Kluwer Arbitration Blog

2022 in Review: Climate Change as a Mainstream Issue for Investment Treaty Policymakers

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2022 was arguably the year when climate change entered the mainstream of policymaking in the investment treaty regime, with a particular focus on aligning the regime with international climate commitments, most notably the Paris Agreement. Nevertheless, debates over the interaction between the investment treaty regime and climate mitigation efforts have been active for around 15 years (including as discussed by Schill, Johnson, Miles, and Firger & Gerrard, as well as in UNCTAD's 2010 World Investment Report at pp. 136–138). However, it is only much more recently that climate change has become a core concern for the policymakers and institutions that have traditionally dominated the investment treaty field.

Concerns about the interaction of the investment treaty regime with climate change policy have often focussed on States' defensive interests and the possibility that climate mitigation measures may give rise to investor-State dispute settlement (ISDS) claims. This concern was alive and well in 2022, with the investor being awarded €190 million in the *Rockhopper v Italy* arbitration (although an annulment proceeding is pending), due to Italy's application of a legislative ban on offshore oil and gas activities to an existing project, which was found to constitute a direct expropriation, and several pending cases brought by investors in the coal sector (e.g. *Towra SA-SPF v Slovenia*, *RWE v Netherlands* and *Uniper v Netherlands*). However, the investment treaty–climate change nexus is now being conceived more broadly, with States going beyond simply focusing on their own defensive interests to also consider the wider interest of the entire international community in ensuring that the investment treaty regime is not encouraging investments that are inconsistent with a low-carbon economy (*see e.g.* Presentation by David Gaukrodger; *see also*, this video, particularly at 47:27 onwards). As we discuss in the following sections, international organisations and many States have been working in 2022 towards aligning the investment treaty regime with international climate commitments.

International Organisations Highlighting the Investment Treaty–Climate Nexus

In January–March 2022, as part of 'track 1' of its work programme on the future of investment treaties, the OECD ran a public consultation on aligning the investment treaty regime with climate change priorities (submissions available here). The OECD process has provided an important venue for bringing together a wide range of policymakers and stakeholders, including both investment treaty specialists and environmental experts, with track 1 meetings held in April and November 2022, and the OECD's annual investment treaty conference in May focusing on aligning investment treaties with Paris Agreement commitments. The OECD is also currently conducting a survey of States on 'Climate Policies for Investment Treaties' that covers a wide spectrum of policy areas where States could seek alignment between the investment treaty and climate regimes, including relatively new ideas such as whether the climate impact of an investment should be a relevant factor in the enforcement of investment treaty awards.

A focal point of the OECD's work has been Article 2.1(c) of the Paris Agreement, which requires Parties to make 'finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.' This provision reflects a broader trend within climate policy to address not only States' domestic emissions, but also to create responsibility for financing emissions in other jurisdictions. Through its track 1 work in 2022 the OECD has raised the important question of how the Paris Article 2.1(c) obligation would apply to investment treaties, as *'[i]nvestment treaties are an important part of the public policy framework governing finance flows'* (OECD background note, pp. 13–17).

At this stage it is unclear to what extent policymakers will follow through on implementing the Paris Agreement Article 2.1(c) obligation with respect to investment treaties. Aligning the investment treaty regime with obligations to ensure finance flows support a low-carbon future would likely require that new investments in carbon intensive sectors, such as fossil fuels, not benefit from protection under investment treaties. Will new investment treaties include as standard a sectoral carve-out to exclude climate-unfriendly investments? An even thornier issue is whether States will be willing to exclude or adjust treaty coverage for existing fossil fuel investments, and if so, with what kind of phase out period?

UNCTAD also focused on the intersection between investment treaties and climate change in 2022. Most notably, in early November, timed for COP27, UNCTAD published a report that appeared squarely aimed at the climate policymaking community. This report draws together several earlier UNCTAD publications from 2022 that addressed different aspects of the intersection between climate policies and investment treaties or wider investment policies (e.g. here, here and here). UNCTAD, building on an earlier IISD report, identified some 192 treaty-based ISDS cases involving fossil fuel investments up to the end of 2021.

Treaty Modernization to Safeguard Space for Climate Change Policies

Developments in the modernization process of the Energy Charter Treaty (ECT) – discussed here and here – also demonstrate that climate change is now a first-order priority for policymakers in the investment treaty field. In recent months numerous EU Member States have announced an intention to withdraw from the ECT, on the basis that the proposed 'agreement in principle' reached in June 2022 does not go far enough in aligning the treaty with urgent climate priorities. As is widely known, this has led to the EU collectively being unable to adopt a position in favour of the modernisation agreement in principle, and to the meeting of the ECT parties, where the amendments were to be voted on, being delayed from November 2022 to April 2023 (here).

In light of these developments, the European Parliament in a resolution of 24 November 2022 called on the European Commission to prepare a coordinated withdrawal of the EU and its

Member States from the ECT, with an agreement to neutralise the sunset clause between withdrawing parties. The legal issues around the effectiveness of an *inter se* agreement among a subset of ECT parties to neutralise the sunset clause have been debated by several authors (see e.g. here, here and here).

Whether or not it is ultimately adopted, the ‘agreement in principle’ for modernization of the ECT is noteworthy as it is the first known example of an investment treaty that uses a carve-out based on the sector of the investment to exclude certain emissions-intensive investments from treaty protection. Whether the agreement in principle goes far enough is heavily debated, for example with respect to the length of the phase outs provided for existing fossil fuel investments, and the emissions thresholds set for excluding certain investments from treaty coverage. Nevertheless, the basic approach of a sectoral carve-out is noteworthy. It can be contrasted with proposals to define the basis of a climate carve-out by reference to the purpose of the measures adopted, an idea that was suggested in numerous submissions to the OECD public consultation and that has been around for some years. Interestingly, the ongoing OECD survey of States on ‘Climate Policies for Investment Treaties’ includes a significant number of questions that focus on sectoral exclusions from treaty coverage for climate-unfriendly investments, including potential exclusions in relation to coal, oil and gas-related projects.

Although it would not amend the treaty text, the recent Draft Decision developed by the European Commission and Germany aims to clarify aspects of CETA’s investment chapter, including several references to climate change (for analysis of this Draft Decision see here). The Draft Decision would require CETA’s investor–State Tribunal to interpret and apply the investment chapter considering the Parties’ commitments ‘under the Paris Agreement and their respective climate neutrality objectives and in a way that allows the Parties to pursue their respective climate change mitigation and adaptation policies’. The Draft Decision also states that investors ‘should expect’ that the Parties will take measures ‘to combat climate change or address its present or future consequences’, and clarifies that non-discriminatory measures taken for these reasons do not constitute indirect expropriation unless the impact of the measures ‘would appear wholly disproportionate’.

Investment Treaties as a Driver of the Clean Energy Transition?

There are ongoing and well-established debates about how investment treaties might positively contribute to climate mitigation efforts. These debates are ‘the flip-side of the coin in the investment and climate change relationship’. In this space, questions include whether additional treaty protections or incentives might be conferred on climate-friendly investments, or whether treaty-based investment liberalization obligations would be useful to lock in levels of openness to foreign investment in sectors where foreign investment and know-how is beneficial for the clean-energy transition (an issue discussed at the OECD Track 1 meeting in November 2022). However, significant questions have been raised about the assumptions that underpin claims that investment treaties and ISDS might facilitate greater clean energy investment.

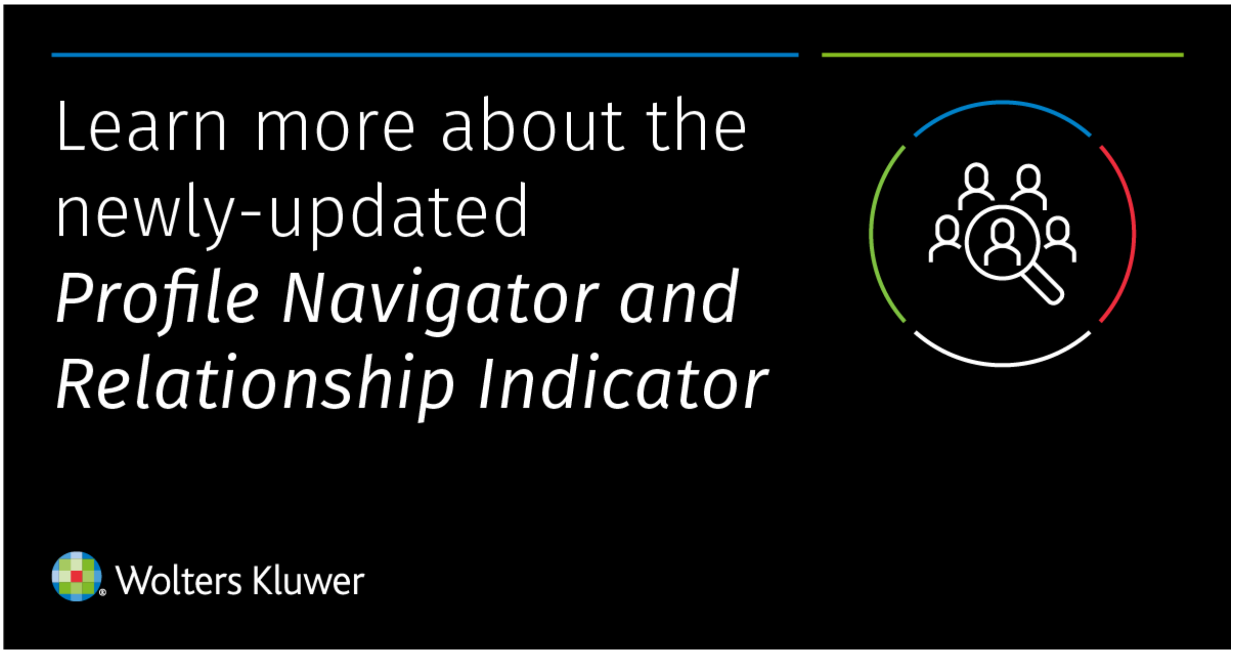
Some international investment agreements (IIAs) concluded in 2022 have included commitments to implement the Paris Agreement and the UNFCCC, including with reference to domestic emissions targets or Nationally Determined Contributions (NDCs), and notably these commitments are subject to State–State dispute settlement and potential trade retaliation (see e.g. EU–New

Zealand FTA, 'Trade and Sustainable Development' chapter, art X.6(2)-(4)) and 'Dispute Settlement' chapter, art X.16(2)). It is too early to say if these sorts of provisions will become standard features of future IIAs, but it seems likely that they may be of greater symbolic value than practical impact. State–State dispute settlement mechanisms are unlikely to be invoked, so it is unclear whether reiterating Paris Agreement commitments in investment treaties or Preferential Trade Agreements will add much value from a climate perspective.

The Path Forward – Bilateral, Plurilateral or Multilateral?

Going forward, it is likely that climate change and alignment with the Paris Agreement will continue to be important topics for the investment treaty regime in 2023 and beyond. The OECD's Track 1 work programme is set to continue, including with the findings of the survey of States on 'Climate Policies for Investment Treaties', which closes in January 2023. In our view, policymakers seeking to align investment treaties with Paris Agreement commitments are likely to face trade-offs between securing broad buy-in from States and acting quickly and ambitiously. UNCTAD has alluded to this challenge, noting that while a multilateral approach may have the benefit of addressing a large number of existing IIAs, action at the bilateral or regional level may be faster. We agree with UNCTAD's suggestion that approaches at a bilateral or plurilateral level should complement any wider multilateral attempt to align existing IIAs with climate commitments. In short, there is likely to be a variety of preferences among States, and more ambitious reforms at a bilateral or plurilateral level should not be postponed due to the difficulty of reaching more wide-ranging multilateral agreement.

The authors made submissions to the OECD public consultation and participated in the Track 1 meetings in April and November 2022. Joshua Paine also presented at the OECD investment treaty conference in May 2022. This post reflects the individual views of the authors.



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