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THE INTERNATIONAL INVESTMENT TREATY REGIME AND CLIMATE ACTION

HIGHLIGHTS

- The international investment agreements (IIA) regime comprises about 3,300 treaties. Old-generation IIAs from the 1980s until the early 2010s were often concluded with little or no attention to host States' regulatory flexibility for environmental protection and climate action. New-generation IIAs signed since 2010 fare relatively better in safeguarding the States' right to regulate and in incorporating specific provisions on the protection of the environment, climate action and sustainable development. However, both old and recent IIAs lack pro-active provisions aimed at effectively supporting climate action.
- IIAs do not distinguish between low-carbon and high-carbon investments. IIAs generally cover investments across all sectors and typically offer high levels of protection.
- As old-generation IIAs significantly outnumber new-generation ones, it is critical to address the problems and risks posed by old-generation IIAs.
- States have options and tools at their disposal to reform their existing IIAs, including based on UNCTAD's IIA Reform Accelerator (2020), the IIA Reform Package (2018) and the Investment Policy Framework for Sustainable Development (2015).
- The current IIA regime can constrain States when implementing measures to combat climate change. States may need to fast-track IIA reform to make it more aligned with climate action as well as other public policy imperatives. Two broad approaches can be considered:
  - Making individual IIAs climate-responsive by ensuring that only low-carbon and sustainable investments are covered and by safeguarding the right and duty of States to regulate in the public interest. This can be coupled with provisions aimed at promoting and facilitating sustainable investment.
  - Exploring the possibilities to reconceptualize the scope, purpose and design of the IIA regime through engagement in holistic IIA reform actions at the multilateral, regional, bilateral and national levels.
- Many past investor–State dispute settlement (ISDS) cases were related to measures or sectors of direct relevance to climate action. A complementary publication looks at such ISDS cases (IIA Issues Note, No. 4, September 2022).

1. Introduction: the IIA regime and climate action

Goal 13 of the Sustainable Development Goals adopted in September 2015 calls for "urgent action to combat climate change and its impacts" (A/RES/70/1). The Paris Agreement – the benchmark for climate action – was adopted shortly after, in December 2015, under the umbrella of the 1992 United Nations Framework Convention on Climate Change (UNFCCC). More recently, on 28 July 2022, the United Nations General Assembly recognized the right to a clean, healthy and sustainable environment as a human right (A/RES/76/300). IIA policymaking has so far shown limited consideration for climate action and environmental protection as a specific concern.

The international investment agreements (IIA) regime consists of 3,300 treaties: 2,871 bilateral investment treaties (BITs) and 429 other treaties with investment provisions (TIPs). IIAs contain substantive protection standards for foreign investors and investments, coupled with access to investor–State arbitration, known as investor–State dispute settlement (ISDS). IIAs proliferated in the 1990s as an instrument of global investment policymaking and have become increasingly contentious over the past decade, including due to the fast-growing number of ISDS claims and States' increased exposure to ISDS risks and costs.[1]

The urgency of climate action has added attention to the need to reform the IIA regime. The 2022 Intergovernmental Panel on Climate Change (IPCC) report highlighted the risks of ISDS being used to challenge climate policies (box 1). To substantially reduce greenhouse gas emissions in order to meet climate change objectives, a transition to a low-carbon economy and significant changes in investment patterns are needed (IPCC, 2014, p. 30). Many governments and other actors in public and private sectors are taking steps to align financial flows with net-zero targets for greenhouse gas emissions and Paris Agreement objectives, notably in the financial sector (lending, asset management and insurance).[2]

Reform of existing IIAs is essential to ensure that IIAs do not hinder States from implementing climate change measures and from achieving a just transition to low-carbon economies. The reform should minimize the States' risk of facing ISDS claims related to climate change policies and those related to high-carbon investments.

Many past ISDS cases were related to measures or sectors of direct relevance to climate action (UNCTAD, 2022a). Using IIAs as the legal basis, investor claimants brought at least 175 ISDS cases concerning measures taken for the protection of the environment. Moreover, investors in the fossil fuel sector have been frequent ISDS claimants, initiating at least 192 ISDS cases against different types of State conduct. The last decade has also seen the emergence and proliferation of ISDS cases brought by investors in the renewable energy sector, with 80 known cases. Many of these cases challenged Governments' legislative changes involving reductions in feed-in-tariffs for renewable energy production. A complementary publication looks at these three types of ISDS cases (IIA Issues Note, No. 4, September 2022).

While IIA reform is underway in many countries, a lot remains to be done. The large stock of old-generation IIAs can constrain States when implementing measures to combat climate change and protect the environment, among other public policy imperatives. The narrow window available to keep warming within 1.5°C and the unprecedented aggregate scale of potential ISDS claims that could challenge climate measures such as fossil fuel phase-outs call for States to deepen and accelerate IIA reform processes (UNCTAD-IIED, 2022). These reforms should align IIAs with the Paris Agreement and net-zero targets by promoting and facilitating investment into climate-related projects – such as renewable energy ones – and limit or exclude coverage of high-carbon investments under IIAs. Such reforms can be taken at the multilateral, regional, bilateral and national levels. A coordinated multilateral approach to IIA reform is preferable as it could result in an international instrument creating legal certainty for multiple stakeholders. More immediate, smaller scale reforms at the bilateral or regional level should be pursued in parallel. Individual regions and countries can lead the way in fast-tracking IIA reforms.

[1] For the evolution of the IIA regime, including the shift from the era of proliferation to the era of re-orientation, see UNCTAD, 2015.
[2] E.g. https://www.unepfi.org/news/industries/insurance/partnership-for-carbon-accounting-financials-collaborates-with-un-convened-net-zero-insurance-alliance-to-develop-standard-to-measure-insured-emissions/; https://www.gfanzero.com/about/; https://ec.europa.eu/info/sites/default/files/business_economy_euro/accounting_and_taxes/documents/211104-international-platform-sustainable-finance-cop26-statement_en.pdf; https://group30.org/images/uploads/publications/G30_Mainstreaming_the_Transition_to_a_Net-Zero_Economy.pdf.

This may require a reconceptualization of the scope, purpose and design of IIAs. Intergovernmental and multistakeholder dialogue can play a role in identifying and devising investment policy tools to promote and facilitate sustainable investments, in support of climate action.

States have options and tools at their disposal to reform their existing IIAs, including based on UNCTAD's IIA Reform Accelerator (2020), the IIA Reform Package (2018) and the Investment Policy Framework for Sustainable Development (2015). A recent UNCTAD-IIED Policy Brief highlighted key policy recommendations supporting the reform of the IIA regime in order to advance climate goals (UNCTAD-IIED, 2022).

Box 1. The 2022 Report of the Intergovernmental Panel on Climate Change (IPCC) and ISDS

Climate change is among the most pressing global challenges of our time. The Intergovernmental Panel on Climate Change (IPCC) found that human-induced global warming has already caused changes in the climate system and that global warming will exceed 2°C unless "deep reductions" in greenhouse gas emissions occur (IPCC, 2022, Chapter 15). The achievement of the Sustainable Development Goals (SDGs) is directly at stake, as are human rights including the rights to life, health, water, and a clean and healthy environment.

Rising to this challenge will require transformations in economies and societies. Regarding the energy sector, the International Energy Agency noted that a global transition to net-zero emissions energy involves "nothing less than a complete transformation of how we produce, transport and consume energy" (IEA, 2021, p. 13). This transformation includes phasing out unabated coal power plants and reorienting energy sources from fossil fuels to renewables. Energy scenarios consistent with limiting global warming to 1.5°C require more investments in renewable energy.

The IPCC Report highlighted that ISDS based on IIAs might significantly hamper governments in adopting necessary climate policies:

> "A large number of bilateral and multilateral agreements, including the 1994 Energy Charter Treaty, include provisions for using a system of investor-state dispute settlement (ISDS) designed to protect the interests of investors in energy projects from national policies that could lead their assets to be stranded. Numerous scholars have pointed to ISDS being able to be used by fossil-fuel companies to block national legislation aimed at phasing out the use of their assets […]." (IPCC, 2022, Chapter 14, p. 81, citations omitted)

> "In particular, transactions in the energy sector show a high level of investor protection also against much needed climate action which is also well illustrated by share of claims settled in favour of foreign investors under the Energy Charter Treaty and investor-state dispute settlement […]." (IPCC, 2022, Chapter 15, p. 66, citations omitted)

According to a recent study on this issue, climate adaption ISDS claims may run as high as USD 340 billion (Tienhaara et al., 2022).

Source: UNCTAD, based on IPCC and others.

2. Stocktaking of IIA provisions relevant to climate action

Some 3,300 IIAs were concluded between 1959 and 2009 representing over 85 per cent of all IIAs ever signed.[3] About 2,300 of them are still in force today. Typically, these are old-generation IIAs that do not contain explicit provisions to preserve States' regulatory space for environmental protection or climate action. They feature broad and vague formulations for substantive treatment standards, with few exceptions or safeguards. Such old-generation IIAs serve as a basis for virtually all existing ISDS claims. As old IIAs significantly outnumber more recent ones, it is critical to address the problems and risks posed by them (UNCTAD, 2018).

New-generation IIAs fare relatively better in safeguarding the States' right to regulate and in incorporating specific provisions on the protection of the environment, climate action and sustainable development. As documented in UNCTAD's World Investment Reports, new-generation IIAs generally contain more circumscribed and clarified substantive provisions, often accompanied by narrower access to ISDS (UNCTAD, 2020b). Questions remain whether refined provisions in newer IIAs will shield climate change measures from ISDS claims or prevent investors with high-carbon investments from invoking ISDS to claim compensation.

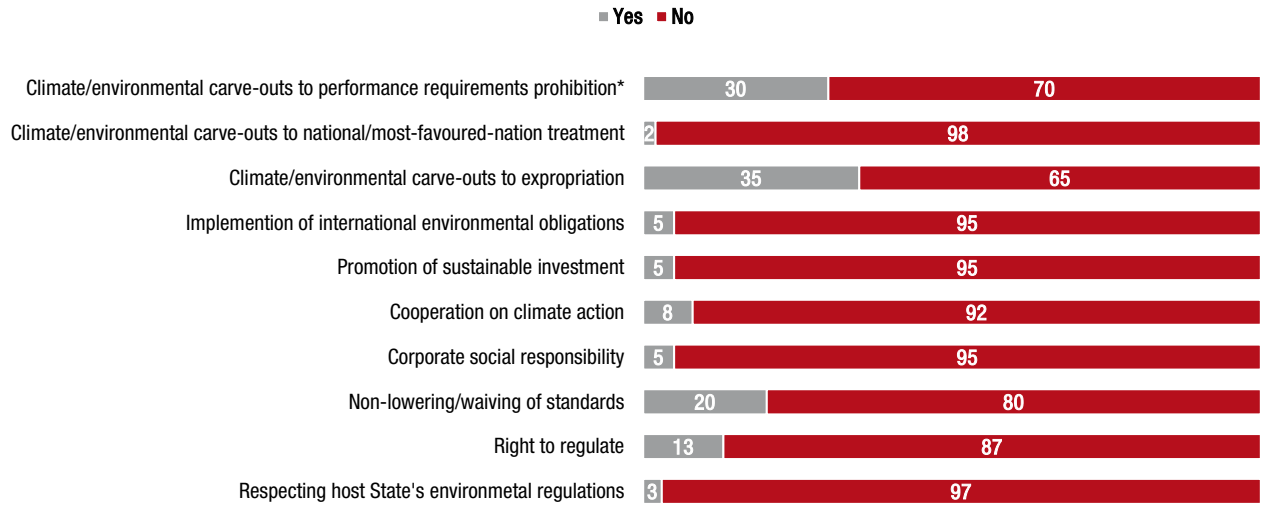
[3] This includes about 500 IIAs that were signed but have not entered into force and 500 IIAs that have been terminated.

Since 2010, some 500 IIAs were concluded and about half of them are in force. While climate change and the environment feature more prominently in these IIAs (figure 1), they are still relatively rare. Some newer IIAs contain:

- General environmental provisions aimed at safeguarding the State's policy space
- Specific climate action provisions

Moreover, both old and recent IIAs lack pro-active provisions aimed at effectively supporting climate action. For example, IIAs generally do not distinguish between low-carbon and high-carbon investments.[4] They cover investments across all sectors and typically offer high levels of protection. Old IIAs and most new IIAs also still lack detailed provisions for promoting and facilitating investments. Some IIAs, such as the Cooperation and Facilitation Agreements spearheaded by Brazil, are notable exceptions.

Figure 1. Selected provisions relevant to climate action in IIAs concluded between 2010–2021
(Per cent)



Source: UNCTAD, based on IHEID International Economic Law Clinic Report "IIAs and Climate Action", May 2022.
Note: The survey analysed 347 IIAs signed between 2010 and 2021, with available texts.
* The percentage concerns only the IIAs that include performance requirements provisions, i.e. 103 out of the 347 analysed IIAs.

(i) General environment-related provisions safeguarding the State's policy space

A small share of IIAs concluded since 2010 contain general environmental provisions and provisions dealing with sustainable development that might help safeguarding climate action. While they do not explicitly refer to climate action, they are essential because climate action forms part of sustainable development (e.g. as part of Goal 13 of the SDGs). Provisions of this kind include:

- preambular clauses pertaining to environmental protection
- substantive provisions directly related to environmental protection
- environmental protection as a carve-out from standards of treatment
- procedures for compliance and implementation of environmental protection
- environmental protection as a general exception

Preambular clauses pertaining to environmental protection help establish the overall objective of the IIA. Such references are helpful since the entire treaty must be interpreted in a manner consistent with the aim of environmental protection. Well-drafted preambular clauses serve to clarify the application of substantive provisions. Preambles can contain references to sustainable development and environmental protection, reaffirm the right to regulate in the area of environment and reiterate commitments to uphold levels of environmental protection.

[4] See further Brauch, 2022 (forthcoming), available at https://academiccommons.columbia.edu/doi/10.7916/d8-300v-7h63.

Box 2. Preambular clauses pertaining to environmental protection: recent treaty examples (illustrative)

Myanmar–Singapore BIT (2019), Preamble
"RECOGNISING the important contribution investments can make to sustainable economic growth and development, and seeking to promote, protect, and facilitate such investments within the territories of the Parties.
REAFFIRMING the Parties' right to regulate and to introduce new measures, such as health, safety, and environmental measures relating to investments in their territories in order to meet legitimate public policy objectives."

Colombia–Spain BIT (2021), Preamble
"Convencidos de que la inversión tiene el potencial de contribuir al desarrollo sostenible y a aumentar la prosperidad en ambos países.
Reafirmando el derecho de cada Parte Contratante a regular las Inversiones hechas en su Territorio para cumplir objetivos legítimos de bienestar público, que se pueden lograr sin disminuir sus estándares de salud, orden público y seguridad, derechos laborales y de medio ambiente de aplicación general."

Source: UNCTAD.

Substantive provisions directly related to environmental protection can be found in the main text of the IIA. For example, new-generation IIAs contain specific sections on environmental protection and sustainable development or the implementation of multilateral environmental agreements. They can also have clauses for the non-lowering of environmental protection, the promotion and facilitation of sustainable investment, the right to regulate, requirements for environmental impact assessments and the maintenance of an environmental management system, and corporate social responsibility (box 3).

Box 3. Substantive provisions directly related to environmental protection: recent treaty examples (illustrative)

Implementation of environmental agreements

China–Switzerland FTA (2013), Art. 12.2
"1. The Parties reaffirm their commitment to the effective implementation in their laws and practices of multilateral environmental agreements to which they are a party, as well as of the environmental principles and obligations reflected namely in the international instruments referred to in Article 12.1. They shall strive to further improve the level of environmental protection by all means, including by effective implementation of their environmental laws and regulations.
2. The Parties recognise that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic environmental laws, regulations, policies and practices. The Parties agree that environmental standards shall not be used for protectionist trade purposes.
3. The Parties recognise the importance, when preparing and implementing measures related to the environment, of taking account of scientific, technical and other information, and relevant international guidelines."

Non-lowering of environmental standards

Belarus–Hungary BIT (2019), Art. 2(7)
"The Contracting Party shall not encourage investment by lowering domestic environmental, labour or occupational health and safety legislation or by relaxing core labour standards. Where a Contracting Party considers that the other Contracting Party has offered such an encouragement, it may request consultations with the other Contracting Party and the two Contracting Parties shall consult with a view to avoid any such encouragement."

Promotion and facilitation of sustainable investment

China–Switzerland FTA (2013), Art. 12.3
"1. The Parties shall strive to facilitate and promote investment and dissemination of goods, services, and technologies beneficial to the environment.
2. For the purpose of paragraph 1, the Parties agree to exchange views and will consider cooperation in this area.
3. The Parties shall encourage cooperation between enterprises in relation to goods, services and technologies that are beneficial to the environment."

Box 3. Substantive provisions directly related to environmental protection: recent treaty examples (illustrative)

Right to regulate

Rwanda–United Arab Emirates BIT (2017), Art. 9

"1. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining, or enforcing any measure that it considers appropriate to ensure that an investment activity in its territory is undertaken in accordance with the applicable public health, security, environmental and labour law of the Contracting Party, such measures should not be applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or investors.
2. The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing domestic public health, security, labour or environmental measures. Accordingly, a Contracting Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, expansion or retention in its territory of an investment of an investor, as long as such derogation or waiver diminish its public health, security, labour and environmental standards."

Canada–EU CETA (2016), Chapter 8 Investment, Art. 8.9

"1. For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity."

Environmental impact assessment

Morocco–Nigeria BIT (2016), Art. 14

"1) Investors or the investment shall comply with environmental assessment screening and assessment processes applicable to their proposed investments prior to their establishment, as required by the laws of the host state for such an investment or the laws of the home state for such an investment, whichever is more rigorous in relation to the investment in question.
2) Investors or the investment shall conduct a social impact assessment of the potential investment. The Parties shall adopt standards for this purpose at the meeting of the Joint Committee.
3) Investors, their investment and host state authorities shall apply the precautionary principle to their environmental impact assessment and to decisions taken in relation to a proposed investment, including any necessary mitigation or alternative approaches of the precautionary principle by investors and investments shall be described in the environmental impact assessment they undertake."

Environmental management system

Morocco–Nigeria BIT (2016), Art. 18

"1) Investments shall, in keeping with good practice requirements relating to the size and nature of the investment, maintain an environmental management system. Companies in areas of resource exploitation and high-risk industrial enterprises shall maintain a current certification to ISO 14001 or an equivalent environmental management standard.
2) Investors and investments shall uphold human rights in the host state.
3) Investors and investments shall act in accordance with core labour standards as required by the ILO Declaration on Fundamental Principles and Rights of Work, 1998.
4) Investors and investments shall not manage or operate the investments in a manner that circumvents international environmental, labour and human rights obligations to which the host state and/or home state are Parties."

Source: UNCTAD.

Environmental protection as a carve-out from and clarification of standards of treatment aims at safeguarding policy space and reducing the discretion of ISDS tribunals in relation to environmental matters. Several IIAs have introduced carve-outs and clarifications in provisions dealing with indirect expropriation, national treatment and the prohibition of performance requirements (box 4).

Notably, the reviewed new-generation IIAs do not include environmental carve-outs from fair and equitable treatment (FET). Given the broad interpretations of FET in ISDS practice, this could be seen as a shortcoming of the recent reform efforts.

Box 4. Environmental protection as a carve-out from and clarification of standards of treatment: recent treaty examples (illustrative)

Expropriation

India–Kyrgyzstan BIT (2019), Art. 5(5)

"Non-discriminatory regulatory measures by a Party or measures or awards by judicial bodies of a Party that are designed and applied to protect legitimate public interest or public purpose objectives such as public health, safety and the environment shall not constitute expropriation under this Article."

National treatment and most-favoured-nation treatment

Iran–Slovakia BIT (2016), Art. 4(3)

"For greater certainty, a determination of whether an investment or an investor is in comparable situations for the purposes of paragraphs 1. and 2. of this Article shall be made based on an assessment of the totality of circumstances related to the investor or the investment, including:
a) the effect of the investment on
i. the local community where investment is located;
ii. the environment, including effects that relate to the cumulative impact of all investments within a jurisdiction;
b) the character of the measure, including its nature, purpose, duration and rationale; and
c) the regulations that apply to investments or investors."

Performance requirements

China–Mauritius FTA (2019), Art. 8.9

"(d) Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraph 1(b), (c), and (f), and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures:
(i) necessary to secure compliance with the laws and regulations that are not inconsistent with this Agreement;
(ii) necessary to protect human, animal, or plant life or health; or
(iii) related to the conservation of living and non-living exhaustible natural resources."

Source: UNCTAD.

Procedures for cooperation in and implementation of environmental protection. Some recent IIAs require their contracting parties to effectively enforce their environmental laws and establish institutional mechanisms for cooperation (box 5). These procedures include joint-committee mechanisms, public participation, consultations, panel of experts, national focal points and expert reports. These procedures do not preclude investors from challenging environmental measures in arbitration, i.e. environmental measures would not be shielded (as IIAs generally do not carve-out such measures from the scope of ISDS).

Box 5. Procedures for cooperation in and implementation of environmental protection: recent treaty examples (illustrative)

Environmental cooperation

USMCA (2018), Chapter 24 Environment

Art. 24.25

"1. The Parties recognize the importance of cooperation as a mechanism to implement this Chapter, to enhance its benefits, and to strengthen the Parties' joint and individual capacities to protect the environment, and to promote sustainable development as they strengthen their trade and investment relations.
2. The Parties are committed to expanding their cooperative relationship on environmental matters, recognizing it will help them achieve their shared environmental goals and objectives, including the development and improvement of environmental protection, practices, and technologies.
3. The Parties are committed to undertaking cooperative environmental activities pursuant to the Agreement on Environmental Cooperation among the Governments of Canada, the United Mexican States, and the United States of America (ECA) signed by the Parties, including activities related to implementation of this Chapter. Activities that the Parties undertake pursuant to the Environmental Cooperation Agreement will be coordinated and reviewed by the Commission for Environmental Cooperation as provided for in the ECA."

Art. 24.26

"1. Each Party shall designate and notify a contact point from its relevant authorities within 90 days of the date of entry into force of this Agreement, in order to facilitate communication between the Parties in the implementation of this Chapter. Each Party shall promptly notify, in writing, the other Parties in the event of any change of its contact point.

Box 5. Procedures for cooperation in and implementation of environmental protection: recent treaty examples (illustrative)

2. The Parties establish an Environment Committee composed of senior government representatives, or their designees, of the relevant trade and environment central level of government authorities of each Party responsible for the implementation of this Chapter.
3. The purpose of the Environment Committee is to oversee the implementation of this Chapter, and its functions are to:
(a) provide a forum to discuss and review the implementation of this Chapter;
(b) periodically inform the Commission and the Council for the Commission for Environmental Cooperation (Council) established under Article 3 (Council Structures and Procedures) of the Environmental Cooperation Agreement regarding the implementation of this Chapter;
(c) consider and endeavor to resolve matters referred to it under Article 24.30 (Senior Representative Consultations);
(d) provide input, as appropriate, for consideration by the Council, relating to submissions on enforcement matters under this Chapter.
(e) coordinate with other committees established under this Agreement as appropriate; and
(f) perform any other functions as the Parties may decide."

Source: UNCTAD.

Environmental protection as a general exception. General exceptions or public policy exceptions are included in an increasing number of IIAs (UNCTAD, 2020a). They identify the policy areas for which flexibility is to be preserved in respect of all (or specified) IIA protection standards. New-generation IIAs frequently include environmental protection as a legitimate policy objective in general exceptions clauses (box 6). However, it is critical to note that ISDS tribunals have applied general exception clauses in narrow and unexpected ways.[5]

Box 6. Environmental protection as a general exception: recent treaty examples (illustrative)

Burkina Faso–Türkiye BIT (2019), Art. 5
"1. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying non-discriminatory legal measures:
(a) designed and applied for the protection of human, animal or plant life or health, or the environment;
(b) related to the conservation of living or non-living exhaustible natural resources.
[…]
4. This Agreement shall not imply in any way an obligation for the Contracting Parties to relax their laws and regulations regarding health, safety or environment in order to encourage investment. Neither Contracting Party is under any obligation to waive or otherwise derogate, or to offer to waive or otherwise derogate from such measures for the purpose of encouraging the establishment, acquisition, expansion or the maintenance of an investment in its territory by an investor of the other Contracting Party."

Source: UNCTAD.

(ii) Specific climate action provisions