Kluwer Arbitration Blog

Combating Climate Change: The Role Of Investor-State Arbitration In Africa

Wynne Lawrence, Rosalyn Smith (Clyde & Co LLP) · Tuesday, March 17th, 2020

UN Secretary-General António Guterres opened the COP25 climate change conference on 2 December 2019 saying that:

> "…At current trends, we are looking at global heating of between 3.4 and 3.9 degrees Celsius by the end of the century. The impact on all life on the planet – including ours – will be catastrophic. The only solution is rapid, ambitious, transformative action by all – governments, regions, cities, businesses and civil society […] all the main emitters must do more".

António Guterres was disappointed with the outcome of the COP25 climate change conference. According to the UNEP Emissions Gap Report 2019 a global emissions reduction of 7.6% per year over the next ten years is required to limit global warming to 1.5 degrees Celsius. Even the most ambitious national climate action plans fall short, however, and every fraction of additional warming will bring worse impacts, threatening "*lives, livelihoods and economies*".

In this blog post we will analyse the role of investor-state arbitration in the transition to a sustainable economy.

The risks of ISDS

Traditionally Investor-State Dispute Settlement (**ISDS**) was seen as a valuable tool in facilitating inward direct investment to developing countries in Africa and elsewhere. Bilateral Investment Treaties (**BITs**) incorporated ISDS to provide comfort to investors in cross-border transactions that disputes could be resolved outside of the uncertainties of local legal systems.

More recently ISDS has been the subject of criticism, including a perception that ISDS is skewed in favour of investors, at the expense of state parties' ability to make legitimate policy decisions.[1)] Many BITs include provisions to avoid inequitable (discriminatory) interference with foreign investors' rights, but State action to combat climate change could give rise to such inequity (and therefore claims) regardless of the broader environmental legitimacy of state action.

Some commentators are concerned that fear of costly claims for breach of investment treaties may curb states' appetite for pro-climate legislation and policies. There is a wide range of precedents for investors bringing action against states for losses suffered due to policy changes. Spain, for example, has faced a large number of claims under the Energy Charter Treaty after revising incentives under its (renewable) energy schemes. Whilst Spain might be well placed to absorb the costs of such ISDS cases, the risk of high-cost arbitration may slow the adoption of ambitious climate policies in emerging markets.

The impact of similar claims could be significant in nations dependent upon extractive industries and Foreign Direct Investment (**FDI**). High levels of FDI increase the range and scale of cross-border investments (and necessarily, the risk of investor-state disputes), and extractive industries are in danger of being "stranded" or devalued by environmental policy changes. Although the UNCTAD World Investment Report 2019 shows that FDI into Africa has diversified across sectors including finance and manufacturing, oil and gas still dominate and the threat of ISDS could have a significant impact upon legislators' willingness and ability to enact climate change law and policy.

ISDS as a force for change

Although concerns about ISDS could potentially stall concerted action against climate change, ISDS could also be a force for change. ISDS is not inherently flawed: it provides parties with a neutral and private mechanism for dispute resolution which, under the New York Convention, leads to awards which are recognised in the majority of States. Without ISDS many investments would not proceed, and as a supra-national means of holding states to account, it is an important tool in promoting free, fair, and rules-based international trade and commerce.

Furthermore, present concerns regarding ISDS and climate law or policy seem to arise from perceived inadequacies in international agreements, rather than from ISDS itself. Many BITs are seen to lack reciprocity, imposing obligations on states and granting rights to investors. Some common treaty provisions are also broad in scope. The Fair and Equitable Treatment (**FET**) standard has a 'legitimate expectation' component which leaves it open to investors to claim losses arising not only from changes to regulatory regimes, but also the implementation and enforcement of existing laws.

Many BITs were drafted fifty years ago when the investment landscape and nuances of international law were very different. Could amendments allow states to utilise ISDS in transitioning to a sustainable economy?

Amendments to BITs

In June 2017, the Stockholm Treaty Lab launched a competition inviting entrants to draft a model treaty which encouraged and protected cross-border investments in climate change adaptation and mitigation. The entries raise interesting ideas which could be incorporated into current BITs to manage and foster the transition to sustainable economies. Suggestions from "The Creative

Disrupters”[2)] include a two-tier categorisation of “sustainable” and “unsustainable” investments with different rights and obligations, and the ability to deny certain benefits and remedies to unsustainable investments. The team suggests a more restrictive alternative to the FET standard as well as an explicit right to regulate for legitimate social and economic policy objectives. They also require the conduct of environmental impact assessments prior to the establishment of investments, with a set of minimum national standards.

There are some similar provisions in existing international agreements. The Pan-African Investment Code (**PAIC**) is a template treaty of the African Union (**AU**), which seeks to balance the promotion and protection of investments with each state’s ability to advance sustainable development. Adopted in 2016, the PAIC obliges investors to comply with environmental law, omits the FET standard, and allows states to submit counterclaims in arbitration proceedings. Notably the PAIC retains the right to resolve disputes by ISDS, but requires an African dispute resolution centre. Although the PAIC is non-binding, it will be interesting to see whether AU member states adopt its provisions in future BITs. Its interaction with the African Continental Free Trade Agreement, which recently came into force, will also be of interest.

The Morocco-Nigeria BIT, although not yet in force, is notable in that it contains binding provisions which promote climate change action. Both states will impose duties upon investors to comply with local and/or home environmental legislation, and the performance of the treaty will be monitored by a joint committee, enabling states to scrutinise investors’ compliance with this legislation. Similar provisions could be adopted in other BITs to help further climate change goals.

Provisions promoting the transition to a sustainable economy are present in few existing BITs. However this has not always prevented tribunals from taking environmental considerations into account. In *Cortec Mining Kenya Limited and others v Republic of Kenya* (ICSID Case No. ARB/15/29), discussed here on the blog, the tribunal found that the claimants did not have a protected investment under the UK-Kenya BIT because they had not acquired an environmental impact assessment licence, and thereby failed to comply with local environmental legislation. The definition of “investment” in the UK-Kenya BIT did not require compliance with Kenyan law, but the tribunal held that explicit language to that effect was not necessary. Whether other tribunals would be willing to adopt a similar approach is uncertain, and the claimants are attempting to have the award, rendered in favour of Kenya, annulled.

With amendments to BITs and local legislation promoting environmental and climate-resilient factors, ISDS could have an important role in combating climate change. Tribunals could hold investors to account for breaches of environmental legislation, prevent them from claiming in respect of states’ legitimate policy changes, and enforce protective measures in favour of sustainable investments. To combat the global problem of climate change most effectively, however, it is not sufficient to enforce action at a national level alone.

Is there a role for state-state arbitration?

The main supra-national legislation in respect of climate change adaptation and mitigation is the Paris Agreement. Unlike the majority of BITs, the Paris Agreement does not contain compulsory provisions for arbitration, but instead adopts Article 14 of the 1992 United Nations Framework Convention on Climate Change (**UNFCCC**). This provides for settlement of disputes by "negotiation or any other peaceful means", with the option to opt-in to compulsory arbitration by written declaration. The UN website only lists two declarations accepting compulsory arbitration under the UNFCCC, from the Netherlands and the Solomon Islands, and the "annex on arbitration" detailing the appropriate procedure has yet to be drafted.

There is little incentive for state signatories, particularly those responsible for the most greenhouse gas emissions, to opt-in to arbitration. They risk exposure to large claims for the loss and damage some states are experiencing because of climate change, resulting from sea level rise, desertification, and the exacerbation of extreme weather events, for example. Whilst many African (and other) states suffering such loss and damage might wish to hold other countries to account for their contributions to climate change, they are, for the moment, unlikely to be able to do so.

The immensity of the challenge ahead requires co-ordinated action at a global scale. A recent United Nations Development Programme report suggests:

> "[i]t's clear that business as usual simply isn't good enough anymore. We must do more – much more – in areas related to mitigation, adaptation, and the finance to support all of this work. And we must do it quickly."

In light of the difficulties of enforcement between nations, it would seem prudent for states to consider the role of ISDS (and existing and future BITs) in meeting their international obligations in respect of climate change. Investors too should seek to understand how their existing and future investments and ISDS may be shaped by the growing raft of environmental regulation and climate policies.

References

?1 UNCTAD's Reform Package for the International Investment Regime discusses amendments in this regard, from page 38.

?2 Nathalie Bernasconi-Osterwalder, Martin Dietrich Brauch, et al (2019) Journal of International Arbitration, 36(1), pp. 7-36.

This entry was posted on Tuesday, March 17th, 2020 at 8:07 am and is filed under BIT, Climate change, International agreement, Investor-State arbitration, Sustainable economy
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.