would be a windfall for these investors (Flora and Brown 2021).

12. Even the knowledge that ISDS claims are possible can also distort the power dynamics in negotiations between investors and states on compensation (Tienhaara and Cotula 2020). For example, the German coal power phase-out involved a negotiated compensation scheme that has been widely criticized as being overly generous and is currently being investigated by the European Commission (Flues 2022). It has been noted that the contracts negotiated with the main firms involved (which include RWE, a firm suing the Netherlands over its coal power phase-out) have explicit provisions to prevent ISDS cases under the Energy Charter Treaty (Flues 2022).

13. ISDS is an "inefficient" form of subsidy because it does not provide any public benefit. Numerous studies that have attempted to demonstrate that investment treaties lead to increased investment have only provided weak and inconsistent evidence (Bonnitcha 2017; Pohl 2018; Brada et al. 2021) and countries that have terminated treaties have not experienced any loss of FDI (Public Citizen 2018). However, even if it could be demonstrated that investment treaties do facilitate FDI, in the case of fossil fuels, increased investment is not a desirable outcome. In line with G20 commitments, governments should rapidly phase-out this inefficient subsidy by removing access to ISDS by fossil fuel investors.

14. Quantifying the amount of support that the industry receives from ISDS is challenging. However, a recent report has demonstrated that the industry has benefited substantially, with an average award of US$600 million, which is much higher than the average across all ISDS cases (Di Salvatore 2021). Taking measures to cap the amount of compensation that can be awarded in ISDS (see Aisbett and Bonnitcha 2021, Brewin et al. 2021) would be another avenue for governments to quickly reduce support.

Opportunities for the OECD to improve transparency

15. In a recent study (currently in peer-review) we attempted to quantify the proportion of upstream fossil fuel assets that are covered by investment treaties in order to demonstrate the potential risk for states that want to adopt a Paris-aligned phase-out of production. We encountered several challenges in this research. As noted in the 2021 Production Gap Report, current public information on fossil fuel production is "incomplete, often inconsistent and scattered across various, mostly voluntary, government-driven and non-governmental

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efforts" (SEI et al. 2021). After pursuing several options, we decided to purchase access to an expensive subscription service (Rystad Energy's UCUBE database) and combine the data it provides on oil and gas projects with the publicly accessible data in UNCTAD's Investment Agreement Navigator (UNCTAD 2021). Although UCUBE is incredibly detailed, it does not provide information on how an investment is structured (through subsidiaries etc.). As such, we had to assume that the only applicable treaties would be those signed between the host state and the state where the ultimate owner of a project was headquartered. We have, therefore, likely underestimated treaty coverage in our findings. We also could not include coal mines in our analysis, as this would have required purchase of an additional dataset.

16. The OECD plays an important role in providing transparency around member government subsidies and other forms of support for fossil fuels through an open-access inventory (OECD 2021). The inventory includes estimates of "the value of support arising from policies that encourage the production or consumption of fossil fuels" (OECD 2021). We suggest that this work could be usefully expanded to include investment-treaty coverage of fossil fuel assets.

17. An inventory of treaty-covered assets would identify all projects covered by investment treaties that any OECD members are party to. This would require that companies that are provided with protection through these treaties disclose information on their projects, including how their investments are structured, and to promptly provide any updates in terms of changes in structure or ownership.

18. An additional layer of transparency would be to require governments to report any instances where an investor refers to investment treaty protection of its fossil fuel assets in meetings or correspondence concerning climate policy. This would act in a similar way as many existing transparency efforts in OECD countries around lobbying[4] and could assist in the identification of instances of regulatory chill.

The need for a just transition for the Global South

19. While transparency from OECD member countries is important, our research highlights that some oil and gas producing countries in the Global South face substantial financial risk from ISDS if they cancel new projects and those under development, in line with keeping warming below 1.5ºC. If left unchecked, ISDS could create a flow of finance from those countries to private companies based primarily in the Global North. This would be in opposition to international pledges to provide climate finance to the Global South (which rich countries are already failing to meet, see Timperly 2021).

[4] See, for example, https://lobbycanada.gc.ca/

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20. In some cases, ISDS awards to oil and gas firms could absorb a substantial amount of the public finance necessary to achieve Nationally Determined Contributions (NDCs) to the Paris Agreement. For example, Indonesia has some of the highest annual emissions in the world (473 Mt CO_2 yr^{-1}), but its total mean valuation of protected oil/gas assets ($3.9 billion) constitutes 17% of the costs needed to achieve their NDCs. Other countries that might struggle to find the fiscal space to reduce their high emissions and achieve their NDCs amidst the threat of ISDS claims include Nigeria ($8 billion; 26% of NDC costs) and Uzbekistan ($800 million; 24% of NDC costs). The outlook is particularly grim for the United Arab Emirates and Venezuela where potential ISDS expenses are 7 to 30 times greater than the expected costs of their NDCs, respectively.

21. Several countries with high ISDS risk are also highly vulnerable to the impacts of climate change and need public finance to devote to adaptation measures. For example, Mozambique is in the top 25% of the world's most vulnerable countries to climate change, yet the total mean net-present value of all its treaty-protected oil/gas assets ($29 billion) is nearly twice the size of its GDP in 2019 ($15 billion). Guyana is also facing significant financial risks; the country is in the top 40% of most climate-vulnerable countries, but it faces ISDS risks upwards of $15 billion, which is nearly three times its GDP ($5.2 billion). Other highly vulnerable countries with a significant proportion of their GDP reflected in ISDS risks include Senegal ($2.4 billion; 10% of GDP) and the Republic of the Congo ($1.5 billion; 12% of GDP).

22. Given these realities, it is critical that transparency efforts extend to fossil fuel projects outside of the territory of OECD members that are covered by treaties signed by OECD governments. The OECD should also consider other mechanisms to ensure that exposure to ISDS-risk does not halt or delay the adoption of essential climate mitigation and adaptation measures in the Global South.

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Trade Justice Movement Submission to the OECD Consultation on Investment Treaties and Climate Change

March 2022

About this contribution

Ruth Bergan is Senior Adviser at the Trade Justice Movement and has worked on trade policy and international supply chain sustainability since 2006. She is a member of the UK Department for International Trade Thematic Working Group, which advises on the development impacts of UK trade agreements, and has participated as a panellist in a number of evidence sessions for the UK parliament's International Trade Committee.

The Trade Justice Movement (TJM) is a UK-wide network of sixty civil society organisations, with millions of individual members, advocating for trade rules that work for people and the planet. Our members include trade unions, NGOs, consumer groups and faith organisations. Together we are calling for trade justice, where the global system of trade ensures sustainable outcomes for ordinary people and the environment.

Do investment treaties contribute to sustainable development?

The impact of investment treaties on sustainable development is hard to quantify

It is currently not possible to have a full picture of the impact of investment treaties on sustainable development objectives. One of the reasons for this is an ongoing lack of transparency regarding the number of cases being brought globally. Although in recent years there have been significant improvements in respect of transparency at arbitration centres such as UNCITRAL and ICSID, there remain a number of centres that do not publish cases or all documents associated with cases.

There is also little information regarding the way in which investment treaties impact on government policy decisions. The information that is available, such as research in Canada, offers a worrying indication that investment treaties are preventing governments from taking policy decisions in favour of sustainable development. However there is no overview of the extent of this effect or the kinds of sustainability measures that have stalled for these reasons.

It is by now well understood that there is no clear correlation between countries signing investment treaties and an increase in investment. It is also clear that increased investment is not necessarily beneficial to the host economy. Efforts to promote investment must be accompanied by measures to ensure benefits are brought to local populations and that the investment is sustainable from both an environmental and social perspective.

Investment treaties continue to be more binding and enforceable than agreements on climate, the environment and sustainable development.

A basic problem that has yet to be addressed is that agreements on sustainability, including the Paris Climate Agreement and the sustainable Development Goals (SDGs) are largely non-binding and unenforceable, whilst investment treaties are both. Reference to environmental commitments in trade and investment treaties is also often non-binding and not subject to the same dispute resolution provisions as other provisions in the treaty.

Notable exceptions to this are the Generalised System of Preference (GSP) arrangements of trade blocs/countries such as the EU and UK, who both require beneficiary countries to implement around 27 conventions on human rights, labour rights, the environment and good governance, in order to access additional market access. Preferential investment arrangements could also be predicated on such requirements.

Investment treaties have significant implications for climate and environmental goals
Investment treaties, particularly those that are broadly worded, generally apply to a number of sectors with direct relevance to climate and environmental goals. First among these is the energy sector. Potential profits in the energy sector make it the single largest destination for foreign direct investment, much of which is covered by investment treaties. The last couple of years have seen encouraging trends, with the renewables sector pushing coal, oil and gas off the top spot as a destination for FDI. In 2021 investment in the renewables sector was $87.2 billion (down 10% on 2019). Whilst the $44.8 billion invested in coal, oil and gas was significantly less and a reduction of 62% on 2019 figures, the absolute amount remains very high.[1] Almost half of current ISDS cases have likely implications for climate goals.[2]

As a number of reports produced for the OECD have recognised, the treaties covering this investment are for the most part relatively old. This means that they do not contain the innovations that have been introduced elsewhere in recent years. As such they contain broad, vaguely defined provisions that allow for wide interpretation by tribunals. They also contain little to ensure that measures taken in order to achieve climate and environmental goals are exempted from challenge. A major concern is that the effect of this is to reverse the 'polluter pays' principle by requiring governments to pay companies to stop polluting.

Of particular concern is the Energy Charter Treaty. The provisions of the ECT offer significant protections to investors. As of the end of 2021, the ECT had been used to bring 145 ISDS cases, out of a global total of more than 1,100. It contains a broad definition of 'investment', including property rights, shares and intellectual property. This means that investors with varying levels of 'presence' in a country – from investment in mining to owning shares – are able to use the treaty to protect their interests. It also contains standard, broadly defined protections such as national treatment, most favoured nation treatment and protection against expropriation. The issues with these provisions are outlined extensively elsewhere.

The provisions of the ECT are considered to offer the potential for even broader interpretation of what counts as an investment, as compared with other pre-existing investor protection treaties, as the following example illustrates: "Even a debt under an agreement for supply of equipment for a nuclear plant assigned to the claimant seems to have satisfied the test. The ECT may… be a more attractive option for parties who may struggle to show a qualifying 'investment' under one of the narrower [Bilateral Investment Treaties]".[3]

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[1] https://fdi-report-2021.fdiintelligence.com/files/ThefDiReport2021.pdf
[2] ICSID reports that twenty-nine percent of new cases involved the oil, gas and mining industry, and 18% related to electric power and other energy sources. https://icsid.worldbank.org/news-and-events/comunicados/icsid-releases-2021-caseload-statistics#:~:text=Economic%20Sectors&text=Twenty%2Dnine%20percent%20of%20new,power%20and%20other%20energy%20sources.
[3] https://www.nortonrosefulbright.com/en-gb/knowledge/publications/295e4960/energy-charter-treaty

The ECT contains an article on sovereignty over energy resources and a separate chapter on environmental protection and a commitment to the polluter pays principle. However these commitments lack any of the significant legal clout of the ISDS mechanism because they are 'soft law' commitments. For example, paragraphs in the environment chapter state that parties will "take account of", "promote", "have regard to", "encourage" and "cooperate in" various aspects of environmental policy. Article 19 states only that "each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts" (emphasis added).

The ECT has been undergoing a reform process that is due to conclude before the end of 2022. The EU has attempted to propose reforms that would achieve better alignment of the treaty with its climate objectives. However, even these reforms would still allow fossil fuel companies to use the ECT to challenge climate action. The changes will also be difficult to secure in practice as it would require unanimity of the parties, which thus far appears to be lacking.[4]

Local content bans could be a significant hindrance to a just climate transition
The ECT together with a number of Bilateral Investment Treaties ban local content requirements (LCRs). LCRs place conditions on foreign investors, for example to purchase a certain proportion of goods or undertake a certain proportion of their research and development locally and commit members to apply the principle of freedom of transit "without imposing any unreasonable delays, restrictions or charges" (Article VII of the ECT).

Bans on local content requirements have triggered a large number of cases that have challenged the development of renewable energy sectors in many countries. It is clear that countries are finding it difficult to implement the transition to renewable energy without including provisions that guarantee benefits for local populations and countries from India to the US have sought to use LCRs. Investment rules that prevent this from happening are likely to put a major block on this critical climate goal.

Investment treaties have not kept pace with international human rights law
The past twenty-five years have seen significant developments in human rights protections, including the recognition of economic, social, cultural, civil and political rights. Investment protections have not kept pace with these developments. Instead, they create a special class of rights for investors which are extensive and benefit from powerful enforcement mechanisms with no means for balancing them against fundamental human rights and no equivalent mechanism to protect human rights.

BITs themselves generally contain no language on human rights, which means that there can be no certainty that human rights will be protected in an agreement or taken into account should a dispute arise and tribunals rarely consider human rights arguments because they are not required to do so. This creates a situation of significant inequality: the rights of individuals are formally proclaimed in a manner similar to the rights of international investors but cannot be enforced in an equivalent manner. For example, when local residents in Peru sued Renco in the United States over alleged environmental harm, including high levels of lead, copper, zinc and sulphur dioxide pollution, the company responded by using ISDS to claim against Peru.

ISDS can undermine the rule of law.

There are a number of ways in which BITs can undermine the rule of law in host countries. Many BITs, including those to which the UK is a party, do not require companies to exhaust domestic remedies

[4] https://www.iisd.org/itn/en/2021/06/24/energy-charter-treaty-reform-why-withdrawal-is-an-option/

before they can access ISDS mechanisms. This bypasses domestic legal systems and creates a parallel system. This is problematic because:

1 A process that effectively requires taxpayers to insure the business risk of international investors does nothing to raise governance standards for society as a whole and instead removes some of the incentives for host countries to strengthen domestic governance and judicial systems;

2 It eliminates opportunities for domestic judges and administrative agencies to consider and address the substantive problems faced by investors and to develop corresponding domestic law and expertise;

3 It can create incentives for governments to favour the concerns of foreign investors over other constituencies because ISDS offers significant amounts of protection to foreign investors only;
4National treatment provisions in fact often duplicate existing domestic laws, many of which already offer international investors the same treatment as domestic investors. This offers the potential for investors to have 'two bites of the cherry' when bringing a case;

5 Most Favoured Nation clauses mean that companies can access the benefits of treaties to which their own home state is not a signatory by looking at the full range of deals that the host country has signed and picking the one that offers them the best terms;

6 The ISDS system has no established system of case law or precedent, which means the potential outcomes of a case and the amount of an award are often unpredictable and inconsistent.
ISDS creates special protections accessible only to a particular group of actors. ISDS is only accessible to international investors, there is no equivalent provision made for domestic investors. Whilst compensation is provided for in many countries, compensation orders tend to be rare and the amounts available are generally much lower. There is therefore a significant imbalance between domestic and international companies.

Key steps that governments should take.

Terminate existing provisions. Governments should terminate existing investment treaties and consider replacing them with non-binding investment cooperation agreements. As part of the termination of agreements, countries should seek agreement that sunset clauses should not apply or at minimum should be significantly reduced. ISDS should in particular be removed from all treaties. The approach adopted by Brazil presents a good starting point for this kind of shift.

Exit the Energy Charter Treaty. Governments engaged in this OECD process are in a strong position to influence current discussions happening regarding the status of the Energy Charter Treaty. Given its specific focus on energy, it must necessarily be a key focus for efforts to ensure that the investment regime does not stand in the way of a just transition to achieve climate goals.

Require due diligence from businesses. Countries should consider conditioning business access to the benefits of investment arrangements upon their delivery against responsible business conduct provisions such as due diligence and reporting obligations (following the similar provisions of GSP+ arrangements mentioned above).

Secure greater transparency. Countries participating in this OECD project should commit to publishing information regarding the impact of investment protection provisions on policymaking. It might be easier for countries to contribute information presented as a collective finding rather than highlighting the actions of particular countries.OECD countries could also call for all arbitration centres to publish in a timely manner the fact that cases are being heard and the documents pertaining to those cases.

Direct investment to sustainable development. OECD countries could show global leadership by ensuring that their own efforts to promote both outward and inward investment are accompanied by measures to ensure benefits are brought to local populations and that the investment is sustainable from both an environmental and social perspective.

What alternative arrangements are available?
A number of alternative approaches are available, and countries are already making use of them. Countries should first consider eliminating ISDS from all treaties and reducing or cancelling sunset clauses which can mean they continue to apply for a further twenty years. Reference has already been made in OECD papers to the Brazilian model which we believe holds the most potential to provide a sustainable alternative to the current approach.

Perhaps the most significant step countries should take is to align investment provisions with environmental provisions by basing them on cooperation and information sharing, and removing enforcement mechanisms. Countries could consider a broader and more flexible range of implementation mechanisms such as state-to-state dispute settlement with non-pecuniary or negotiated remedies, expert reports, dispute prevention, as well as implementation of possible business obligations or responsibilities. As a first step, countries could agree side letters or amendments to treaties to ensure that measures taken to achieve climate, human rights or sustainability goals are fully exempted from challenge under all investment provisions. Given that ECT modernisation seems unlikely to achieve alignment with climate and environmental goals, OECD countries should consider withdrawing from the treaty.

Alternative protections are already available for international investors:
Investors can help to avoid problems arising in the first place by taking a number of steps, such as

Undertaking due diligence before an investment is considered; undertaking impact assessments that engage with local communities; designing investment to ensure strong backward linkages into local or national economies, for example by exploring the possibility of a joint venture;

Non-legal mechanisms may prove to be the best way to avoid disputes: disputes can be addressed in the initial stages via mediation; investors may be able to develop good relationships with local actors, such as other businesses or civil society, who could support efforts to address issues that arise;

Investors can use market-based products to protect their investments: commercial political risk insurance is available through a number of private banks, or for investments in developing countries through the World Bank's Multilateral Investment Guarantee Agency;

There are a number of alternative legal mechanisms: investors should seek to exhaust domestic remedies before looking to international instruments; in cases of the most egregious behaviour, disputes can be dealt with under human rights instruments; state-to-state dispute settlement may also be available.

Ruth Bergan
Senior Adviser
ruth@tjm.org.uk
07843388025

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INTERNATIONAL INVESTMENT AGREEMENTS AND CLIMATE ACTION

Policy brief based on a UNCTAD-IIED joint webinar held on 4 February 2022[1]

Climate change is among the most pressing global challenges of our time. The Intergovernmental Panel on Climate Change (IPCC) found that human-induced global warming has already caused changes in the climate system, and that global warming of 1.5°C and even 2°C will be exceeded unless "deep reductions" in greenhouse gas emissions occur.[2] The achievement of the SDGs is directly at stake, as are human rights including the rights to life, health, water and a clean and healthy environment.

Rising to this challenge will require transformations in economies and societies. As regards the energy sector, the International Energy Agency noted that a global transition to net-zero emissions energy involves "nothing less than a complete transformation of how we produce, transport and consume energy"[3]. This includes phasing out unabated coal power plants and reorienting energy sources from fossil fuels to renewables, with energy scenarios consistent with 1.5°C requiring more investments in renewable and clean energies.

Supporting these transformations requires states to reform International Investment Agreements (IIAs) in order to advance climate goals, and to ensure that IIAs do not hinder states from implementing climate measures and accelerating the transition to low-carbon economies. While IIA reform talks are not new, the narrow time window available to keep warming within 1.5°C, and the unprecedented aggregate scale of potential investor-state claims that may be associated with climate measures such as fossil fuel phaseouts, call for states to both deepen and accelerate reform processes.

On 4 February 2022, UNCTAD and the International Institute for Environment and Development (IIED) held an international webinar on IIAs and Climate Action. The event built on UNCTAD's Reform Package for the International Investment Regime (2018), UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD, 2015) as well as UNCTAD's most recent IIA reform tool, the IIA Reform Accelerator (2020). It also built on IIED's policy research, including specifically on IIAs and climate action.[4] The event brought together experts and stakeholders from government, international organisations, civil society

1 https://investmentpolicy.unctad.org/news/hub/1684/20220124-register-now-webinar-on-iias-climate-action-on-4-february

2 https://www.ipcc.ch/sr15/chapter/spm/

3 https://www.iea.org/reports/net-zero-by-2050 (page 13)

4 Kyla Tienhaara and Lorenzo Cotula, Raising the Cost of Climate Action? Investor-State Dispute Settlement and Compensation for Stranded Fossil Fuel Assets (IIED, 2020), https://pubs.iied.org/17660IIED/.

and academia, who generously contributed experiences and ideas. While states may have different policy preferences as regards IIA reform, overarching recommendations from experts and stakeholders during this webinar called on policymakers to:

1. Ensure that investment policy is consistent with, and proactively advances, national, regional and global climate commitments. Strengthening coherence and synergy between IIA and climate policies requires deepening national-level cooperation between investment and environment policymakers, and promoting awareness and debate on IIAs in international processes related to climate change – particularly the United Nations Framework Convention on Climate Change and the Paris Agreement.
2. Distinguish between high- and low-emission investments in IIA policy (e.g. by excluding or limiting legal protection for harmful investments in carbon-intensive industries such as fossil fuel sectors) while promoting and facilitating low-emission investments as well as investments that have a positive contribution on the achievement of the SDGs. At the same time, IIAs should not hinder developing countries energy transition policies being implemented in accordance with their national development objectives.
3. Ensure that any investment protection standards safeguard the right and duty of states to regulate in the public interest. This includes clarifying and limiting the scope of any IIA provisions that could put climate goals at risk, such as expropriation, fair and equitable treatment or full protection and security clauses. Refining protection standards offers a more systemic approach than issue-by-issue carve-outs for climate or other measures. Non-discriminatory measures to address climate change should not entail payment of compensation.
4. Enhance the effectiveness and enforceability of environmental clauses in IIAs, such as investor obligations or non-lowering of standards provisions, including by clarifying the implications of non-compliance in a dispute settlement context. IIAs should also facilitate, or at least not constrain, the transfer of ‘green’ technologies needed for the low-carbon transition. Further, IIAs should discourage states from providing unsustainable incentives such as fossil fuel subsidies.
5. Realign with climate goals the existing stock of IIAs, by considering policy options including jointly interpreting treaty provisions; amending treaty provisions; replacing “outdated” treaties; consolidating the IIA network; managing relationships between coexisting treaties; referencing global standards; engaging multilaterally; abandoning unratified old treaties; terminating existing old treaties; developing new sustainable-development-oriented model IIAs, and withdrawing from multilateral treaties.[5]
6. Strengthen regional and global fora for continued dialogue and coordination on comprehensive IIA reform, and technical assistance programming on IIAs and climate action. ■

5 https://unctad.org/system/files/official-document/diaepcb2017d3_en.pdf

Submission of the Veblen Institute for Economic Reforms to the OECD consultation on investment agreements and climate change

Paris, 18 March 2022

The Veblen Institute for Economic Reforms *is a non-profit think tank promoting economic ideas, public policies and civil society initiatives for the ecological transition. Through our publications and actions we work for a fairer and more democratic economy that respects the physical limits of the planet.*

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"*The cumulative scientific evidence is unequivocal: Climate change is a threat to human well-being and planetary health. Any further delay in concerted anticipatory global action on adaptation and mitigation will miss a brief and rapidly closing window of opportunity to secure a liveable and sustainable future for all*".[1] - IPCC 2022

In this context, governements must take rapid steps to dramatically lower Greenhouse Gases (GHG) emissions driving in order to limit the average warming to +1.5°C before pre-industrial levels, as committed in the Paris Agreement in 2015. This means in particular phasing out fossil fuels such as oil, coal and gas, which according to the IPCC are "*the main contributor to rising CO2-concentrations levels in the atmosphere*"[2]. Importantly, the IPCC adds that the large remaining resources suggest that "*that decarbonization would not be primarily driven by the exhaustion of fossil fuels, but by economics and technological and socio-political decisions*"[3]. Whereas many countries, including members of the OECD, EU-member states and the EU itself have taken ambitious commitments to reduce GHG emissions (net reduction of 55% by 2030 in the case of the EU), there are not on track to achieve such objectives.

If we are to succeed in the transition to a low-carbon economy, the entire economic system will need to be overhauled, and all policy areas will have to be reviewed and reformed according to these objectives. The international investment policy makes no exception.

Indeed, current International Investment Agreements (IAAs) bring no benefits, including when it comes to fighting climate change (I). To the contrary they represent a major obstacle to climate mitigation and adaptation (II). It is therefore necessary to terminate IIAs and stop signing new ones or, at the very least, to significantly reduce the scope of investment protection and the use of ISDS (III).

[1] International Panel on Climate Change, *Working Group II contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*, Summary for Policymakers, 2022 https://report.ipcc.ch/ar6wg2/pdf/IPCC_AR6_WGII_SummaryForPolicymakers.pdf

[2] International Panel on Climate Change, Working Group 3 contribution to the Fifth Assessment Report of the International Panel on Climate Change, Chapter 5 : Drivers, Trends and Mitigation, 2014 https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc_wg3_ar5_chapter5.pdf

[3] *Ibid.*

I. International Investment Agreements (IIAs) bring no benefits, including for the fight against climate change

Since the signature of the first of them in 1959, the number of IIAs has grown rapidly during the past 60 years to reach 3 360 existing IIAs today. Whether under the form of Bilateral Investment Treaties (BITs) or Treaties with Investment Provisions (TIPs), the rollout of IIAs originates in the will to protect, promote, and attract international investments. The underlying assumption is that international investments benefit both home and host countries of investments and have spill over effects on societies at large, bringing jobs and economic growth.[4]

The alleged benefits of international investments and IIAs justified the steady extension of substantive rights granted to foreign investors, as well as the procedural guarantees implemented to enforce them, in particular the Investor-State Dispute Settlement (ISDS) mechanism, present in the vast majority of IIAs.

However, the positive causation between a) IIAs and increase of international investments ; b) ISDS and increase of international investment ; c) international investments and positive economic, social and ecological effects, appear to be supported by little evidence. In fact, the purported benefits, which rely on the cumulative validity of each of the above-mentioned assumptions, is to say the least fragile.

a) IIAs and increase of international investments

As a policy paper from the Columbia Center for Sustainable Investment puts it : "*Evidence that investment treaties have the effect of increasing investment flows is […] inconclusive. In short, common assumptions about the role of [bilateral investment treaties (BITs)] in attracting foreign investment are unsupported by a considerable amount of quantitative and qualitative evidence. For the vast majority of investors, BITs do not appear to be important – directly or indirectly – when determining where, and how much, to invest abroad. Studies on determinants of foreign direct investment (FDI) confirm that other factors – such as market size and growth, the availability of natural resources, and the quality of hard and soft infrastructure – tend to be far more important to investors than investment treaties when making the decision to invest*".[5] According to a Working Paper from the OECD, "*While IIAs almost invariably contain this*[6] *or a similar affirmation of economic benefits in their preamble, surprisingly little evidence is available on its validity*"[7].

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[4] European Commission, "Investment", consulted 7 March 2022
https://ec.europa.eu/trade/policy/accessing-markets/investment/
Such vision is present in the background note to this consultation: "*The benefits that properly regulated international investment can bring are not in doubt. International investment can contribute to prosperity, create employment and help overcome challenges such as the climate crisis.* »

[5] Lise Johnson, Jesse Coleman, Brooke Guven, Lisa E. Sachs, *Costs and Benefits of Investment Treaties: Practical Considerations for States*, Columbia Center on Sustainable Investment, 2018
https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1080&context=sustainable_investment_staffpubs

[6] The authors refer here to the example drawn from the Canada-Kuwait BIT (2011) : "*RECOGNIZING that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development […]*"

[7] Joachim Pohl, *Societal benefits and costs of International Investment agreements. A critical review of aspects and available empirical eveidence*, OECD Working Papers on International Investment, 2018/01, 2018
https://www.sipotra.it/wp-content/uploads/2019/03/Societal-benefits-and-costs-of-International-Investment-Agreements.-A-CRITICAL-REVIEW-OF-ASPECTS-AND-AVAILABLE-EMPIRICAL-EVIDENCE.pdf

Former EU Trade Commissioner Cecilia Malmström admitted in the context of debates on TTIP that *"no direct and exclusive causal relationship can be seen between international investment agreements and foreign direct investments"*[8].

The fact that some countries have sustained levels of investment flows despite having no IIAs in force seems to comfort this hypothesis[9], so does also the fact that the countries which have terminated all of part of their BITs or adopted new BIT models less protective of investments (e.g South Africa, Indonesia, India) do not seem to have suffered losses of Foreign Direct Investments (FDI).[10]

b) <u>ISDS and increased international investment</u>

It seems also hard to find robust evidence that ISDS could be a decisive (and therefore desirable) element of IIAs resulting in increased flows of international investments. First of all, since the quasi-totality of IIAs do contain ISDS provisions, there is no significant "control group" of IIAs against which to check this hypothesis. Secondly, even if it was possible to observe that IIAs with ISDS provisions were more positively correlated to an increase of investment flows in comparison to IIAs without such provisions, it does not mean that the investors would not have carried out similar investment absent the ISDS provisions. Many scholars have warned about the key difference between correlation and causation when looking at the impacts of investment agreements on FDIs.[11]

c) <u>International investments and positive economic, social and ecological effects</u>

Finally, investment flows do not automatically nor entirely translate into job creation or economic growth. Instead, "*FDI can also result in economic, environmental and social damage in the host country and to its citizens*".[12] Capital mobility promoted by IIAs can also lead to capital flight and tax evasion, outsourcing of industries and services, and can be used to finance heavily environmentally impacting projects (such as fossil fuel infrastructures). And recent research[13] have even shown that the use of investment arbitration might even be a spill over effect of corporate tax avoidance. However, the protection provisions are provided to all types of investors and investments, regardless of their impacts.

[8] Sam Morgan, "Positive effects of TTIP tribunals for investments unclear", Euractiv, 16 September 2015 https://www.euractiv.com/section/trade-society/news/positive-effects-of-ttip-tribunals-for-investment-unclear/

[9] Brazil has never adopted the traditional Bilateral Investment Treaties ("BITs") approach. Brazil issued a new model of investment treaty in 2015 (the Cooperation and Facilitation Investment Agreement) which does not include ISDS mechanism.

[10] Lise Johnson, Jesse Coleman, Brooke Guven, Lisa E. Sachs, *Costs and Benefits of Investment Treaties: Practical Considerations for States*, Columbia Center on Sustainable Investment, 2018 https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1080&context=sustainable_investment_staffpubs

[11] "*As has been remarked by several scholars, these types of studies are problematic for a number of reasons, including that data on FDI flows is often inaccurate or inadequately disaggregated, and that, even if one were to find correlation between investment treaties and FDI flows, it would be extremely difficult to establish that the treaties actually caused those investments*. »
Ibid., footnote 5, p. 20
https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1080&context=sustainable_investment_staffpubs

[12] *Ibid.*

[13] "*Firms establish indirect ownership structures in order to access the bilateral tax treaty network, which lowers the tax rate charged on cross-border capital transfers. However, tax and investment treaty networks overlap extensively; investors who sought tax treaty coverage often gain investment treaty coverage as a side benefit, enabling them to file proxy arbitration in the event of a dispute*", Calvin Thrall, Spillover Effects in International Law: Evidence from Tax Planning, November 23, 2021. https://www.calvinthrall.com/assets/taxplanning_postJMP.pdf

Notwithstanding point a) and b), even in the hypothesis that a particular IIA would bring additional flows of inward investments, sums expressed in absolute or relative monetary values do not inform in any way on the benefit for society at large and for specific categories of populations. As reminded by an OECD Working Paper on International Investment, "*as all regulatory interventions have distributional effects, costs and benefits of IIAs are likely to be spread unevenly within the societies of parties to IIAs. Existing studies have largely ignored the distributional effects of IIAs within a given country's society and have rather treated the society of a country – or even a group of countries – as an entity.*"[14]

More generally, the optimism towards international (private) investment seems to go hand in hand with the neglect of the much better proven leveraging power of (public) domestic investment and public regulation when it comes to providing the same benefits. This applies to climate action, the focus of this consultation : the rationale for IIAs as tools able to contribute to address climate change mainly rely on the argument that foreign investments can help finance, develop and spread cleaner technologies through "*greater competition and transfer of know-how*".[15] If innovation and technology may indeed play a role in the transition to a low-carbon economy, this kind of approaches tends to overestimate their transformative capacity and positive impacts and overshadow other structural changes of the socio-economic system and evolutions in collective and individual patterns and production and consumption, that can be achieved through public policies and cultural changes. Also, if such solutions are to emerge, it is doubtful that the liberalisation and market openness brought by IIAs are the most effective, rapid, and just way to achieve them.[16]

II. International Investment Agreements (IIAs) represent a major obstacle to climate mitigation and adaptation

The substantive protection standards provided by IIAs and their enforcement mechanism in the form of Investor-State Dispute Settlement undermine climate action, mainly by a) deterring policymakers to implement ambitious climate measures; b) diverting important financial resources that would be necessary to fund the transition to a low-carbon society and c) de risking investment in fossil fuel stranded assets.

[14] Lise Johnson, Jesse Coleman, Brooke Guven, Lisa E. Sachs, *Op. Cit.* 2018, footnote 5, p. 20

[15] David Gaukrodger, "The future of investment treaties – possible direction", OECD Working Papers on International Investment 2021/03, 2021
https://www.oecd-ilibrary.org/docserver/946c3970-en.pdf?expires=1646839833&id=id&accname=guest&checksum=9BF9A748FD2CBEC2428A9F018B2F28F4

[16] There is mounting evidence that any technology (e.g renewable energy) having in theory the potential to contribute to transition to low-carbon society will fail to do so in the framework of a growth-oriented and poorly regulated economy. Given the absence of long-term, absolute and sufficient decoupling between economic growth on the one hand, and GHG emissions and material and resource use on the other hand, any progress made is outweighed by the increase of the overall energy and material demand and the GHG and environmental footprints they entail.
See European Environment Agency, "Growth without economic growth", 11 January 2021
https://www.eea.europa.eu/publications/growth-without-economic-growth
European Environmental Bureau, *Decoupling Debunked*, July 2019
https://mk0eeborgicuypctuf7e.kinstacdn.com/wp-content/uploads/2019/07/Decoupling-Debunked.pdf
Kallis, Hickel, "Is Green growth possible ?", New Political Economy, volume 25, 2020
https://www.tandfonline.com/doi/abs/10.1080/13563467.2019.1598964?journalCode=cnpe20

a) ISDS deters policymakers to adopt an ambitious climate agenda

The possibility for foreign investors to sue States under rules that are very favourable to them and to demand millions (or even billions) of euros in compensation is not without consequences on the regulatory space: it can deter governments from considering new regulations to protect consumers, workers or the environment, an effect known as a "regulatory chilling"[17]. Foreign investors can also lobby and threaten to sue during the legislative process, with the aim of reducing its scope and ambition. Recent trends in ISDS are already showing hints that it could become a major obstacle in the phase-out of fossil fuels yet inevitable to preserve chances of keeping global warming under control: Multinational companies in the energy sector are already abundantly making use of ISDS. According to two recent studies, 17% to 20% of disputes concern investments in or related to the fossil fuel industry, mainly oil and gas.[18]
The ISDS threat on climate measures is already a reality. No less than 13 cases of investor-state disputes directly related to climate measures have occurred since 2012.[19] And this trend would be on the rise since the Paris Agreement as shown by the list of fossil fuel arbitrations initiated to challenge a climate measure[20].

The dispute triggered in 2021 by RWE and Uniper after the Netherlands passed a law banning the use of coal for electricity generation in 2019 is a telling illustration of this risk. One can fear that this type of complaints will become more and more frequent as governments implement policies that shut down highly GHG-emitting sectors or more generally introduce new regulations that may reduce the profitability of investments in such sectors. Given that all public policies must be oriented toward climate action, this means very few governmental actions would not be risk being challenged by ISDS disputes.

In the same logic, given that keeping global warming below 2°C by the end of the century requires liquidating all the fossil fuels activities and infrastructure, the pool of potential lawsuits from fossil fuel investors in an attempt to shift the cost of transition to society is enormous : the value of what will become “stranded assets” in the oil and gas sector is estimated to amount to US$ 3-7 trillion; this figure is US$ 1.8 trillion in the power sector alone.[21] Investigate Europe journalists estimate that the Energy Charter Treaty alone protects €345 billion of fossil fuel assets in the EU, UK and Switzerland,

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[17] Kyla Tienhaara, « Regulatory chill and the threat of arbitration », 2010, in: C. Brown and K. Miles (eds) Evolution in Investment Treaty Law and Arbitration, 606-627; Gus Van Harten and Dayna Nadine Scott, “Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study from Canada”, 2016 ; Jane Kelsey, “Regulatory chill: learnings from New Zealand's plain packaging tobacco law, QUT Law Review”, 2017 ; Kyla Tienhaara, “Regulatory chill in a warming world: The threat to climate policy posed by investor state dispute settlement”, 2018 Transnational Environmental Law.
[18] LSE, Grantham research Institute on Climate Change and the Environment, “Investor-State Dispute Settlement as a new avenue for climate change mitigation”, 2 june 2021
https://www.lse.ac.uk/granthaminstitute/news/investor-state-dispute-settlement-as-a-new-avenue-for-climate-change-litigation/
and,
IISD, *Investor-state Disputes in the Fossil Fuel Industry*, Décembre 2021
https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf
[19] While these cases do not always contain explicit references to climate change, they all relate directly to the introduction, withdrawal or amendment of a policy measure explicitly developed to meet a country’s climate goals
LSE, Grantham research Institute on Climate Change and the Environment, *Op. Cit.*, 2021
[20] *Ibid,* table 17, p 40
[21] Kyla Tienhaara, Lorenzo Cotula, *Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuels assets*, Institute for Environment and Development, 2020
https://pubs.iied.org/sites/default/files/pdfs/migrate/17660IIED.pdf

in the form of fossil fuel infrastructure such as pipelines, oil and mining fields, gas and coal plants.[22] Another report estimated that based on total FDIs in ECT signatories by January 2020, stranded fossil fuels assets protected under the ECT regime, since its entry into force, are estimated at €870 billion[23].

It is not even necessary for companies to actually sue states before an arbitration tribunal to undermine efforts to achieve a green transition: simply holding out the threat of litigation can pressure policymakers to abandon or water down a bill. This was very likely the case in 2017, when French Minister for Ecological Transition Nicolas Hulot presented a bill to end hydrocarbon exploration and exploitation in France by 2040.[24] By prohibiting the issuing of new exploration permits and the renewal of existing ones, this text would have put an end to the extraction of fossil fuels on French territory. However, a law firm acting on behalf of the Canadian oil company Vermilion, owner of 27 operating concessions in France,[25] wrote a letter to the Council of State, the institution responsible for providing the government with a legal opinion on the text of law before it is examined by the Parliament.[26] The letter said that the bill infringed its investor rights (under the ECT) and that it was considering taking France to an arbitration tribunal. This pressure seems to have paid off: the final version of the law allowed the renewal of oil licences to continue until 2040.

The possibility of ISDS litigation confers considerable bargaining power against states to large fossil fuel companies. Thus, rather than run the risk of being ordered by an arbitration tribunal to pay damages, the German state preferred to reach an agreement with the coal companies RWE and LEAG. This agreement entailed the payment of 4.35 billion euros in compensation for the anticipated shutdown of the facilities and the companies promised not to initiate arbitration proceedings against the German law to phase out coal-fired electricity by 2038. While it is not possible to determine exactly how much of this sum is attributable to legitimate reimbursement of the costs of dismantling the infrastructure, many experts believe that given the huge amount of compensation, it is highly likely that the threats of arbitration have significantly inflated the bill.[27]

A 2021 report of the Working Group on the issue of human rights and transnational corporations and other business enterprises of the United Nations points out the effects of ISDS in the same terms as the arguments presented above.[28]

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[22] Olivier Moldenhauer, Nico Schmidt, "ECT data analysis: results and methods", Investigate Europe, 23 February 2021 https://www.investigate-europe.eu/en/2021/ect-data/

[23] Yamina Saheb, "Modernisation of the Energy Charter TreatyA Global Tragedy at a High Cost for Taxpayers", Openexp, January 2020, https://www.openexp.eu/sites/default/files/publication/files/modernisation_of_the_energy_charter_treaty_a_global_tragedy_at_a_high_cost_for_taxpayers-final.pdf

[24] Les Amis de la Terre France, "Nouvelles révélations sur le lobbying au sommet de l'État", 30 août 2018 https://www.amisdelaterre.org/communique-presse/loi-hulot-nouvelles-revelations-sur-le-lobbying-au-sommet-de-l-etat/

[25] Vermilion Energy, « Les concessions de Vermilion en France »

[26] Friends of the earth Europe, « An axe to climate action. 10 reasons the EU and governments must quit the Energy Charter Treaty », May 2020 https://friendsoftheearth.eu/wp-content/uploads/2020/05/ECT-axe-to-climate-action.pdf

[27] Powershift, « Teuer erkauft: Wie der Energiecharta-Vertrag die Kosten des deutschen Braunkohleausstiegs in die Höhe trieb », November 2021 https://power-shift.de/wp-content/uploads/2021/11/Wie-der-ECT-die-Kosten-des-deutschen-Braunkohleausstieg-in-die-Hoehe-trieb-web.pdf

[28] *"As far as the effect of arbitration claims on States' right to regulate is concerned, reference may be made to the fossil fuel companies relying on the Energy Charter Treaty to challenge government measures aimed at mitigating climate change. In the past, tobacco companies have also initiated arbitration claims against States for taking legitimate measures to protect the right to health. Even if the States concerned had been able to justify their measures in the end, the process entailed spending unnecessary time and resources in defending claims that should not have existed in the first place. Such claims also tend to*

Several new concrete cases of regulatory chill have been documented in recent journalistic investigations.[29]

b) <u>ISDS diverts colossal sums of public money that could be used to finance climate action and the green transition.</u>

In 2019, Friends of the Earth Europe, CEO and TNI estimated that the total amount of awards paid by states to companies in the framework of ISDS was $88 billion ($38 billion excluding the sum of awards in the Yukos cases), on a total of $623 billion claimed by investors.[30] This sum only takes into account cases that have been made public and for which information is available: it is likely to be much higher in reality.

The absence of caps on the awards fuels an important inflation in the amounts demanded by investors and awarded by arbitrators: the sums of a few tens of millions of euros awarded at the beginning of the 2000s - already considered very large at the time - appear quite modest in comparison[31] to the average of USD 438 million per dispute.[32]

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create a regulatory chill not only in States involved in such claims but also in bystander States". United Nations General Assembly, *Human rights-compatible international investment agreements. Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises*, 27 July 2021 https://documents-dds-ny.un.org/doc/UNDOC/GEN/N21/208/09/PDF/N2120809.pdf?OpenElement

[29] The Danish climate minister Dan Jørgensen, said that the 2050 deadline for ending exploration projects, which is expected to affect just one fossil fuel licensing agreement, was chosen in order to avoid to pay "incredibly expensive" compensation to the companies that have invested in plants and equipment under fossil fuel deals. See Elizabeth Meager, "Cop26 targets pushed back under threat of being sued", Capital Monitor, January 14, 2022 - updated 21 Feb 2022, https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/

A Danish energy ministry spokesman even told Capital Monitor by email: "*The ministry is aware of examples of companies suing governments for fossil fuel phase-out laws and seeking compensation under the ECT. This is not something we expect in terms of the decision to phase out North Sea oil and gas production by 2050.*"

According to its country's climate change minister, James Shawn, New Zealand could not join the Beyong oil & gas alliance as a full member because by doing so it "*would have run afoul of investor-state settlements ISDS*". "*So by saying there's just not going to be any new exploration we weren't challenging any existing rights, and while lots of people complained, it wasn't legally challengeable.*" See *Ibid.*

The German finance also warned the chancellor's office in 2019 that using regulation to phase out coal would create an "*increased risk of litigation, especially international litigation based on the ECT*", according to an email seen by the Financial Times. See Camilla Hodgson,"European energy groups seek €4bn damages over fossil fuel projects", Financial Times, 21 February 2022, https://www.ft.com/content/b02ae9da-feae-4120-9db9-fa6341f661ab

And one reason why the German governement decided to halt the certification of Nord Stream 2 project rather than cancelling it, might also be the fear of litigation. The environment minister Svenja Schulze said in February "*We also run the risk of ending up in international arbitration courts with compensation claims if we stop the project". See* Yamina Saheb, An energy investment treaty has been holding Nord Stream 2 hostage", Climate Home News, 24/02/2022, https://www.climatechangenews.com/2022/02/24/the-energy-charter-treaty-delayed-nord-stream-2-halt/

[30] Friends of the Earth Europe, Friends of the Earth International, Transnational Institute, Corporate Europe Observatory, "Red Carpet Courts : 10 stories of how the rich and powerful hijacked justice", june 2019 https://friendsoftheearth.eu/wp-content/uploads/2019/09/foe-red-carpet-courts-final-web1.pdf

[31] Jonathan Bonnitcha, Sarah Brewin, *Compensation Under Investment Treaties: What are the problems and what can be done?*, IISD Policy Brief, December 2020 https://www.iisd.org/system/files/2020-12/compensation-investment-treaties-en.pdf

[32] Statistic based on a sample of more than 400 ISDS cases.
Matthew Hodgson, Yarik Kryvoi, Daniel Hrcka, *2021 Empirical Study: Costs, Damages, and Duration in Investor-State Arbitration*, British Institute of International and Comparative Law, June 2021 https://www.biicl.org/documents/136_isds-costs-damages-duration_june_2021.pdf
"Among successful investors, the mean amount of damages claimed stands at US$1.5bn while the mean amount awarded is just US$438m (the median figures being US$143m and US$21m, respectively)."

This upward trend can be explained by the absence of clear and uniform rules concerning damages in investment treaties,[33] which left significant room for interpretation to arbitrators[34] and turned out to be very advantageous for investors[35].

Also, regardless of the amount of potential arbitration awards, arbitration proceedings are costly in themselves: States spend an average of 4.7 million dollar per dispute in defence costs.[36] This sum covers, among other things, lawyers' fees, the remuneration of arbitrators and experts, the administrative costs of the tribunal, etc. The larger the amount claimed by the investor and the longer the procedure, the higher are generally the costs.

Considering the points above, IIAs and ISDS will significantly increase the costs of taking climate measures. States will have to pay billions of euros of public money to multinational companies instead of dedicating these resources to the investments necessary for the transition[37].

c. By de risking investment in fossil fuel stranded assets, ISDS distorts market developments and delays investors' decisions to exit the fossil fuel sector

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[33] To the exception of cases of direct expropriation, for which the ISDS was initially designed.

[34] Jonathan Bonnitcha, Sarah Brewin*, L'indemnisation en vertu des traités d'investissement*, Série des bonnes pratiques de l'IISD, novembre 2020, p. 10
https://www.iisd.org/system/files/2021-01/compensation-treaties-best-practicies-fr.pdf

[35] In particular, two trends account for the inflation of awards:
- Arbitrators increasingly take into account the "expected future profits" in addition to the cost of direct damage such as expenses already incurred in carrying out the project.
- Arbitrators almost systematically grant interests* (compound interests in 9 out of 10 cases**) in addition to the compensation for damages as such. As a result, interests now account for almost ¼ of the total amount paid to investors.***

* PwC, *Tribunals' conflicts on interest*, Dispute perspectives, 2015
https://www.pwc.co.uk/tax/assets/tribunals-conflicts-on-interest-new.pdf

** Yarik Kryvoi , « Valuation of damages in investment disputes – conference takeaways », 22 October 2019,
http://kryvoi.net/blog/itf-valuation-of-damages-in-isds-conference-takeaways/

*** PwC, *op.cit.* 2015, note n°2, p.1

[36] Matthew Hodgson, Yarik Kryvoi, Daniel Hrcka, *2021 Empirical Study: Costs, Damages, and Duration in Investor-State Arbitration*, British Institute of International and Comparative Law, June 2021
https://www.biicl.org/documents/136_isds-costs-damages-duration_june_2021.pdf

[37] While the end of protection for fossil fuel investments in the framework of the modernization of the Energy Charter Treaty has been called for by the European Parliament as part of the climate law in October 2020, some supporters of the ECT argue now that the treaty remains an essential tool for protecting renewable energy investments.
See Karen Beckman, Interview: A new Energy Charter Treaty as a complement to the Paris Agreement, Bordelex, 18/06/2020,
https://www.energycharter.org/fileadmin/DocumentsMedia/Other_Publications/A_new_Energy_Charter_Treaty_as_a_complement_to_the_Paris_Agreement.pdf
But this solution could be counterproductive. Indeed, in the context of a climate crisis and rapidly changing economic conditions, governments need to maintain their policy space and to have the agility to adapt how public money is spent to encourage the green transition. The recent pandemic and financial crises have shown how quickly contexts can change and the necessity for states to sometimes review their policies. In some cases, after an initial period of strong support for renewables through public expenditures, governments had to reduce subsidies as the market appeared to be highly competitive or because the initial supporting schemes had become unsustainable due to the decline in electricity demand or the unexpectedly enthusiastic adoption of the incentives by producers.
See Nikos Braoudakis, Clémentine Baldon, Sara Lickel and Mathilde Dupré, "Protecting renewables with the Energy Charter Treaty: a false good idea", July 2021, Veblen Institute, https://www.veblen-institute.org/IMG/pdf/renewables_ect_veblen_institute_050721.pdf

Phasing out fossil fuels is a necessity to stay within the Paris Agreement's objectives and the majority of all estimated reserves of coal, oil, and gas must remain in the ground. Within the EU, coal must be phased out by 2030, gas by 2035 and oil by 2040 to have a chance to limit temperature rise to 1.5°C.

Article 2.C. of the Paris Agreement states the objective of "*making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*." One of the measures needed to achieve this objective is to remove fossil fuel activities from the list of activities covered by investment protection as soon as possible[38]. Investment arbitrage and the colossal compensations regularly obtained by investors in the fossil fuel sector contribute to blurring the climate signals that investors should consider and keeping the sector attractive (or even making it more attractive).

III. It is necessary to terminate IIAs and stop signing new ones or, at the very least, to significantly reduce the scope of investment protection and the use of ISDS

Both previous sections lead to the conclusion that governments of OECD and EU Members states, and the UE itself should urgently take steps **to entirely review and reform their investment policy** in order to make it compatible with Sustainable Development Goals, their commitments in the framework of the Paris Agreement and the EU Green New Deal. The governing principle must be to ensure the **primacy of international social, human rights and environmental standards over international investment law.**

The best option consists in terminating all existing IIAs and halt the signature of new ones. Such a termination process raises the issue of the sunset clauses contained in many existing investment agreements. State should withdraw their consent to arbitration and work together to neutralize the sunset clauses.

In the specific case of the Energy Charter Treaty (ECT) – which is a plurilateral investment agreement that has been the main source of ISDS cases, including against climate action – the withdrawal might be accompanied by the conclusion of an inter se agreement among the former contracting states in order to neutralize the sunset clause.

While we are convinced that this option would be both sounder and more efficient, if it was eventually not chosen, an array of alternative levers exist that would nevertheless reduce the harm caused by IIAs and ISDS on climate and climate action. Preferably, **a multilateral process** (coordinated at OECD level for instance) could facilitate such reform. And this **new model should be applied to all new IIAs signed, if any.**

1) Supremacy clause

In order to clarify the hierarchy between the different instruments of international law, it is first necessary to enshrine in investment protection agreements the primacy of multilateral environmental agreements. Such a clarification would be an undeniable step forward. However, it would not be sufficient since arbitration tribunals may be reluctant to take account of international

[38] 75% of the foreign-owned coal power plants that need to be retired early in line with the Paris Agreement are covered by at least one treaty with ISDS. See Kyla Tienhaara & Lorenzo Cotula, *Op. Cit.,* 2020, p 27

environmental and human rights law in their awards, considering that these are not relevant to the dispute.

2) Narrowed scope of investment protection standards

It is key to significantly reduce the broad-encompassing substantive protection standards granted by IIAs. Foreign investors should benefit from no more rights and standards of protection than domestic investors. This is why investment protection should be strictly limited to cases such as direct expropriation without compensation, gross denial of justice, and discrimination. This means removing protection provisions such as Fair and Equitable Treatment (FET) or Indirect Expropriation (to cite but a few) which tend to be vaguely defined and interpreted extensively by ISDS tribunals to the benefit of investors. This option is along the lines of the proposal made in the draft report on the future of EU international investment policy presented to the INTA Committee in the European Parliament in February 2022.[39]

Additionally, the review should seek to adopt a more restrictive definition the investors and investments covered by treaty protection. Portfolio investments, governments bonds and debts securities should be excluded from the potential beneficiaries of investment protection.

Investments should also be granted a basic level of protection only if they meet a set a socio-ecological criteria.

3) Removal of ISDS mechanism

ISDS should be eliminated from all treaties, and national jurisdictions should be in charge of handling investors' complaints. At international level, state to state dispute settlements might also be used to deal with the most problematic situations.

4) End of protection for investments in or related to fossil fuels

Investments in the fossil fuel industry should no longer be covered by investment treaties provisions. In October 2020, the European Parliament adopted an amendment to the European Climate Law later rejected by the Council of the EU stating that "*the Union shall end protection of investments in fossil fuels in the context of the modernisation of the Energy Charter Treaty*".[40] The same logic should be applied to all IIAs. At the very least, investors linked to fossil fuels should not be able to trigger a litigation in an ISDS tribunal.

5) Climate veto

All litigations contesting action taken by States in the framework of their action to reduce GHG emissions could be barred from accessing to ISDS. In practice, all dispute cases would be reviewed by an independent panel of climate experts able to invalidate a litigation if it has the potential to

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[39] *Draft report on the duture of EU international investment policy*, (2021/2176(INI)), Committee on International Trade, 2021 https://www.europarl.europa.eu/doceo/document/INTA-PR-704874_EN.pdf

[40] Yamina Saheb, "Energy Charter Treaty strikes again", Euractiv, 12 février 2021 https://www.euractiv.com/section/energy/opinion/energy-charter-treaty-strikes-again/

contradict the actions and efforts made by States to deliver on their Nationally Determined Contributions (NDCs) on the reduction of GHGs.[41]

6) "Clean hands" provisions

Any company having committed any human rights violation or environmental crime should be denied treaty protection and access to ISDS. States should limit the scope of their consent to arbitration to situations where the investment has been made in compliance with the international standards of Human Rights due diligence defined in the United Nations Guiding Principles on business and human rights or even the domestic requirements on this matter (such as the future EU Directive on corporate sustainability due diligence).

[41] European Parliament resolution of 14 October 2015 on Towards a new international climate agreement in Paris (2015/2112(INI), 2015
https://www.europarl.europa.eu/doceo/document/TA-8-2015-0359_EN.pdf

ISDS Constrains Government Actions to Reduce Climate Change: the OECD Can Do Something About It

Louis T. Wells*

The danger of climate change is well known to OECD member states.

There is no need in this forum to argue that climate change is a threat to our future.[1] Nor ought there be any doubt that governments must be free to legislate, regulate, and comply with treaties that are designed to slow climate change and mitigate its effects.

There is also broad agreement that actions of foreign investors that produce fossil fuels or that are heavy users of fossil fuels are particularly relevant to climate change. They are not alone, however: actions of foreign investors in other sectors also influence climate. Investors should not be able to thwart steps by their host governments to address this critical issue. Yet, they do so under the current Investor-State Dispute Settlement Regime.

The Investor-State Dispute Regime has resulted in constraints on government actions on climate change.

The Investor-State Dispute Regime (ISDS) comprises a network of agreements between countries as well as adjudicating mechanisms. The Regime was created to safeguard foreign investors. The adjudicating bodies that decide the merits of claims by investors and any damages awarded to them are ad hoc private arbitration tribunals. Tribunals have heavily penalized some host governments that have taken legislative or regulatory steps that are in the public interest. Penalties and threats of penalties have acted as a chilling effect on other governments, leading them to moderate their actions on climate change.

For example, threats by a Canadian company led France to weaken legislation on extraction of fossil fuels when it attempted to comply with the 2015 Paris Climate Agreement.[2] Swedish Vattenfall brought a case against Germany in response to Germany's phasing out of nuclear power plants. Páez-Salgado cites further examples: U.S.'s Westmoreland Coal Company, in 2018, initiated arbitration against Canada following Alberta's plan to eliminate coal-based energy by 2030; Germany's Uniper expressed its intention, in 2019, to file a claim against The Netherlands after its parliament passed a bill calling for a 55% cut in GHG emissions by 2030; in 2021 the German RWE A.G. filed an ECT[3] claim against The Netherlands for the same step; and in 2021 Australia's Berkeley Energia said it was considering arbitration if Spain passed an amendment to a bill that would ban mining of uranium in the country.[4] Similarly, Canada's TC Energy Corporation has recently brought a case against the United

* The author is the Herbert F. Johnson Professor of International Management, Emeritus, Harvard Business School. He has served as an expert in more than a dozen investor-state arbitrations.

States for $15 billion in damages for its cancelation of the Keystone Pipeline, which the U.S. Environmental Protection Agency concluded would add 1.3 billion tons of greenhouse gasses during its 50-year life span.[5] All these examples are investors from wealthy countries with investments in other wealthy countries. In many other cases, the hosts have been developing countries, which are especially likely to yield to avoid the risks and huge costs of international arbitrations.

Arbitration tribunals judge these claims of foreign investors by whether the actions of host governments meet the standard of "Fair and Equitable Treatment," as stated in investment agreements. On the surface, the standard appears quite innocuous. Yet, in applying it, tribunals have introduced an additional principle: they have asked whether changes in legislation and regulation violate an investor's "Legitimate Expectations."

The result has been clear:

> The tension between the state's right to regulate and the protection of the legitimate expectations of an investor involves 'a state's insistence on its authority to adapt its rules to the public interest and an investor's insistence on a right to rely on a regime which induced it to invest.' [6]

Tribunals have considered almost any change in government legislation or regulation that has a significant impact on an investor's future returns as not being "Fair and Equitable" because the change was not a "Legitimate Expectation" on the part of the investor. That the change left the investor with adequate returns on its investment or, more important, that it was in the public interest – as is climate change legislation-- has played little to no role in arbitrators' decisions.[7]

Limiting progress on confronting climate change cannot be the intent of the countries that built the ISDS Regime. Yet, that has been the result. The OECD member states can jointly do something about this now.

There have been many proposals for effecting change in ISDS, but all take too long.

There is no absence of proposals for reforming the ISDS Regime.

First, some proposals focus on improving the terms of new investment agreements. New terms might ensure the ability of governments to protect the environment. Although straightforward and do-able, any impact of improved agreements would take years – probably decades – given the existence of old agreements. Moreover, with treaty shopping available, investors will set up holding companies in countries with old agreements to benefit from the old terms, avoiding new agreements. Of course, current treaties do eventually expire and can be replaced with better ones. Waiting for that to happen is just not an acceptable way to deal with climate change now.

Second, there are proposals to terminate existing agreements or renegotiate them. But agreements include survival clauses that provide for continued protection of old investors even if agreements under which they invested are ended. Moreover, it takes "guts" for a government of a developing country to terminate or insist on renegotiation of agreements.[8] Many officials have been convinced by investors' home countries that agreements attract investors. Or, that they encourage reform of the domestic justice system. This, even though there is little or no empirical evidence to support the views.[9] The alternative of renegotiating existing agreements is a huge undertaking. The process of renegotiating several thousand agreements would demand the time of busy skilled officials and would take years. Climate change is moving too fast to depend on this slow and perhaps unproductive process.

Third, there are proposals for establishing international investment courts, or appeals courts. Proponents seek consistency in decisions from standing courts, but some also hope that the courts would see themselves as defenders of the public interest, not solely the interest of investors. That public interest would include not punishing states for steps aimed at saving the planet from the disastrous effects of climate change. But there is no guarantee that this would be the outcome. It would take years for one or more such court to be established and to generate rulings, on matters such as climate change. Proposals for investment courts have already been around for some time, but none have been created.[10]

Although starting long-term reforms of the ISDS, or even its dismantling, is, in the view of critics, is needed, none of the proposed reforms is likely to occur soon. The very nature of the ISDS Regime makes it especially difficult to reform. The Regime was not the creation of a multilateral effort, as were the GATT and then the WTO, or the World Bank Group, for example. The ISDS Regime comprises a network of thousands of bilateral investment agreements and investment provisions in regional trade agreements, each separately negotiated by states over many years. The administering tribunals are independent, appointed case by case. With no central institution[11] parallel to the WTO or the World Bank, the ISDS Regime is largely immune from political pressures: it provides no target for a "Battle of Seattle"[12] where protestors might advocate change for the sake of saving the earth from climate disaster. [13]

The climate change issue is upon us; waiting years for the proposed reforms in the ISDS Regime simply will not do. Collective action by the OECD could, however, effect quick change.

The OECD can act to reduce the chilling effect of ISDS on climate change legislation and regulation.

OECD member states can act to quickly reduce the chilling effect of the current ISDS Regime. The majority of investors that bring ISDS cases are based in OECD member states and are protected by investment agreements to which those states are party.

The most serious impediment to host government policies on climate change lies in tribunals' interpretation of the "Fair and Equitable Treatment" (FET) provisions of most investment agreements and the standard of "Legitimate Expectations." Tribunals' interpretations result in punishing damages for governments that institute new legislation and regulatory actions to limit climate change and to counter its effects.

A joint statement by OECD member states clarifying their view on how "Fair and Equitable Treatment" and "Legitimate Expectation" standards should be interpreted would have a major impact on the decisions of ISDS tribunals. The clarification would be a "Multilateral Interpretive Statement," a powerful tool in the defense of host governments that wish to address climate change and mitigate its effects.[14] Lawyers have made it clear that states do have the right to issue interpretive statements with respect to treaties;[15] moreover, interpretive statements by parties to treaties are generally heeded. States have, in a few limited cases, unilaterally issued interpretive statements with respect to investment agreements, but special power would lie in a multilateral statement focused on climate change. [16]

What should the Multilateral Interpretive Statement say? Something like this:

> The following countries believe that it is urgent that ISDS no longer hinder government actions that are aimed at slowing climate change and mitigating its effects. It was never the intent of these states to limit legislation and regulations in host countries that are beneficial to the common good. To that end, Fair and Equitable Treatment provisions, standards of Legitimate Expectations, and other provisions and interpretations of investment agreements should not be applied in ISDS arbitrations in any way that limits or penalizes host governments' ability to legislate or to regulate with the aim of addressing climate change or mitigating its effects, or to enforce international commitments that are directed at those ends.

Many, including this author, would like to add "or protecting safety, health, the environment, and human rights," but past efforts to generate several limitations in a single multilateral interpretive statement have failed.[17] Home-country governments have not been able to agree on which limitations in a list should be accepted. A statement addressing only climate change, however, ought to be non-controversial.

A recent success of the OECD shows the member states can take important joint actions.

The success of the OECD's recent effort to deal with international taxation is encouraging. The OECD/G20 project on Base Erosion and Profit Shifting (BEPS) led to an agreed "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" in 2021.

The statement on taxation took years to negotiate. And the commitments are effective only if countries enact legislation to implement them. Moreover, the tax agreement includes a call for an international treaty. Neither national legislation nor or treaty is required for OECD action with respect to ISDS and climate change.

The proposed Multilateral Interpretive Statement is consistent with policies implemented by OECD member states for other incentives they offer foreign investors.

In other measures designed to encourage foreign investors, OECD states have already acted to reduce harmful impacts of investors. The proposed Multilateral Interpretive Statement would be consistent with those policies.

For example, Government-sponsored entities offer political risk insurance to their foreign investors. Examples of insurers are the International Development Finance Corporation of the United States,[18] France's COFACE, and United Kingdom's ECGD. At the multilateral level, similar insurance is offered by the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group.

Political risk insurance could have a chilling effect on climate-oriented legislation and regulation like that of ISDS. Host governments whose actions lead to claims are usually liable to reimburse the insurer.

When private insurers collaborate with government insurers, as they do in Germany and the United States, insurers' pressure on host governments often provides reimbursement of private insurers as well as government insurers.

Yet, these insurance programs do not, in practice, lead to the kind of chilling effect on climate action that one might assume:

First, the triggers to claims are much more limited than in ISDS. Nationalizations, expropriations, steps equivalent to expropriation, inconvertibility of currency, and violations of terms of an investment contract are typically covered and can trigger claims. But there is no concept comparable to "Legitimate Expectations."

Second, awards for claims under insurance policies are generally much smaller than the awards of ISDS tribunals. Coverage is limited to some portion of actual investment or a narrow definition of covered returns, while awards by ISDS tribunals have regularly been based on an often-inflated net present value of all future earnings, a sum many times the amount invested by the foreign firm. In fact, two recent awards have been around $6 billion for, in one case, an investment of less than $500 million, and for another, an investment of not more than $40 million. No political risk insurance award would match these sums.

Third, and most important, the actions of national insurance agencies (and MIGA) have reflected their governments' concern with climate change by explicitly addressing the issue.[19] They require environmental impact studies before they insure an investment, and some continue to monitor investments they insure. Some refuse to offer any insurance at all for fossil fuel projects.

Other entities, such as development finance and aid agencies in OECD countries, have been similarly responsive to public policy aimed at addressing climate change.[20]

Since OECD member countries have led their providers of political risk insurance and financing to reflect national policies on climate change, acting on the chilling effect of ISDS on climate change is a natural next step. Agreeing on the proposed Multilateral Interpretive Statement is a way to do for ISDS what governments have already done for their own insurance and finance programs.

Non-members of the OECD should be invited to join the statement.

Some ISDS claims made by firms are brought under investment agreements between the host country and states that are not the "real" home states of the investors. Investors establish "mailbox" subsidiaries as holding companies in "haven countries," such as the British West Indies, the Cayman Islands, Mauritius, and Cyprus. Disputes are then governed under investment agreements between the country of the "mailbox" subsidiary, usually a non-OECD country,[21] and the host state. For example, US petroleum companies operating in Venezuela established entities in countries with bilateral investment agreements with Venezuela, because there was no agreement between the United States and Venezuela. Other "treaty shopping" moves were made to take advantage of agreements that are especially favorable to investors. An Interpretive Statement by OECD countries would not have a <u>direct</u> effect on cases brought under these agreements.

Similarly, failure of some non-OECD countries to sign onto the OECD tax agreement would have left loopholes, but many non-member countries did eventually join in. Attracting similar countries to sign the Multilateral Interpretive Statement ought to be easier, since the benefits to countries from serving as haven countries are small.

Even if some "haven" countries fail to join in the Statement, when a number of tribunals are seen as honoring the OECD Statement, other tribunals are likely to follow along.

To conclude.

With the recent report of the Intergovernmental Panel on Climate Change, a body of experts convened by the United Nations, the UN Secretary General, António Guterrez, said:

> "Unchecked carbon pollution is forcing the world's most vulnerable on a frog march to destruction — **now**…This abdication of leadership is **criminal**."[22]

The OECD member states can collectively exercise leadership **now** with respect to the impact of the current ISDS Regime. Failure on its part might someday be viewed as **criminal**.

The chilling impact on legislation and regulation addressed to climate change is clear. Foreign investors threaten, or actually file, claims under investment agreements that discourage new legislation and regulations. As tribunals are now interpreting investment agreements, governments may face claims of billions of dollars on top of millions of dollars in legal fees for actions on climate change. The impact of discouraging legislation and regulation is not solely on foreign firms, but on all firms in the entire sectors where foreign firms are present. And foreign firms are present in particularly important sectors affecting climate change: petroleum extraction, coal mining, and power generation, for example.

OECD member states can free governments to act on climate change by agreeing to a Multilateral Interpretive Statement that makes it clear that they did not and do not intend that investment agreements to which they are party should be interpreted in ways that restrict or penalize governments for enacting new legislation and regulations that are addressed to climate change and its impacts. Member states should encourage non-member states to join the Statement. But, a Statement by OECD member states alone would constitute a significant step in reducing the barriers to legislation and regulations on climate change that the current ISDS Regime has created.

[1] *Climate Change 2022: Impacts, Adaptation and Vulnerability*, Intergovernmental Panel on Climate Change, Sixth Assessment Report, was made public in February 2022, as this paper was being written. The careful report was prepared by 270 researchers from 67 countries and serves as a warning that immediate action is necessary.

[2] Paul Fauteux, "Investor State Dispute Settlement and Climate Change—Who Protects the Public Interest?" *Canadian Arbitration and Mediation Journal*, Vol. 30, No. 2, Spring 2021.
p. 16.

[3] Energy Charter Treaty.

[4] Daniela Páez-Salgado, "A Battle on Two Fronts: Vattenfall v. Federal Republic of Germany," *Kluwer Arbitration Blog*, February 18, 2021. Available at: http://arbitrationblog.kluwerarbitration.com/2021/02/18/a-battle-on-two-fronts-vattenfall-v-federal-republic-of-germany/#:~:text=On%20May%2014%2C%202012%2C%20Vattenfall,energy%20under%20the%20Thirteenth%20Amendment. [viewed 2/22]

[5] Marianne Lavelle, "Requiem for a Pipeline: Keystone XL Transformed the Environmental Movement and Shifted the Debate over Energy and Climate," *Inside Climate News,* June 20, 2021. Available at: https://insideclimatenews.org/news/20062021/keystone-xl-pipeline-environmental-movement-energy-climate/#:~:text=In%202015%2C%20the%20Environmental%20Protection,it%20were%20carrying%20conventional%20crude. [Viewed 3/22]

[6] From Levashova, op. cit., citing Jan Paulsson, "Can 'Legitimate Expectations' ever be 'Rights'?" (2016), no longer available at the locaton cited by the author.

[7] There are exceptions, where the public interest should be obvious. In Urbaser v. Argentina, the tribunal did say that the investor should have been aware that the Constitution requires the government 'to ensure the population's health and access to water.' Quoted from Levashova, op. cit., p. 253.

[8] A few countries have acted to terminate investment agreements or to withdraw from ICSID.

[9] For a summary of empirical studies on the effects of investment agreements, see: Joachim Pohl, "Societal Benefits and Costs of International Investment Agreements: A critical review of aspects and available empirical evidence," *OECD Working Papers on International Investment,* 2018/01. Available at: https://www.oecd-ilibrary.org/docserver/e5f85c3d-en.pdf?expires=1645908724&id=id&accname=guest&checksum=4388AF8B3408620BD3F94A2F0C03E50A. [Viewed 2/22]

[10]Although a single court for the ISDS Regime is unlikely to be created anytime soon, courts that administer investment provisions of regional trade agreements are more likely to be developed. For one early proposal for such a court, see Michael D. Goldhaber, "Wanted: A World Investment Court," *Transnational Dispute Management*, Vol. 1, No. 3, July 2004. For an ongoing effort, see the proposal of the European Commission to establish a multilateral investment court: "Legislative Train Schedule: A Balanced and Progressive Trade Policy to Harness Globalization." Available at: https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-multilateral-investment-court-(mic) [Viewed 3/22]

[11] The International Center for the Settlement of Investment Disputes (ICSID) is largely an administering body with a set of rules and procedures for arbitration. In claims under its administration, it does appoint third arbitrators, if the two party-appointed arbitrators cannot agree on the third. And it appoints reviewers if a party seeks annulment of an award, but the annulment process relies on procedural and very technical grounds. It is not an appeals court. Associated with its creation is a treaty that commits governments to enforce the decisions of arbitrators. This is in addition to the so-called New York Convention that also obligates governments similarly. Even if ICSID were to be abolished, many investment agreements provide for alternative administering institutions.

[12] The reference is to the mass protests at the Ministerial Conference of the WTO in Seattle in 1999.

[13] Changes in investment provisions in regional trade agreements are an exception. With the renegotiation of NAFTA, its protection of foreign investors was partially eliminated. Although some reforms at the regional level are possible, they hardly affect the worldwide ISDS Regime.

[14] As an American, the author uses the preferred American spelling of "interpretive." The reader can, of course, substitute the British "interpretative."

[15] See, for example, Alain Pellet, Third Report on Reservations to Treaties, International Law Commission, UN Doc. A/CN.4/491/Add.4, p. 261. There is a clear distinction between statements that are reservations and those that are interpretive.

[16] The members of NAFTA, the United States, Mexico, and Canada, did issue a joint statement on interpretation of the "Fair and Equitable Treatment" ("FET") provisions of the North American Free Trade in 2001. NAFTA Free Trade Commission, "Notes of Interpretation of Certain Chapter 11 Provisions, dated July 31, 2001." The NAFTA agreement was amended soon thereafter to include in the text the interpretation called for. The statement was,

however, signed onto by all parties. An OECD statement would, on the other hand, often cover only one member of an investment agreement.

[17] The statement on NAFTA could be viewed as an exception, but it involved only three countries, the only states that were treaty parties.

[18] For a very good but now dated study of OECD member states' political risk insurance programs, see: Kathryn Gordon, "Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development," *OECD Investment Policy Perspectives*, 2008. Available at: https://www.oecd.org/finance/insurance/44230805.pdf. [Viewed 3/22]

[19] The recent media statement by the U.S. agency emphasizes the renewable energy projects it has insured. See: "DFC Approves More Than $1.4 Billion in New Investments for COVID-19 Response, Global Health, Gender Equity, Technology, and Renewable Energy," Media Statement, September 17, 2021. For MIGA's Climate Change Action Plan, see: https://www.miga.org/sites/default/files/2021-08/CCAP-2021-25-2.pdf. The study of Kathryn Gordon, op. cit., goes through the efforts of national insurance programs by the time she conducted her study. See pages 98-103, in particular. The British agency has a committee on climate change. Other national agencies include environmental impact in their criteria for insurable projects and/or corporate behavior.

[20] Governments have pledged to stop funding fossil fuel development abroad. Germany, for example, "signed the declaration to end public financing of unabated fossil fuel projects overseas by the end of 2022." See: https://www.argusmedia.com/en/news/2272025-germany-to-end-foreign-fossil-fuel-funding#:~:text=Germany%20today%20signed%20the%20declaration,UN%20Cop%2026%20climate%20conference.[Viewed 3/22] The CONNEX Support Unit, sponsored by the German GIZ and partially funded by the European Union, will not provide assistance to developing countries to develop fossil fuels.

[21] One popular "haven" country for treaty shoppers is, however, an OECD member because its investment agreements are especially favorable to investors.

[22] As quoted in the *The New York Times*, March 1, 2022, p.1. Emphasis added.

UNIVERSITY of WISCONSIN LAW SCHOOL

March 11, 2022

Dear Sir/Madam:

Please accept this submission in response to your call for public comments on investment treaties and climate change. I am a Professor of Law at the University of Wisconsin-Madison (USA). I have a graduate degree in law (J.D.) from Duke University and a Ph.D. in political science from the University of North Carolina. For the last 20 years my research agenda has focused almost entirely on the law and policy of investment treaties, and I have published numerous articles on investment treaty issues and investor-state dispute settlement (ISDS).

I. Summary of contribution

I am writing to encourage the OECD to strongly consider ways in which the current investment law regime might be modified to provide states with greater flexibilities to address the existential challenges of climate change. Let me emphasize at the outset that my position is hardly a radical one. As the Financial Times recently reported, ISDS has promoted "volleys of litigation" by companies against domestic climate-change regulations, and that "[e]ven those who generally support the principle of ISDS" think that current treaties, like the Energy Charter Treaty (ECT) are "too crude and plaintiff-friendly."[1] The Financial Times elsewhere describes a "rush of [ISDS] litigation" by energy companies seeking to discourage European states from enacting carbon phaseout policies.[2] The FT notes that in response "[m]any governments increasingly seem to believe that ISDS is expendable."[3] Indeed, a good case can be made that ISDS reforms are an *essential* part of the policy response to climate change. As recently filed ISDS lawsuits by European coal power interests against the Netherlands demonstrate, ISDS places states that are taking reasonable steps to address climate change at the risk of massive legal liability. ISDS litigation undoubtedly delays and discourages policy responses to climate change. This chilling effect is especially unfortunate given that the climate change crisis requires states to act quickly and in the face of substantial uncertainty. The risk of ISDS litigation, by giving energy sector investors an exaggerated right to policy stability, disincentivizes precisely the kinds of bold, flexible, and experimental policy actions on climate change that our moment demands.

[1] FT, Oct. 7, 2021.
[2] FT, Nov. 30, 2020.
[3] Ibid.

I will proceed by making three main points: first, I discuss scholarship showing that the ISDS regime fails to provide benefits sufficient to outweigh the costs of the regime; second, I discuss institutional alternatives to treaty-based ISDS; third, I briefly discuss potentially desirable ISDS reforms.

II. ISDS Provides Little Demonstrated Benefit to States

Proponents of strong ISDS often claim that it provides states with important benefits that outweigh any potential costs. For example, perhaps ISDS promotes foreign direct investment (FDI) inflows, or the peaceful settlement of investment disputes. In fact, as my research shows, the empirical evidence behind these instrumental justifications for ISDS is often quite weak. Data limitations prevent definitive quantitative empirical testing, but the most reasonable evaluations suggest that, on net, ISDS has little capacity to provide functional benefits that outweigh the system's likely costs.[4]

Statistical studies that claim to show a large positive effect on FDI inflows suffer from serious econometric problems, like endogeneity. Data on FDI inflows is of poor quality, and doesn't provide an adequate basis for testing the kinds of bilateral and sectoral theories that underly most claims that ISDS is likely to promote substantial investment. Moreover, a number of quantitative empirical studies fail to find a significant link between ISDS and FDI.[5]

In addition, there is evidence that would-be foreign investors pay little attention to the prospect of ISDS when deciding whether and where to invest.[6] The decision to ignore ISDS at the investment decision-making stage may be a product of bounded rationality; or it may reflect the (arguably rational) sense that access to ISDS is irrelevant for almost all investors, as governments, especially in modern, developed democracies, have little interest in treating foreign investors poorly. There is also evidence that *states* don't act like ISDS helps them to attract foreign investment. One study canvassed the universe of state investment promotion agencies and found that barely any of them advertised their state's ISDS commitments as a tool to attract investment, presumably because

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[4] For a summary of the arguments of this section, as well as citations to relevant sources, see Jonathan Bonnitcha, Lauge Poulssen, and Jason Webb Yackee, "A Future without Treaty-Based ISDS: Costs and Benefits," in *International Economic Dispute Settlement: Demise or Transformation* (Manfred Elsig, Rodrigo Polanco & Peter van den Bossche, eds.; Cambridge UP, 2021).

[5] See, e.g., Jason Webb Yackee, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*, 42 Law & Society Review 805 (2008*); Jason Webb Yackee, Do BITs 'Work'? Empirical Evidence from France*, 7 Journal of International Dispute Settlement 55 (2016).

[6] Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 Virginia Journal of International Law 397 (2010).

investment-promotion specialists don't actually believe that ISDS is relevant to the decision to invest.[7]

The theoretical case that ISDS promotes FDI to developed countries is especially weak on theoretical grounds; after all, modern democracies like France or the United Kingdom enjoy exceptionally strong domestic legal and political institutions that provide reasonable protections against the worst forms of government mistreatment.

It is sometimes argued that ISDS is needed to "depoliticize" investment disputes by promoting peaceful, law-based resolution. These kinds of arguments are often based upon cartoonish, ahistorical invocations of the risk of "gunboat diplomacy." In fact, careful empirical and historical research suggests that states are often able to use diplomatic and other non-ISDS tools to peacefully resolve investment disputes in reasonable ways.[8] Moreover, ISDS itself has proven to generate serious political and diplomatic controversy by facilitating international litigation over government responses to emergency situations (as in the case of Argentina) or to climate change (as in the numerous arbitrations against Spain over its renewable-energy policies).

Finally, it is sometimes argued that ISDS is beneficial because it encourages states, by threat of expensive litigation, to undertake domestic reforms that strengthen the rule of law. However, the evidence in favor of this theory is slight and unconvincing. High-quality, in-depth case studies, such as Jonathan Bonnitcha's of ISDS in Myanmar, suggest the contrary—that ISDS does *not* promote beneficial domestic institutional spillovers.

In sum, there is little evidence that ISDS provides states with important benefits. The case that ISDS is beneficial is especially weak as to modern, developed states. ISDS is unlikely to promote significant flows of desirable investment; it is unlikely to "depoliticize" investment disputes; and it is unlikely to improve the quality of domestic institutions.

It is admittedly difficult to show empirically the existence or magnitude of the costs of ISDS on, say, state policy flexibility or sovereignty. However, in my view, and especially as to climate change policy, there is reason to believe that ISDS seriously threatens the ability of states to take reasonable efforts to address the climate change threat. Given the lack of benefits of ISDS, the prospect of substantial costs means that the rational policy decision is to restrict or eliminate ISDS.

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[7] Jason Webb Yackee, "Do investment promotion agencies promote bilateral investment treaties?", in *Yearbook on International Investment Law & Policy* (Karl Sauvant, ed., Oxford UP, 2015).

[8] See, e.g., Jason Yackee, *Investor-State Dispute Settlement at the Dawn of International Investment Law: France, Mauritania, and the Nationalization of the MIFERMA Iron Ore Operations*, 59 American Journal of Legal History 71 (2019); Geoffrey Gertz, Srividya Jandhyala, & Lauge N. Skovgaard Poulsen, *Legalization, diplomacy and development: Do investment treaties de-politicize investment disputes?* 107 World Development 239 (2018).

III. Alternatives to ISDS

Treaty-based ISDS is often presented not just as beneficial to states, but as *uniquely* capable of committing states to treating investors reasonably and fairly. This presentation is highly misleading. In fact, there exist numerous alternative ways in which states might credibly commit to providing investors with reasonable and fair treatment.

For example, states can embed legal guarantees in domestic foreign-investment laws, and they can secure those guarantees by providing investors with irrevocable access to international arbitration. Domestic foreign-investment laws can function as more or less complete alternatives to treaty-based ISDS, with the benefit of increased flexibility for states, who can adjust their degree of liability going on an ongoing basis by modifying the scope guarantees or by targeting guarantees to particular classes of investors. Pretty much everything contained in a standard investment treaty can be accomplished via domestic law, and domestic law can be "frozen" as to existing investors for reasonable periods of time (but modified as to future investors) through standard stabilization clauses, supported by irrevocable access to international arbitration. Indeed, at the origins of the modern ISDS system, it was explicitly envisioned that most states would rely upon domestic law to consent to international arbitral fora such as ICSID and that the substantive content of the applicable law would be domestic law, not international. The development of a massive and complex network of investment treaties, with the development of substantive law permanently conceded to ad hoc arbitrators, was largely unanticipated.

States can also embed arbitration clauses into investment contracts with foreign investors.[9] Investment contracts are hardly unusual; indeed, they are quite common in sectors, like energy, that are said to most need access to arbitration as a condition to invest. While not all investors will enjoy the bargaining power sufficient to convince a state to grant generous legal guarantees via contract, that fact is hardly bothersome, as the decision to invest or not remains the investors'.

The benefit of these alternatives to treaty-based ISDS is that they allow states to actively manage and limit international legal liability, much in the same way that private businesses routinely manage and limit their own legal liability via contract design (including choice of law and choice of forum clauses), through corporate structures, and through the manipulation of the location of the corporation's legal home. States can target favorable legal guarantees to desirable sectors; they can adjust the content or enforceability of guarantees in response to new information about the costs and benefits of particular guarantees. Investment treaties, in contrast, impose upon states a one-size-fits-all package of obligations, difficult to amend, and control over the development of which is

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[9] Jason Webb Yackee, *Pacta Sunt Servanda in the Era before Bilateral Investment Treaties: Myth & Reality*, 32 Fordham International Law Journal 1550 (2009).

transferred quasi-permanently to unaccountable arbitral tribunals.[10] States lose control over the scope and content of their commitments. A refocus on domestic law and contract can restore control to states, while still allowing them to provide enforceable guarantees in a more targeted and flexible way when needed as to particular investors or investments.

IV. Potential Reforms

In my view, investment treaties that have proven problematic for efforts to address the threat of climate change, such as the ECT, could be abandoned with little or even no impact on the attractiveness of signatory states as desirable, competitive locations for socially responsible foreign investment—including in the energy sector itself. States could use treaty alternatives to focus legally enforceable guarantees where needed, while regaining policy flexibility to respond to the unprecedented challenges of climate change. The ECT was intended as an instrument to promote the integration of Eastern European energy resources into the European market; it has outlived that original purpose, and there is no compelling reason to maintain the treaty in the face of adequate domestic-law and contract-based alternatives. The prospect that Russian investors may use the ECT to challenge European attempts to reduce Europe's energy dependence on Russia are particularly alarming.

It is also possible to reform existing instruments without abandoning them. A good example is the US-Mexico-Canada Agreement, the successor to NAFTA, which reduced the U.S.'s exposure to ISDS by limiting ISDS access on a sectoral basis. Existing treaties can be limited to desirable investment sectors, or problematic sectors (such as energy) might be excluded. It is also possible to use treaty exceptions clauses to carve out policy flexibility for purposes of addressing climate change. The model here is the common treaty clause excepting state conduct necessary for national security. Finally, states might reform existing treaties by limiting the substantive guarantees that are challengeable before arbitral tribunals. Early-generation Soviet treaties typically limited access to arbitration to disputes involving classic expropriation. To modern pro-treaty, pro-investor eyes such a limitation might seem unduly restrictive. In fact, the main theories justifying the desirability of treaty-based ISDS are almost always based upon a correspondingly narrow view of the problem that such treaties are supposed to address: the risk of opportunistic expropriation. Investor actions against climate change policies almost never involve opportunistic expropriation; instead, investors use overly broad and excessively generous treaty provisions to challenge reasonable policy choices that have emerged through democratically legitimate political processes. Investment treaties were never intended to insure investors against the possibility of unfavorable domestic policy outcomes; they were intended to protect investors against a limited set of extreme state actions. By amending investment treaties to exclude those guarantees that have been most susceptible to investor abuse and to tribunal-led expansion (such as the guarantee of fair and equitable treatment), we can

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[10] Jason Webb Yackee, *Controlling the International Investment Law Agency*, 53 Harvard International Law Journal (2012).

return the ISDS system to something closer the original understanding while preserving (or returning) to states the ability to adequately respond to the challenges of climate change.

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Thank you for the opportunity to participate in this public consultation. Please do not hesitate to contact me if I can be of any further assistance to your efforts on this important topic.

Sincerely,

Jason Yackee, JD, PhD
Professor of Law
University of Wisconsin Law School
jyackee@wisc.edu
https://secure.law.wisc.edu/profiles/jason.yackee@wisc.edu

Contribution to OECD Public Consultation on Investment Treaties and Climate Change

Climate Change and Investor-State Arbitration: The Essential Importance of Issues of Compensation and the Calculation of Quantum

Yawen Zheng*

N. Jansen Calamita**

Introduction

An immediate and steep decline of fossil fuel production and usage has been said to be necessary to limit global warming to 1.5°C to 2°C as States have pledged in the Paris Agreement.[1] Accordingly, various States have begun implementing fossil fuel phase-out policies with the purpose of achieving "net-zero" emissions.[2] In response to these policies, investors have begun bringing claims, asserting rights under international investment treaties. For instance, investment treaty claims have already been lodged against the Netherlands for its enactment of legislation to ban coal-fired energy by 2030,[3] and against Italy for its ban on oil and gas development.[4] In these cases, investors are seeking compensation covering not only the amounts they have invested, but also the estimated profits they allege would have been produced over the lifetime of the investment.[5]

Investment treaties are typically silent about the standards of compensation to be used where treaty violations are established, like unlawful expropriations and violations of the fair and equitable

* Postdoctoral Fellow, Chinese University of Hong Kong (yawenzheng@cuhk.edu.hk). Postdoctoral Fellow, Centre for International Law, National University of Singapore (from July 2022).

** Head, Investment Law and Policy, Centre for International Law, National University of Singapore; Research Associate Professor (CIL), Faculty of Law, National University of Singapore (n.j.calamita@nus.edu.sg).

[1] SEI and others, 'The Production Gap: Governments' Planned Fossil Fuel Production Remains Dangerously out of Sync with Paris Agreement Limits' (2021).

[2] See Climate Watch, 'Net-Zero Tracker' (2021): www.climate watchdata.org/net-zero-tracker.

[3] Lisa Bohmer, 'The Netherlands Is Facing Its First ICSID Arbitration, as German Energy Giant RWE Makes Good on Earlier Threats', *Investment Arbitration Reporter* (3 February 2021); Lisa Bohmer, 'Uniper Lodges Treaty-Based Claim against the Netherlands' *Investment Arbitration Reporter* (27 April 2021).

[4] 'Updated: Italy's Ban on Oil and Gas Development near Its Coastline Leads to Investment Treaty Arbitration Claim', *Investment Arbitration Reporter* (23 March 2017).

[5] Claire Provost and Matt Kennard, 'The Obscure Legal System That Lets Corporations Sue Countries', *The Guardian* (10 June 2015).

treatment standard.[6] As a result, the prevailing approach used by tribunals is to refer to the general international law standard of reparation for internationally wrongful acts, i.e., the "full reparation standard", which requires the responsible State to "wipe out all the consequences of the illegal act" and restore the injured party to the condition in which it would have found itself but for the State's wrongful conduct.[7] This approach has been used by tribunals consistently to justify awarding investors compensation for anticipated revenues (or lost profits),[8] which often vastly exceeds the amounts actually invested in the business.[9] Concerns about standards of compensation and the size of quantum awards are especially salient in the context of investment treaty claims raised by fossil fuel investors. Due to the generally long-term nature of the contracts at issue, and the large sunk costs faced by investors, damages awarded in cases brought by fossil fuel investors generally have been very large. The average amount awarded in known fossil fuel cases exceeds USD 600 million, more than five times the amount in non-fossil fuel cases.[10] While the size of these awards is concerning on its own, they become even more concerning in the context of climate change and investor challenges to net zero policies. Damages awarded in investment arbitrations concerning fossil fuel restrictions can divert millions of dollars from government budgets, and thus significantly exacerbate the budgetary constraints faced by many States seeking to achieve net zero.[11] Moreover, even in cases in which individual States do not face claims or are not required to pay exorbitant arbitral awards to investors, States may nevertheless be discouraged ("chilled") from adopting effective environmental measures to address climate change and achieve their net zero goals.[12]

Much attention has been given to the ways in which States might better draft their investment treaties to indicate more clearly the limits of protection granted to investors, especially when the State is exercising its right to regulate for the public good (such as enacting measures to protect the environment). While attention to the formulation of substantive protections in treaties is undoubtedly important, the drafting of new substantive protections – without express reference to issues of compensation and quantum – is insufficient to address the risk States face of massively large awards in favour of investors. Moreover, while new treaty language may help to address

[6] Kyla Tienhaara and Lorenzo Cotula, *Raising the Cost of Climate Action? Investor-State Dispute Settlement and Compensation for Stranded Fossil Fuel Assets* (iied 2020).

[7] International Law Commission (ILC), Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries - 2001, Art 31.

[8] In the absence of restitution – which almost never takes place in investment treaty arbitration – customary international law obligates the State to compensate the investor for the damage caused by its wrongful acts, which covers "any financially assessable damage including loss of profits insofar as it is established". *Ibid*., Art 36(2).

[9] Jonathan Bonnitcha and Sarah Brewin, 'Compensation Under Investment Treaties' (International Institute for Sustainable Development 2020).

[10] Lea Di Salvatore, 'Investor–State Disputes in the Fossil Fuel Industry' (International Institute for Sustainable Development 2021).

[11] See e.g. UK National Audit Office, 'Achieving Net Zero' (4 December 2020).

[12] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7 Transnational Environmental Law 229.

claims in the future, it can do little to address the risks posed by the thousands of already existing investment treaties. Accordingly, it is essential that policy makers consider not only how investment treaties can be drafted better, but also how current treaties can be rebalanced with respect to damages and compensation to adequately address the risks that States urgently face.

Despite the critical need to address issues of compensation and the calculation of quantum awards in cases involving fossil fuel investments – and climate change policies in particular – there has been relatively little attention given to the issue of compensation in the literature.[13] Accordingly, this submission focuses on the problem of compensation and the calculation of quantum, and on the need for States and researchers to examine different approaches which might be used to reduce/limit/control the amount of compensation awarded to investors in investment treaty cases concerning fossil fuel phase-out policies. In the interests of brevity, five heads of inquiry are briefly noted below.

1. Contribution

The first line of inquiry into which research might be undertaken concerns contribution. The principle of contribution is well-recognized in customary international law, which requires that a determination of reparation take into account any "wilful or negligent action or omission" that contributed to the injury.[14] Tribunals have used this doctrine to reduce the amount of compensation awarded to investors in a variety of cases, although not as yet with respect to climate change.[15] In principle, it would seem possible to argue that fossil fuel investors bear some degree of contributory fault for the harm caused by their investments in light of readily available knowledge about, e.g., the adverse impacts of carbon dioxide emissions on climate change. In other words, it might be said that fossil fuel companies should have the expectation for, and bear the risk of, increased climate and decarbonization regulations that affect their investments, especially when the host State is under an obligation arising from international environmental law to reduce carbon emissions. As a result, therefore, the principle of contribution may be seen as a tool to reduce compensation on account of investors' failure to investigate adequately the risks and consequences of their investments.

Some commentators, however, have expressed concern that applying the principle of contribution to the calculation of quantum may encourage tribunals to consider the investor's conduct as an issue relevant to the determination of damage rather than to the claim's merits, thus making tribunals more likely to find treaty violations in the first place.[16] Moreover, given the lack of specific guidance provided in investment treaties, tribunals have noted their wide margin of

[13] But see e.g. Bonnitcha and Brewin (n 9).

[14] ILC (n 7) Art 39.

[15] See e.g. *MTD Equity Sdn. Bhd. v. Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004 [243]–[246]; *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012 [687].

[16] Bonnitcha and Brewin (n 9).

discretion in apportioning fault.[17] Consequently, even with the application of the principle of contribution, tribunals may still award large amounts of damages.[18] In light of these issues and uncertainties, it worth examining whether further guidance regarding the apportionment of fault can be provided to arbitral tribunals through joint interpretative statements, "softer" multilateral or plurilateral guidelines, or, in future treaties, through express textual direction.[19]

2. International Environmental Obligations

A second line of inquiry concerns the use of States' international environmental obligations as a ground on which to reduce/limit/control the amount of compensation awarded in cases concerning fossil fuel phase-out policies. Giving adequate consideration to States' international environmental obligations in the interpretation and application of standards of compensation is a potentially promising approach to avoid overemphasizing the rights of investors under investment treaties and giving insufficient weight to the rights and obligations of States to act in the public interest. Such an approach is supported by customary international law in Article 31 of the Vienna Convention on the Law of Treaties,[20] which requires the interpretation of treaties to take into account relevant international rules applicable to between the State parties. In the context of climate change, this would include international environmental instruments like the United Nations Framework Convention on Climate Change and the Paris Agreement.

In considering this line of inquiry for possible further work, it warrants noting that States' environmental obligations have only rarely been considered in investment arbitrations relating to the energy sector.[21] Various reasons may be put forward for the reluctance of tribunals to rely on non-investment obligations, e.g., a lack of familiarity with non-investment instruments; concerns about going beyond the tribunal's jurisdictional grant; and uncertainty as to the application of non-derogation clauses in certain treaties,[22] which provide that treaty provisions more favourable to

[17] For example, the damage awarded in *Hulley v. Russia* still amounted to USD 40 billion even after a 25% reduction because of the investor's contributory negligence. *Hulley Enterprises Limited (Cyprus) v. Russia*, UNCITRAL, PCA Case No. 2005-03/AA226, Final Award, 18 July 2014 [7.32]. See also *Occidental Petroleum Corp.* [670].

[18] Additionally, it bears noting that fossil fuel investors may also be able to argue that they have been protected against the risk of regulatory change by long-term contracts with host States, which generally include stabilization clauses guaranteeing the maintenance of legal *status quo* to a certain extent and mandating the payment of compensation for damage suffered from a change in the law. See International Energy Charter, *Handbook on General Provisions Applicable to Investment Agreements in the Energy Sector* (2017).

[19] For example, providing interpretive directions to require tribunals to interpret stabilization clauses in light of changing circumstances, or to reduce compensation in cases involving poor investment decisions, like rejection of the use of technologies to reduce carbon emissions.

[20] Adopted 23 May 1969, entered into force 27 January 1980, 1155 United Nations, Treaty Series 331.

[21] Climate Change Counsel, 'The Energy Charter Treaty, Climate Change and Clean Energy Transition: A Study of the Jurisprudence' (2022). See e.g. *Compañia del Desarrollo de Santa Elena v. Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000 [71]-[72].

[22] See Moshe Hirsch, 'Conflicting Obligations in International Investment Law: Investment Tribunals' Perspective' in Tomer Broude and Yuval Shany (ed), *The Shifting Allocation of Authority in International Law: Considering*

the investor shall prevail over other treaties in the event of a conflict. While such issues and uncertainties can certainly be addressed through careful drafting in new treaties, the conclusion of better treaties in the future does little to address the risks States face today of massively large awards arising out of fossil fuel phase-out policies. As a result, in considering the interface between investment treaty commitments and climate change imperatives, States would do well to consider how to address these issues both with respect to current treaties, e.g., through joint interpretative statements and/or "softer" multilateral or plurilateral guidelines, as well as in future treaties, through express textual direction.

3. Polluter Pays and Precautionary Principles

A third critical area for consideration regards the use of the polluter pays and precautionary principles and how these principles can be used to rebalance the approach to investor compensation in investment treaty disputes. The issues and opportunities raised by each are addressed in turn below.

a. Polluter Pays Principle

The polluter pays principle requires polluters to internalize the costs of their harmful activities rather than allowing those costs to be externalized onto the community.[23] Under the polluter pays principle, those who pollute must not only make best efforts to restore the precedent equilibrium, but they must also pay for harm caused.[24]

The polluter pays principle is emerging as a recognized principle of international law.[25] Accordingly, the polluter pays principle can be relevant to the settlement of international investment disputes. For example, it would be contrary to the principle of polluter pays if an investor were able to receive compensation for lost future profits without having that quantum adjusted to reflect the environmental costs of those investment activities.[26] Arbitral tribunals have not yet applied the polluter pays principle in their compensation analyses, at least not by name. That said, there are examples of cases in which tribunals have decided to limit the amount of

Sovereignty, Supremacy and Subsidiarity (Hart Publishing 2008). For an example of such a provision, see Energy Charter Treaty (signed December 1994, entered into force April 1998) Art 16.

[23] Mizan R Khan, 'Polluter-Pays-Principle: The Cardinal Instrument for Addressing Climate Change' (2015) 4 *Laws* 638.

[24] Flavia Marisi, *Environmental Interests in Investment Arbitration: Challenges and Directions* (Kluwer Law International 2020) 48.

[25] See e.g. International Convention on Oil Pollution Preparedness, Response and Cooperation (adopted 30 November 1990, entered into force 13 May 1995) 1891 UNTS 77 Preamble.

[26] Ole Kristian Fauchald, 'Property and Environmental Protection in Investor – State Arbitration' in Gerd Winter (ed), *Property and Environmental Protection in Europe* (Europa Law Publishing 2015).

compensation owed to the investor in order to account for the environmental effects of the investor's activities.[27]

According to the polluter pays principle, polluters should not only pay for the direct harm caused by their activities, but they should also pay for the costs incurred by the adoption of measures aimed at pollution control and prevention, like the loss incurred by the implementation of fossil fuel phase-out policies, as otherwise the principle would also be frustrated.[28] The application of this aspect of the polluter pays principle, however, can be problematic. It can be difficult, for example, to determine what constitutes environmental degradation, to identify the culpable polluter, and to quantify the costs of harm and remediation, especially when considering the cumulative effects on environment.[29] Scholars have recognized these challenges, although for some a precise and exhaustive accounting of damages and culpability is not the point of the polluter pays principle. Rather, according to Mayer, the principle intends to dissuade polluters from polluting simply by charging some fee instead of requiring them to "pay all the costs in every circumstances".[30] Going forward, research and analysis in this area will need to consider the evident tension between the adjudication of individual investor responsibility on the one hand, and the broader application of the polluter pays principle as a means of achieving an end. Moreover, research will need to address the development of legal principles which can be used to establish a quantum value of environmental impact that an arbitral tribunal could apply to reduce compensation in a given case, e.g., calculations based on the "social cost of carbon", that is, applying "a dollar value to the potential impacts of greenhouse gas emissions" associated with the contribution of their carbon-intensive investment to climate change.[31]

b. The Precautionary Principle

The precautionary principle counsels that the lack of conclusive evidence of harm should not be considered as a sufficient reason for postponing the adoption of environmental measures.[32] Operationally, this means that it is not the State's burden of proof to demonstrate the certainty of environmental harm, but rather it is the burden of the person intending to carry out an activity to show that the activity will be harmless to the environment.[33] Accordingly, potential polluters

[27] See e.g. *Metalclad Corporation v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000 [127].

[28] David Hunter and Steve Porter, 'International Environmental Law and Foreign Direct Investment' in Daniel Bradlow and Alfred Escher (ed), *Legal Aspects of Foreign Direct Investment* (Kluwer Law International 1999).

[29] Nicolas de Sadeleer, *Environmental Principles: From Political Slogans to Legal Rules* (Oxford University Press 2002) 75-79.

[30] Benoit Mayer, *The International Law on Climate Change* (Cambridge University Press 2018) 74.

[31] Kyla Tienhaara, Lise Johnson, and Michael Burger, 'Valuing Fossil Fuel Assets in an Era of Climate Disruption', *Investment Treaty News* (20 June 2020).

[32] See Rio Declaration on Environment and Development (12 August 1992) A/CONF.151/26 (Vol. I) Principle 15.

[33] Philippe Sands, *Principles of International Environmental Law* (Cambridge University Press 2018) 234.

should share the burden caused by the risk of future environmental degradation, which includes precautionary measures adopted by the host State to avoid or reduce such risk.[34]

The award in *Bilcon v. Canada* provides a suggestion of how this principle might be applied in investor-state disputes. There, the tribunal rejected the investors' claim for lost profits due to the investors' failure to show that those profits would have materialised given environmental concerns about the project and the possibility that there would be further tightening of environmental regulations in the future.[35] The tribunal's approach thus reduced the valuation of the investment by requiring the investors (i.e., the potential polluters) to bear the risk that the State would take precautionary measures in order to avoid or reduce future environmental harm. In the context of fossil fuel phase-out policies, and the pursuit of net zero, a similar approach might be taken whereby the possibility of regulatory change is treated as one of the general, fundamental risk factors in the valuation of an asset, which can lead to a significant reduction in compensation.[36]

4. <u>Environmental Counterclaims</u>

A fourth area for consideration is the expanded use of counterclaims in investor-State arbitration. Historically, the right of respondent States to bring counterclaims in investment arbitration has not been assured, as tribunals have declined jurisdiction on grounds including that the counterclaim was outside the scope of the consent to arbitration,[37] not closely related to the investor's primary claim,[38] or lacked legal basis (express investor obligations).[39] That said, there have been some instances in which States have been successful in raising counterclaims, including in situations involving environmental damage. For instance, in *Perenco v. Ecuador*, Ecuador's counterclaim based on environmental harm caused by the investment was upheld and the compensation awarded to the investor was reduced accordingly.[40]

Investment arbitration can be an important forum to enforce international environmental standards.[41] Indeed, in some cases, it may be the only viable forum available to hold investors

[34] Tomoko Ishikawa, 'The Role of the Precautionary and Polluter Pays Principles in Assessing Compensation' (2015) RIETI Discussion Paper Series 15-E-107.

[35] *Bilcon v. Canada*, PCA Case No. 2009-04, Award on Damages, 10 January 2019 [276]-[279].

[36] Ishikawa (n 34).

[37] See e.g. *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011 [871]-[872].

[38] See e.g. *Saluka v. Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004 [80]-[81].

[39] *Teinver, Transportes de Cercanías and Autobuses Urbanos del Sur v. Argentina*, ICSID Case No. ARB/09/1, Award of the Tribunal, 21 July 2017 [1066]-[1067].

[40] *Perenco Ecuador v. Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/08/6, Award, 27 September 2019 [1023].

[41] Francesco Francioni, 'The private sector and the challenge of implementation' in Pierre-Marie Dupuy and Jorge E Viñuales (ed), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* (Cambridge University Press 2013).

accountable for environmental harm. Domestic courts of the investor's home state may decline jurisdiction due to *forum non conveniens.*[42] Courts may refuse jurisdiction in light of contractual arbitration clauses.[43] Local courts may lack the capacity to deliver prompt and effective justice,[44] and investors, even when brought before local courts, may seek to overturn domestic judgments of liability for environmental harm through the use of investment treaties.[45] In light of these challenges, an increased focus on the potential use of counterclaims, especially in cases involving allegations of environmental harm, is warranted. By providing an avenue for States to be heard on claims of environmental harm caused by the claimant's investment, an effective counterclaims mechanism can serve to rebalance the investment treaty regime and mediate some of the excesses of quantum awards.[46]

Establishing an effective counterclaims mechanism poses challenges for States and researchers to consider. Counterclaims mechanisms can be improved in future treaties of course through careful drafting, but for existing treaties the challenges are trickier, potentially requiring the amendment of arbitral rules and/or jurisdictional provisions in treaties. Future research and discussion can help to inform the development of options to address the challenges posed by existing treaties, for example, by considering the feasibility of joint interpretations by treaty parties; wholesale rule amendments via a multilateral investment court; or "softer" guidance through multilateral statements of intent.

5. Looking Ahead: Redrafting Investment Treaties to Control Compensation Awards

As noted at the outset, the most pressing concern faced by States with respect to investment treaties and fossil-fuel phase out programs is the potential for claims and exorbitant awards under the thousands of already existing investment treaties (which do not contain language addressing investor compensation or broader concerns regarding the State's right to regulate). That said, while it is essential for States to consider ways in which to address the issues raised under these older treaties, it is of course also essential for States ultimately to replace these older treaties with new treaties containing provisions which better reflect their intended balance of rights and obligations.

In this respect, it bears giving to note to some as yet experimental treaty practices which seek to address specifically concerns about large awards in investment arbitration. For instance, the SADC

[42] See e.g. *In Re Union Carbide Corp. Gas Plant Disaster*, 634 F. Supp. 842 (S.D.N.Y. 1986).

[43] See e.g. BBC News, 'Court ends Newmont civil case' (15 November 2005).

[44] See Debayan Roy, 'SC to begin hearing in Bhopal gas tragedy: All you need to know about 36-yr-old case', *The Print* (11 February 2020). See also Marc Galanter, 'Legal Torpor: Why So Little Has Happened in India After the Bhopal Tragedy' (1985) 20 *Texas International Law Journal* 273.

[45] See e.g. Jarrod Hepburn, 'Chevron v. Ecuador Award Analysis: Tribunal Considers Final Questions of Jurisdiction and Surveys Evidence of How Ecuadorian Environmental Trial Was (Mis)conducted', *Investment Arbitration Reporter* (9 September 2018).

[46] Kyla Tienhaara, *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy* (Cambridge University Press 2009) 268.

Model Bilateral Investment Treaty requires compensation to reflect "an equitable balance between the public interest and interest of those affected",[47] and the Revised Investment Agreement for the COMESA Common Investment Area allows compensation to reflect aggravating conduct of investors or their failure to seek to mitigate damage.[48] Moreover, some commentators have proposed other options for investment treaty reform to limit the amount of damage, like capping compensation at the total expenditure actually incurred by the investor, requiring compensation to be determined according to the law of the host State,[49] and choosing the lesser between the loss suffered by the investor and the gain the host State has obtained from the investment.[50] Other proposals address fossil fuel investments specifically, for example, by excluding access to investment arbitration for investments in fossil fuels,[51] and by providing specialized approaches to the valuation of investments in fossil fuels to take into account their "stranded" character.[52] The feasibility and effectiveness of these proposals are worth further exploring.

6. Concluding Remarks

Compared to investment treaty provisions delimiting substantive protections, or provisions addressing the procedures of investor-State dispute settlement, the approach to compensation and quantum in investor-State arbitration has been understudied by States and researchers. Now, however, as States face a global imperative of reducing carbon emissions and phasing out fossil fuels, the issue of compensation in investor-State arbitration looms large. Not only may large awards of compensation have severe impacts on government budgets and capacities to deliver needed public goods, but even in cases in which individual States do not face claims or are not required to pay exorbitant arbitral awards to investors, the spectre of such awards may nevertheless discourage some States from pursuing environmental measures necessary to achieve their net zero goals.[53] Accordingly, the issues raised in this submission are important and timely for States' consideration in this OECD Consultation.

25 March 2022

[47] Southern African Development Community, 'SADC Model Bilateral Investment Treaty Template with Commentary' (July 2012).

[48] Art 20 (3).

[49] Bonnitcha and Brewin (n 9).

[50] Emma Aisbett and Jonathan Bonnitcha, 'A Pareto-Improving Compensation Rule for Investment Treaties' (2021) 24(1) *Journal of International Economic Law* 181.

[51] Tienhaara (n 12).

[52] Bonnitcha and Brewin (n 9).

[53] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7 *Transnational Environmental Law* 229.