Kluwer Arbitration Blog

Investment Arbitration and Climate Change: An Expert Panel Conversation

Margherita Bollis · Saturday, April 6th, 2024

On the 7th of March, Wolters Kluwer hosted a webinar to mark the launch of the book *Investment Arbitration and Climate Change*, edited by Anja Ipp and Annette Magnusson (co-founders of Climate Change Counsel) and published by Wolters Kluwer in January 2024. The webinar featured four of the book's contributing authors: Caline Mouawad (Partner at Chaffetz Lindsey, New York, United States), Helionor de Anzizu (Center for International Environmental Law (CIEL), Geneva/Paris), Clara Reichenbach (Associate at WilmerHale, London, United Kingdom) and Oliver Hailes (Assistant Professor of Law at the London School of Economics, United Kingdom).

The book centres on the potential conflict between States' obligations to reduce greenhouse gas emissions and their commitments to provide foreign investors with a stable and predictable legal framework. State actions and measures necessary to mitigate or adapt to climate change have already triggered liability claims by foreign investors under international investment treaties.

Within this central theme, each speaker focused on a separate factor: the role of climate science in the various stages of arbitration, the State's duty to regulate and protect climate-related human rights, the challenges and opportunities of climate-related counterclaims, and finally, the valuation of compensation in fossil fuel phase-out disputes.

Climate Science and Investment Arbitration

Caline Mouawad addressed the question of whether climate science could assist tribunals in striking a balance between investor claims and the State's right to protect the public interest. The consensus reached was affirmative: climate science has a vital role in each stage of investment arbitration.

In the liability phase, climate science can serve several purposes: first, to examine the occurrence of environmental damage and to establish causation. It does so by analysing and comparing the environmental conditions before and after the conclusion of the investment agreement. Second, climate science may serve to assess the State's right to regulate and intervene for climate change purposes. Climate science can help determine whether the acts of the State are "well-founded", that is, non-arbitrary and not idiosyncratic and can assist in supporting the rationale and efficiency of the challenged measure.

In the damages phase, climate science can help assess the conditions at the starting date of the investment to value the investor's losses subsequently. The counterpart to this is that it can also be used by the tribunal to possibly reduce or award damages to the State in the form of a counterclaim if the investor were to be deemed liable for environmental harm.

State's Duty to Regulate Under Human Rights Treaties

Helinor de Anzizu spoke about climate-related state obligations that arise under human rights treaties, such as the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights.

These treaties require States to respect, protect, and fulfil the human rights of its citizens, including taking measures to ensure that actions private entities, including investors and companies, do not endanger human rights and do not exacerbate climate change. De Anzizu argued that, in an era of climate emergency, arbitral tribunals need to view investor claims and agreements regarding the treatment of foreign investors in the context of these human rights obligations.

There are three ongoing cases in which states have asked international tribunals to issue Advisory Opinions on the obligations of States in relation to climate change mitigation and adaptation. First, the International Tribunal for the Law of the Sea (ITLOS) was asked by the Commission of Small Island States on Climate Change and International Law (COSIS) to clarify whether GHG emissions qualify as marine pollution and, if so, what are the obligations of States to prevent, reduce, and control pollution under international law. Second, the InterAmerican Court of Human Rights (IACHR) has been asked to clarify State obligations in the context of the climate emergency. Third, the International Court of Justice (ICJ) has been asked by the United Nations General Assembly to give an advisory opinion on "the obligations of States in respect of climate change".

Climate-Related Counterclaims in Investment Arbitration

Clara Reichenbach addressed the issue of counterclaims in investment arbitration. She noted that critics of investment arbitration often emphasise the asymmetrical nature of investment agreements. In origin, investment agreements were seen and perceived as exclusively providing recourse only to investors seeking redress against misbehaving States. Situations may arise, however, in which the investor has caused environmental damage, which causes the State to decrease its capacity to adapt to climate change.

In her comments, Reichenbach summarised the key hurdles a host State has to overcome to bring a climate-related counterclaim against an investor. The first hurdle is establishing the jurisdiction of the arbitral tribunal over the host State's counterclaim, meaning that the State has the burden of proving the parties' consent to allow the arbitration of the counterclaims raised by the host State. Some treaties explicitly provide for the host State to bring counterclaims, such as in the Slovakia-Iran BIT Article 14(3). Where this is not the case, a tribunal may find that the dispute resolution clause implicitly consents to a counterclaim, such as in *Saluka v. Czech Republic*.

The second hurdle is admissibility, which relates to whether a particular claim is appropriate for

adjudication in the arbitration at hand. A host State must demonstrate a close connection between the counterclaim and the investor's primary. Some tribunals (e.g., *Paushok v. Mongolia*) have held that the investor's central claim and the State's counterclaim must share the same legal basis. This would limit the possibility of bringing a counterclaim as the source of the obligations of the counterclaim is typically found in domestic law and rarely stems from the investment treaty. Other tribunals (e.g., *Tethyan v. Pakistan*) have departed from this strict approach and found a sufficient connection where the investor's treaty claims necessarily include an examination of the contractual and regulatory instruments on which the counterclaims are based. Finally, some tribunals do not require any legal connection, finding instead that counterclaims are admissible when they arise from the same subject matter as the main dispute (e.g., *Goetz v. Burundi; Urbaser v. Argentina*).

The third hurdle appears at the merits stage of the arbitration. To bring a counterclaim, the State will have to prove that a cause of action exists against the investor, meaning that the investor owed and breached a duty toward the host State. Due to the lack of awareness of climate change in the previous century, when most investment treaties were made, few treaties placed explicit climate-related obligations on investors. If the treaty includes a provision stating that foreign investors must abide by national law, this can be used as a "hook" for a counterclaim based on an investor's obligations under national climate or environmental legislation..

Valuation of Compensation in Fossil Fuel Phase-Out Disputes

Oliver Hailes spoke about the valuation of compensation in fossil-related disputes. A new kind of dispute has arisen from State decisions to mitigate climate change by phasing out the extraction, combustion or other use of oil, gas or coal by a fixed date, and more of these disputes are expected to arise. If tribunals find that such phase-outs meet the criteria for an indirect expropriation under the applicable treaty, the tribunal also has to determine the appropriate compensation due to the investor.

Treaties tend to prescribe a standard of compensation for lawful expropriation determined at fair market value (FMV). There are three main methods for determining FMV: asset-based, market-based, and income-based. The focus here is turned towards the latter of the three, mainly discounted cash flow (DCF) valuation, which converts the expected future income of a profitable investment into a present value and is most widely applied in the energy sector and investment arbitration. However, a tribunal will only adopt this method if the investment is expected to produce legitimate income with reasonable certainty in the "but-for" scenario. Furthermore, any future income must remain legitimate under the host State's laws (e.g., *SPP v. Egypt*).

Lastly, Hailes noted that the quantum of compensation may be reduced if the claimant has materially contributed to its alleged injury by any wilful or negligent conduct or if the claimant has failed in its reasonable duty to mitigate damages (ILC ARSIWA, Article 39). In the discontinued *RWE v. Netherlands* case, for example, the Netherlands argued that the claimant failed to mitigate damages by not converting its plants from coal to biomass.

Conclusion

The Wolters Kluwer expert panel discussed the intersection of legal, scientific, and environmental

considerations in investment arbitration and climate change, providing invaluable insights. The panellists' consensus underscored the critical role of climate science in guiding investment arbitration proceedings, particularly in assessing liability, regulatory measures, and damages. Moreover, the discussion shed light on the obligations of States in mitigating the impact of climate change while safeguarding human rights, emphasising the need for coherence and proactive measures in addressing this global challenge. The examination of the host State's counterclaims in investment arbitration highlighted the evolving landscape where States seek recourse against investors for environmental harm, navigating jurisdictional challenges and legal interpretations, aiming to strike a balance between public interest and investment obligations. Lastly, the compensation valuation in fossil fuel phase-out disputes underscored the complexities of determining fair market value amidst shifting regulatory landscapes and industry projections. Overall, the dialogue illustrated the complex interplay between investment law, climate science, and environmental protection, underscoring the necessity for nuanced approaches to address the pressing challenges of climate change within international investments.

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