

Submission to the OECD's Public Consultation on Investment Treaties and Climate Change

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As someone who has been an active participant in ISDS for the past fifteen years and acted as lead counsel in several of the world's largest international arbitrations, I fully support this OECD initiative and any other that would dedicate intergovernmental attention to the threat that ISDS poses, not just for climate change policy but more broadly for the ability of states to exercise their sovereign prerogatives in addressing environmental, health, safety and other issues of public interest.

A recent law firm bulletin reveals why there should be concern about the ISDS threat in the context of climate change policy. It says:

ISDS is therefore likely to be an increasingly important avenue for the resolution of climate change disputes. Companies in industries most affected by States' climate change obligations (e.g., fossil fuels, mining, etc.) should audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty. Such restructuring should take place before any climate-related dispute with the State has arisen or is reasonably foreseeable. Notably, some treaties have superior investor protections than others. It is thus important to assess which treaty would best protect the company from any adverse climate-related government measures.²

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² Jones Day (Michelle Bradfield, James Egerton-Vernon, Melissa Stear Gorsline, Fahad A. Habib, Sylvia Tonova and Philip J. Devenish), *Climate Change and Investor-State Dispute Settlement*, February 22, 2022, available at www.jonesday.com/en/insights/2022/02/climate-change-and-investorstate-dispute-settlement.

In fact, there is little doubt that many investors, third-party funders and their counsel are eyeing ISDS with a view to challenging, and even profiting from, governmental action relating to climate.³

I have previously written and spoken in detail about the problems and dangers of ISDS, as seen from my vantage point as counsel defending respondents in ISDS cases.⁴ Of course, opinions on the subject vary greatly. There is no shortage of defenders of ISDS, who wax eloquent about its function in promoting foreign direct investment (FDI) and providing a neutral, peaceful way of settling investment disputes. On the other side, critics of ISDS question whether it really has a discernible positive impact on FDI and see investment treaties as weapons of legal destruction.

By 2017, the criticism of ISDS reached a decibel level that could no longer be ignored. UNCITRAL Working Group III was formed to address the issue of whether ISDS reform was needed and, if so, to make recommendations for reform. But in recognition of the difficulty in reaching consensus on a full-blown model investment treaty, the mandate of the Working Group was limited to issues of procedure.⁵ This limitation is a

³ In 2021 alone, investors have brought at least three climate-related ISDS claims against European states. These are *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/4; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22; and *Discovery Global LLC v. Slovak Republic*, ICSID Case No. ARB/21/51. More are undoubtedly on the drawing board. See also the Keystone Pipeline case against the United States. *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, ICSID Case No. ARB/21/63.

⁴ See, for example, *Rethinking ISDS*, TDM 5 (2018), available at www.transnational-dispute-management.com/article.asp?key=2603; *The Inaugural Brooklyn Lecture on International Business Law: "ISDS: The Wild, Wild West of International Practice"*, 44 BROOK. J. INT'L L. 1 (2018), available at <https://brooklynworks.brooklaw.edu/bjil/vol44/iss1/1>; DAMAGES IN ISDS: JUST COMPENSATION OR HIGHWAY ROBBERY? WEBINAR HOSTED BY THE COLUMBIA CENTER ON SUSTAINABLE INVESTMENT (CCSI), November 2, 2020, available at <https://d20qsj1r5k97qe.cloudfront.net/news-attachments/George-Kahale-DAMAGES-IN-ISDS-Nov-2-2020.pdf>; *It's quantum!*, COLUMBIA FDI PERSPECTIVES NO. 314, September 20, 2021, available at <https://d20qsj1r5k97qe.cloudfront.net/news-attachments/George-Kahale-Its-Quantum-Columbia-FDI-Perspectives-September-2021.pdf>.

⁵ United Nations Commission on International Trade Law, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Thirty-Fourth Session (Vienna, 27 November-1 December 2017)*, U.N. Document No. A/CN.9/930, dated December 19, 2017, ¶ 20 ("It was also recalled that ISDS provided a method to enforce the substantive obligations of States. It was noted that critical questions on possible ISDS reform involved the underlying substantive rules. Nonetheless, it was clarified that the mandate given to the Working Group focused on the procedural aspects of dispute settlement rather than on the substantive provisions.").

source of frustration for states that have become progressively more disillusioned with and concerned about the dangers of ISDS. From their perspective, ISDS has not delivered the promised benefits in the form of substantial increases in FDI, at least not desirable FDI,⁶ but it has brought with it all the attendant risks of subjecting what normally would be considered ordinary and legitimate exercises of sovereign authority to the scrutiny of ISDS tribunals.

The camp of the frustrated and disillusioned is not confined to the capital importing countries. Rather, it now includes the traditional capital exporting countries of Europe, with the European Commission playing a leading role in the reform movement. That sea change in the attitude of capital exporting countries is not unrelated to the fact that European countries in recent years have unexpectedly found themselves in the position of respondent in so many ISDS cases – it is a lot easier for a state to see the downside of ISDS when it is on the receiving end of claims it never imagined possible. One might expect the United States to participate more actively in the reform movement if it happens to suffer its first ISDS defeat in the US\$15 billion dollar Keystone Pipeline case, but as schedules go in these cases, the outcome of that case is not likely to be seen for years.

Despite best efforts and good intentions, a realistic assessment of the current reform movement as embodied in UNCITRAL Working Group III is that no reform is imminent. Five years have already passed without any tangible result, and that might only be a midterm report. Moreover, particularly given the Working Group's limited mandate, one cannot be optimistic that any reform ultimately emerging would satisfactorily address the major concerns surrounding ISDS, and it is hard to see how any serious "procedural" recommendations proposed by the Working Group, including the proposals for a multilateral investment court, would be implemented. In the meantime, ISDS becomes more entrenched and the dangers it presents grow more serious with

⁶ See, e.g., Josef C. Brada, Zdenek Drabek and Ichiro Iwasaki, *Does Investor Protection Increase Foreign Direct Investment? A Meta-Analysis*, 35 JOURNAL OF ECONOMIC SURVEYS 34 (2020); Lorenz Reiter and Christian Bellak, *Effect of BITs on FDI: The Role of Publication Bias*, in HANDBOOK OF INTERNATIONAL INVESTMENT LAW AND POLICY (J. Chaisse, L. Choukroune and S. Jusoh eds., Springer 2020); Joachim Pohl, *Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence*, OECD WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2018/01 (OECD Publishing 2018), available at <https://doi.org/10.1787/e5f85c3d-en>.

each passing year. This is not bad news for the defenders and beneficiaries of ISDS, but it is for the real stakeholders in the system: the states that created it.

Why is all this important? Because ISDS tribunals are not merely deciding issues of international law for the textbooks; they are rendering awards that too often are not only inexplicable from a substantive standpoint but also shocking in amount. There was a time when a fifty million dollar award was considered huge. Now billion and even multibillion dollar claims are commonplace. Of course, not all end in awards against states, and not all awards against states are bad awards. But that is not the point. The size of claims in today's ISDS, coupled with the undeniable fact that some investor-friendly tribunals have not shied away from adopting novel and expansive theories of liability, poses a clear and present danger not only to respondent states but in some cases even to international peace and security. Every state finding itself on the wrong end of a particularly egregious mega-award can attest to that. Again, not all awards are egregious and not all are mega-awards, but far too many are, and even one is too many when the stakes are so high.

The impact of ISDS is not limited to states actually suffering a huge defeat. Anyone familiar with states' policy-making processes appreciates that the threat of an ISDS claim has a chilling effect on state action.⁷ The chill actually increases in accordance with the knowledge and experience of the state actors. Naturally, the more one is aware of a risk, the more concerned one becomes. This means that informed state officials around the world are factoring into their decision-making processes in virtually all matters that could have an impact on foreign investors the risk of an ISDS claim, which often costs millions to defend even if totally meritless and could have disastrous consequences if the defense does not succeed.

⁷ For recent climate-related examples, see, for example, Elizabeth Meager, *Cop26 Targets Pushed Back Under Threat of Being Sued*, CAPITAL MONITOR, January 14, 2022 (updated February 21, 2022), available at <https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/> ("Countries party to the Energy Charter Treaty are under yet more pressure to reform the agreement following the Cop26 climate summit, with Denmark and New Zealand admitting the threat of investor-state lawsuits has hindered their climate policy ambitions.").

There is no easy remedy for this situation. The reality is that ISDS is a system built to last, and the obstacles to meaningful change are formidable. The question then is: what is to be done or, as a practical matter, what can be done? That is what the OECD initiative should address as a matter of urgency. I would offer just a few basic suggestions:

- First, avoid the temptation to get bogged down in endless debate over the pros and cons of ISDS. Acknowledge that a problem exists, even if the solution is not readily apparent. The head-in-the-sand approach of simply denying the existence of a problem and seeing only virtue in ISDS is not credible. Absent acknowledgement of the fact that a problem exists, solutions will remain elusive.
- Second, the acknowledgement should be express and widely disseminated. Public declarations of concern from various corners, including academia, may not be binding, but they are useful in creating momentum for change and are often cited to ISDS tribunals to encourage them to exercise self-restraint when faced with the temptation to adopt overly expansive interpretations of concepts such as indirect expropriation and fair and equitable treatment.⁸ OECD declarations would carry even greater weight.
- Third, see if consensus can at least be reached on certain basic principles. For example, in the context of climate issues, it would be useful if consensus could be achieved on a declaration along the following lines: “It is understood and agreed that measures taken by states to mitigate the effects of climate change do not constitute expropriation or a violation of the fair and equitable treatment standard incorporated in

⁸ See, e.g., Public Statement on the International Investment Regime, August 31, 2010, *available at* www.osgoode.yorku.ca (“Awards issued by international arbitrators against states have in numerous cases incorporated overly expansive interpretations of language in investment treaties. . . . This is especially evident in the approach adopted by many arbitration tribunals to investment treaty concepts of corporate nationality, expropriation, most-favoured-nation treatment, non-discrimination, and fair and equitable treatment, all of which have been given unduly pro-investor interpretations at the expense of states, their governments, and those on whose behalf they act.”); 230 Law and Economics Professors Urge President Trump to Remove Investor-State Dispute Settlement (ISDS) from NAFTA and Other Pacts, October 25, 2017, *available at* https://www.citizen.org/wp-content/uploads/migration/case_documents/isds-law-economics-professors-letter-oct-2017_2.pdf; 220+ Law and Economics Professors Urge Congress to Reject the TPP and Other Prospective Deals that Include Investor-State Dispute Settlement (ISDS), September 7, 2016, *available at* <https://ccsi.columbia.edu/sites/default/files/content/docs/publications/isds-law-economics-professors-letter-Sept-2016.pdf>.

investment treaties.” If consensus cannot be reached on such simple principles without unduly complicated analysis, the prospects of any meaningful outcome from the OECD initiative are dim.

- Fourth, express concern over the proliferation of huge damage awards in ISDS cases, particularly those calculated based on the discounted cash flow methodology, which is inherently speculative and susceptible to abuse. In that regard, it is worth recalling the warning in the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment that “[p]articular caution should be observed in applying this method as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits.”⁹ That warning has gone unheeded by too many ICSID tribunals.
- Fifth, acknowledge that the foregoing are only baby steps that are not intended to foreclose or substitute for more radical change. States should be encouraged to undertake in-depth reviews of their own investment treaties to analyze whether they yield any significant, measurable benefits and, if not, to consider the action to be taken to avoid or mitigate the substantial risks of ISDS. Many states are already in the process of reevaluating their investment treaties with a view toward amending, interpreting or terminating them. This is a process that undoubtedly will and should continue, both within and outside of UNCITRAL Working Group III.

In sum, the OECD initiative is long overdue. The issues for consideration are not the traditional ones debated at ISDS conferences around the world. Rather, the initiative should address the fundamental question of whether states, either individually or collectively, should retain the exclusive responsibility for addressing the full range of issues of public interest, including climate change, or whether ISDS tribunals and the private participants in the system should be left to play an increasingly important role in directly or indirectly shaping policy and determining the consequences of policy decisions. At bottom, the question is whether states wish to cede a significant portion of their sovereignty to ISDS tribunals, giving them the authority to decide which state measures

⁹ LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT, VOLUME II: REPORT TO THE DEVELOPMENT COMMITTEE AND GUIDELINES ON THE TREATMENT OF FOREIGN DIRECT INVESTMENT (World Bank 1992), p. 26.

taken in the public interest are legitimate and to award billions of dollars in damages for those that they deem not to pass muster. If the answer is yes, then there is no need for action. If it is no, action is urgent.