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LIDW 2024: How Can Investment Protection Contribute to the Energy Transition?

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On 6 June 2024, Hogan Lovells and Twenty Essex co-hosted a London International Disputes Week ("LIDW") event on the topic "How Can Investment Protection Contribute to the Energy Transition?". The event brought together leading experts to discuss the intersection of investment law and the global shift towards sustainable energy.

The discussions were held under the Chatham House Rule, with each panelist presenting his or her insights, followed by a moderated Q&A session. The panel was moderated by Markus Burgstaller (Hogan Lovells) and the list of speakers comprised Scott McPherson (Hogan Lovells), Veronika Korom (ESSEC Business School), Kate Parlett (Twenty Essex), and Camilla Goldman (Omni Bridgeway).

Several topics were addressed during the event, including (i) the Energy Charter Treaty ("ECT"), (ii) the future relevance of the upcoming and issued advisory opinions on climate change on ISDS, and (iii) the third-party funding ("TPF") perspective on funding claims.

Energy Charter Treaty Perspectives

One of the primary points of discussion was the ECT, the reasons behind the recent numerous state withdrawals from the ECT, and the potential effects on investors.

One of the motivating factors for states withdrawing from the ECT was to remove the treaty protections it offered to fossil fuel investments, as those treaty protections resulted in a regulatory chill preventing states from enhancing their environmental regulations. However, it was expressed that such withdrawals are unlikely to aid the energy transition and may make it more difficult and costly for taxpayers to achieve a decarbonised economy. This perspective is based on the belief that investment protection treaties, like the ECT, provide the necessary legal security for investors in renewable energy projects. According to the panelists, arguably, without these protections, foreign investment may decline, shifting the financial burden to taxpayers and potentially slowing the transition to a cleaner economy.

In considering the downsides of the states' withdrawals from the ECT, the point was made that the regulatory environment for long-term renewable investments would be more unstable without the

ECT's protections. For example, politicians may endorse net-zero policies to gain short-term electoral advantages but often lack a commitment to long-term policy. Such a short-term approach is not necessarily conducive to fostering renewable energy investments such as offshore wind farms that require years to produce returns. Likewise, were the ECT to remain in effect, the possibility of facing investment claims might prompt governments to more carefully consider introducing pro-renewable energy measures for short-term political gain.

Another negative effect of the ECT withdrawals discussed was its impact on investor confidence, especially those in long-term projects. ECT protection has proved crucial for many investors, particularly in the renewable energy sector. Since 2010, over 60 investment arbitrations related to changes in renewable energy incentives have resulted in claims totalling around 10 billion. Accordingly, by withdrawing from the ECT, states would need to reconsider their broader strategy for attracting foreign investment in the energy sector.

In considering how investors might continue to protect their interests following the ECT withdrawals, the following four options were discussed.

First, the ECT's sunset clause ensures that investments made within a year of a withdrawal notice remain protected for 20 years. This clause has not been revoked, meaning that despite withdrawals, existing investments retain their protections. This point highlights that the withdrawal from the ECT may not immediately impact existing investments but could deter future investments, as new projects would lack the long-term security provided by the treaty. This reduced security could lead to a decline in foreign direct investment in renewable energy, increasing the financial burden on taxpayers to support the energy transition.

Second, investors should consider structuring new investments to benefit from alternative treaties, ideally involving non-EU member states, given the growing limitations on intra-EU BITs due to the CJEU's *Achmea* judgment (covered, here), which has significantly impacted the enforceability of intra-EU arbitration agreements.

Third, investors might negotiate new or amend existing contracts with EU member states or their agencies to include provisions for arbitration with substantive protections, preferably seated outside the EU.

Fourth, as a relatively untested avenue would be protection through the European Convention on Human Rights as applied by the European Court of Human Rights ("ECtHR"), which provides protection of property rights, fair trials, and anti-discrimination provisions. Although the ECtHR has a substantial case backlog and applications may be deemed inadmissible without explanation, it has been effective in significant cases, such as *Yukos v. Russia*, where the ECtHR affirmed the right to property under the Charter. Despite its uncertainties, the ECtHR may offer viable recourse for investors in certain cases.

TPF Perspectives

Another key point of discussion for the panel of speakers was TPF and the considerable risks and extended timelines associated with funding investment claims, especially those related to environmental regulations and the energy transition. It was noted that it is essential for funders to evaluate the economic viability of these claims to ensure that any potential damages justify the

significant funding costs. However, the complexity of climate change policies and evolving tribunal stances on states' regulatory rights are increasingly complicating those funding decisions.

In considering how third-party funders might mitigate their financial risks, it was noted that funders require robust financial protections, such as security for costs, to address the potential insolvency of claimants. Further, the importance of planning for budget overruns was discussed, given the unpredictable nature of investment claims in terms of their duration and cost.

Enforcement challenges were also discussed as a critical consideration, especially in intra-EU disputes, where legal complexities and shifting international attitudes towards arbitration enforcement complicate the process (e.g. *NextEra v. Spain*). Hence, funders must carefully select jurisdictions where enforcement is feasible and consider the political and economic stability of those regions when considering the prospects for collection. A view was expressed that the real challenge of a case was often not winning on the merits but rather enforcement.

Additionally, reference was made to the *Gabriel Resources v. Romania* case, to illustrate the complexities of environmental regulations on investment treaty claims.

Therefore, despite the availability of significant capital for litigation funding, including for energy transition sector-related investment treaty claims, it was stressed that such claims require a strategic and cautious approach due to their inherent risks and uncertainties.

The Relevance of Upcoming and Issued Advisory Opinions on Climate Change

The speakers further discussed the relevance of pending and issued advisory opinions on climate change from international courts and tribunals. It was noted that international law is currently undergoing significant scrutiny concerning climate change, especially in the realm of ISDS. As such, advisory opinions from various international courts, including the International Tribunal for the Law of the Sea ("ITLOS"), the Inter-American Court of Human Rights ("IACtHR"), and the International Court of Justice ("ICJ") are poised to reshape the legal landscape.

Examples of such advisory opinions that were mentioned include states' obligations under international law concerning climate change. ITLOS, for example, focuses on states' duties to prevent, reduce, and control pollution of the marine environment under the UN Convention on the Law of the Sea. The IACtHR is examining how states' human rights obligations intersect with climate change impacts, particularly regarding the rights to life and personal integrity. Meanwhile, the ICJ is addressing the general principles of international law related to states' responsibilities for climate change mitigation and adaptation. These advisory opinions aim to clarify and reinforce the legal frameworks guiding states' climate actions.

The motivation behind these advisory opinions is to establish clear, authoritative guidance on states' obligations related to climate change. Although advisory opinions are non-binding, they are intended to influence domestic and international litigation. They may be used to justify changes in domestic laws and regulations or to support arguments in investment tribunals about states' regulatory rights concerning environmental protection.

For foreign investors, the impact of these advisory opinions will depend on their reception and perceived authority. Should states adopt these opinions as part of their regulatory framework, it

could strengthen their defenses in ISDS cases by demonstrating that regulatory actions were in line with international obligations.

The speakers further discussed how the interplay between ISDS and climate change regulation is not new but is becoming increasingly prominent. Historically, investor-state disputes have arisen over environmental regulations, such as bans on certain chemicals or mining techniques. Recently, there has been a surge in cases related to renewable energy investments and climate change actions. High-profile cases include German energy companies suing the Netherlands under the ECT for phasing out coal power by 2030. (*see*, *RWE v. Netherlands*, see also, *Uniper v. Netherlands*)

The distinction between older and newer treaties was also highlighted. While modern investment treaties often include provisions allowing legitimate environmental regulation, older treaties might not have such explicit carve-outs. Nonetheless, tribunals have recognized states' rights to enact environmental measures, provided they are not arbitrary, unreasonable, or discriminatory. Balancing the interests of investors and host states has become a focal point in these disputes, especially with the rising public scrutiny over climate change issues.

Finally, it was recalled that the ECtHR has also contributed to this discourse, notably in cases like the *KlimaSeniorinnen v. Switzerland* Case (see previous coverage on the Blog here), where the ECtHR found that states' failure to take adequate climate action breached human rights under the European Convention on Human Rights. Such judgments underscore the evolving nature of international obligations concerning climate change and their potential to influence ISDS.

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