

A photograph of several wind turbines in a field at sunset. The sky is a mix of blue, orange, and yellow. The turbines are silhouetted against the bright sky. The image is partially obscured by a white border on the right side.

INTERNATIONAL ARBITRATION:
ACROSS THE POND
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CLIMATE CHANGE AND INVESTMENT TREATY ARBITRATION

MAYER | BROWN

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LEGAL FRAMEWORK: OVERVIEW

CLIMATE CHANGE

Following the COP 26 summit in Glasgow, climate change is on everyone's radar. Yet, to understand the legal framework related to climate change, it is important to look at the developments in this area since the 1990s.

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The world is our garden. Together, we must cultivate it."

-John Major, Rio Earth Summit 1992

A brief history of the legal framework relating to climate change:

- **1992** – the UN Framework Convention on Climate Change (**UNFCC**) was signed by 197 member states at the Earth Summit in Rio de Janeiro, Brazil, making it the first global agreement on climate change. Since the Earth Summit, a Conference of the Parties (**COP**) has been held annually.
- **1997** – the Kyoto Protocol was signed. The Protocol, which was the first time binding greenhouse gas emission reduction targets were set, was subsequently ratified by 192 UNFCC member states.
- **2009** – COP 15 was held in Copenhagen, Denmark. The UNFCC member states failed to reach an agreement on a successor to the Kyoto Protocol.
- **2015** – COP 21 was held in Paris, France. The UNFCC member states agreed on a successor to the Kyoto Protocol, the Paris Agreement.
- **2016** – the Paris Agreement was signed in New York by 175 member states.
- **2020** – the Paris Agreement takes legal effect, requiring member states to submit Nationally Determined Contributions (**NDCs**).
- **2021** – COP 26 was held in Glasgow, UK, during which member states agreed to revise their NDCs.

INVESTMENT TREATY ARBITRATION

There are currently over 3000 International Investment Agreements in force across the globe, which include, but are not limited to:

- Bilateral investment treaties (**BITs**);
- Multilateral investment treaties;
- Trade and investment partnerships (**TIPS**); and
- Free trade agreements.

The main purpose of these International Investment Agreements is to promote foreign direct investment (**FDI**).

In order to attract FDI, Contracting States often offer foreign investors certain protections.

Investor Protections

The protections offered to investors commonly include:

- Guaranteed fair and equitable treatment of investments by a State;
- Guarantees against the expropriation of investments;
- Promises to ensure the full protection and security of investments; and
- Undertakings by a State to not act in an arbitrary or discriminatory manner towards foreign investors, or foreign investments, within their territory.

If these protections are breached by a State, then the State's international liability will often be invoked. Most investment treaties will also provide wronged investors with the right to bring arbitral proceedings against the State.



LEGAL FRAMEWORK: INTERPLAY

CLIMATE-RELATED TREATY DISPUTES

As global, cross-border investment increases in climate change-related ventures, it is likely that there will be a concurrent rise in the number of climate-related disputes arising out of these ventures.

Since many of these ventures will be international, they may be able to benefit from the protections offered to investors under Investment Treaties. As a consequence, there is likely to be an increase in investment treaty arbitration.

Climate change-related ventures

Climate change is presenting opportunities for the development of new ventures, including, but not limited to:

- Renewable energy projects;
- Transition technologies;
- Offsetting projects; and
- Participating in emissions trading schemes, such as the European Union Emissions Trading Scheme (**EU ETS**).

CLIMATE-RELATED TREATY PROVISIONS

As a result of the new climate-related commitments that States are signing up to, there is currently a wave of new generation investment treaties that are incorporating environmental protection provisions. Existing treaties are also being updated to include similar provisions.

The Energy Charter Treaty (**ECT**), for instance, is currently being revised in an attempt to align it with the goals of the Paris Agreement. As part of the revision process, it has been proposed that investments in fossil fuels should be carved-out from the ECT's protection provisions. If this proposal is accepted, it may mean that investors with investments in fossil fuel-based industries would not be able to bring claims under the ECT which arise from the impacts of a States' climate policies.

Environmental Protection Provisions

Examples of environmental protection provisions being incorporated into International Investment Agreements include, but are not limited to:

- Prohibiting the lowering of environmental standards to attract investment;
- Encouraging investors to act in an environmentally responsible way;
- Including exceptions to treaty protections which would otherwise be available in the interests of achieving environmental objectives; and
- Excluding certain investments from the scope of a treaty for environmental reasons.

CLIMATE-RELATED TREATY PROVISIONS

Cont'd

International investment agreements traditionally focus on State obligations. In the context of climate change, these obligations often relate to the implementation of legislation that addresses areas of environmental protection.

Obligations for investors are, however, starting to emerge as a result of the increasing focus on the environmental impact of international investments.

Investor Obligations

Many new BITs, for example, have introduced climate-related obligations for investors, which include, but are not limited to:

- Mandating investors to carry out a full environmental impact assessment for any investment; and
- Mandating investors to maintain an environmental management system throughout the life of their investment.

ENFORCEMENT OF INVESTOR OBLIGATIONS

It is currently unclear whether investor obligations could be used by States to bring environmental claims, or counterclaims, against investors in international treaty arbitration.

Although traditional BITs do not explicitly address counterclaims, the UNCITRAL Rules and ICSID Convention do.

Despite this, the main obstacle to the success of State counterclaims against investors to date has been identifying specific investor obligations under international law. This has been demonstrated by cases such as:

- *Urbaser v Argentina*; and
- *Aven v Costa Rica*.

Future prospects of State counterclaims against Investors

Even if it can be demonstrated that an investor has a positive obligation under international law, States may be dissuaded from bringing counterclaims against investors since there will be a high evidential burden to prove an investor's consent to arbitrate.

That said, the risk landscape for future FDI may change if international environmental regulations are adopted which create enforceable obligations on States and investors.

Moreover, there may well be an increase in the inadmissibility of investors' claims if, for example, an investor has failed to invest in accordance with certain environmental standards. This would make defending such counterclaims far more difficult for investors.



CLIMATE-RELATED TREATY DISPUTES: EXAMPLES

FAILURE BY A STATE TO TAKE ACTION

States are now subject to international commitments to take actions to address climate change under the Paris Agreement.

Investors will, therefore, expect States to adhere to these commitments as part of their international treaty obligations.

If, for example, an investor's investments suffer damage from climate change-related extreme weather events and the host State has not been adhering to its climate commitments, then the investor may be able to bring a claim for breach of the Full Protection and Security (**FPS**) obligation in an international treaty.

Example: Energy Charter Treaty Revision

The proposed revisions to the ECT would impose a specific obligation on Contracting States to "*effectively implement ... the Paris Agreement ... including [a State's] commitments with regard to its [NDCs].*"

Such an obligation may provide a legal basis for an investor to bring a claim against a State based on the State's breaches of its commitments under the Paris Agreement.

That said, investors will likely face significant evidentiary challenges in proving that a State's actions caused environmental damage.

CONFLICT BETWEEN A STATE'S ACTIONS AND INVESTOR PROTECTIONS

The array of new legislation that States have passed, and will continue to pass, in order to adhere to their Paris Agreement commitments is substantial.

There is a risk that this new legislation will conflict with existing investor protections under international investment treaties, which States are bound to afford to foreign investors.

For example, if a State decides to phase out the extraction of fossil fuels, it may face claims of expropriation from foreign investors who have invested in fossil fuel-based industries.

That said, under some international investment treaties, there may be a carve-out from the investor protection provisions in respect of a State's actions to protect the environment.

Addressing conflicts between a State's commitments under the Paris Agreement and Investment Treaties

Tribunals may look to Article 30 of the Vienna Convention to help resolve such conflicts, which provides that "*when the parties to an earlier treaty (e.g. BITs) are parties also to the later treaty (e.g. the Paris Agreement)...the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty*".

That said, Article 30 is only designed to cover treaties "*relating to the same matter*", which may not be the case for BITs and the Paris Agreement.

It is likely, however, that Tribunals will expect investors to be more recognisant of the fact that investments made subsequent to the adoption a State's environmental commitments should have considered those commitments when making the investment. Given that States will continue to implement climate-related legislation, it is likely that environmental factors will become more mainstream for tribunals to consider in investment disputes.



CONCLUSION

THE FUTURE OF INVESTMENT ARBITRATION

Environmental issues are emerging as a focus point in the investment arbitration sphere.

The movement towards addressing climate change, including the corresponding legal effects of this movement, will increasingly affect the international investment landscape.

In particular, the coming together of the climate change and investment treaty arbitration legal frameworks will likely result in an increase in the number of investor-state climate change-related claims.

Investors and States will, therefore, want to keep up-to-date with developments in this area over the coming decades.

“Environmental factors will play a significant part in the future of investment arbitration.”

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Kwadwo has extensive experience with regard to litigation, mediation and adjudication. He also has wide-ranging international experience, having advised in relation to projects and disputes in Sub-Saharan Africa, South America, India, Russia and the Middle East. He regularly advises in relation to international arbitrations, including under the ICC, UNCITRAL and LCIA rules. Kwadwo has written extensively regarding dispute resolution and arbitration in Sub-Saharan Africa.



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Charles has significant experience in all areas of arbitration. He has represented clients engaged in domestic and international arbitration before many administrators, including the AAA, ICDR, ICC and IFTA. He has also litigated dozens of actions to enforce arbitration agreements. And, in doing so, Charles has faced many threshold questions of arbitrability, such as whether the court or an arbitrator decides if an arbitration agreement permits class arbitration. In addition, Charles acts as a commercial and consumer arbitrator for the AAA. He has presided over arbitrations ranging from complex computer software integration disputes to disputes regarding the control of a business entity. Charles is also a fellow of the Chartered Institute of Arbitrators.

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