**POTENTIAL SOLUTIONS FOR PHASE 3:**

ALIGNING THE OBJECTIVES OF UNCITRAL WORKING GROUP III

WITH STATES’ INTERNATIONAL OBLIGATIONS TO COMBAT CLIMATE CHANGE

**Introduction**

The United Nations Commission on International Trade Law (UNCITRAL) Working Group III has a broad mandate to work on possible reform of investor-state dispute settlement (ISDS). The Working Group has completed Phase 1, in which governments identified and considered concerns regarding ISDS, and Phase 2, where participating governments debated whether reform is desirable in light of those concerns. The third and final phase will involve the development of potential reform options.

The present briefing seeks to assist governments in identifying all potential solutions for reform. As the process moves forward, it is in fact essential for the Working Group to consider an expansive range of proposals that will preserve the regulatory space required by states to ensure consistency and coherency with their international obligations to achieve the Sustainable Development Goals and the targets that states have committed to under the 2015 Paris Climate Agreement.

In this briefing, ClientEarth will:

- outline the specific threat posed by ISDS on global climate change efforts;
- recall states’ international obligations to combat climate change and the institutional context of UNCITRAL Working Group III;
- suggest procedural reform options to address the negative impacts of ISDS on climate change policy and align the reform process with the international obligations of states.

1. **Risks posed by ISDS to the global fight against climate change**

The climate emergency is the most imminent and most serious threat to humanity. In October 2018, the Intergovernmental Panel on Climate Change (IPCC) issued a stark warning: the world’s governments have less than twelve years to take action to completely transform our energy systems in order to avert catastrophic climate change. By 2030, we must collectively reduce global greenhouse gas emissions by 45% and we must reach net zero by mid-century. The burning of fossil fuels is the most significant source of greenhouse gases and a rapid phase-out of coal, oil and gas is necessary to meet these objectives.

This means business as usual is simply no longer an option, particularly for the fossil fuel industry. Known fossil fuel reserves as well as associated infrastructure (e.g. pipelines, power plants) and other assets are increasingly at risk of becoming ‘stranded’. This risk is created as a result of government regulation (e.g. coal phase-out), technological innovation (e.g. alternative sources of energy), changes in societal norms and consumer behaviour (e.g. increased use of electric vehicles), and litigation (e.g. legal challenges resulting in court orders preventing pipeline construction in Indigenous territory).

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1 The Working Group agreed that, prior to developing project schedules, it is important for governments to first identify all potential solutions for reform. With respect to such potential solutions, “it was recalled that some were listed in document A/CN.9/WG.III/WP.149 and its annex. However, the Working Group agreed that other solutions could also be proposed,” ideally by July 15 via these submissions to the Secretariat. See Report of UNCITRAL Working Group III (Investor-State Dispute Settlement Reform) on the work of its 37th session (New York, 1–5 April 2019), A/CN.9/970, paragraph 83
2 United Nations, Transforming Our World: The 2030 Agenda for Sustainable Development (2015), A/RES/70/1
There is an estimated USD1-4 trillion worth of assets in the energy sector that may become stranded prior to 2050.6

Stranded asset risk is a financial risk that companies should take into consideration when making an investment decision. However, firms may attempt to shift this risk onto states by employing investment protections under international investment treaties. These bilateral and regional treaties were initially designed to ensure stability in the investment environment and provide extraordinary protections to foreign investors. If a firm considers that a domestic measure negatively affects its investment, it can use ISDS provisions to challenge states in relation to those measures. Investors with successful claims are awarded compensation, which can include ‘lost future profits.’

Any requirement for governments to pay compensation to aggrieved investors that are protected by international treaties will significantly increase the cost of the energy transition. Even the cost of participating in, and subsequently winning an ISDS case, can be very high for governments, especially in developing countries.7 As such, authorities may be discouraged from introducing or encouraged to revoke or dilute regulations because of the risk, threat or initiation of legal action by an investor before an ISDS tribunal. There is a growing body of evidence demonstrating this “regulatory chill” effect of ISDS on public interest measures.8 Research also increasingly indicates that foreign investors may want to use ISDS mechanisms as a strategic tool to challenge and delay emission-reduction policies.9 The Canadian oil and gas company Vermilion did just that in 2017, when it threatened to sue France under ISDS if it pushed ahead with the law to phase-out fossil fuel extraction in all French territories drafted the French Environment Minister. 10

It is impossible to quantify how many regulations have been affected by the threat of arbitration. However, it is unquestionable that the ISDS system has given rise to an alarming number of claims against environmental measures, which are now the fastest-growing trigger for disputes.11 Investors have challenged environmental measures such as a nuclear power phase-out,12 a refusal of permits

8 IEA and IRENA 2017, Perspectives for the Energy Transition: Investment Needs for a Low-Carbon Energy System
9 For example, in the ISDS case brought by tobacco giant Philip Morris against an Australian health policy, the government’s legal fees and arbitration costs amounted to almost AUD24 million. Although Australia won the case, Philip Morris was only required to pay fifty percent of these costs. Uruguay fought a similar ISDS case against the same company (and also won) but was only able to do so because it had received financial support from a philanthropic organisation to cover some of its costs. See further Ranald, P. (2019) “The costs of losing an ISDS case against a strong and rich investor: the Philip Morris Canada;” Van Harten, G. and Nadine Scott, D. (2016) Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study of the Australian Tobacco Plain Packaging Law,” in Global Investors/Government Confrontation in Arbitration: Contemporary Issues and Future Directions, Alan B. Schwartz (ed), Oxford University Press, 2016.
12 The law was subsequently gutted, although it is not possible to determine the role that ISDS played in influencing the Minister on the basis of available evidence. See Corporate Europe Observatory, the Transnational Institute and Friends of the Earth Europe/International (2019) “Red carpet courts: 10 stories of how the rich and powerful hijacked justice”, June 2019, www.10isdsstories.org
14 Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No. ARB/12/12 ; the case was settled
relating to a cyanide-based open pit gold-mine, environmental restrictions on a coal-fired power plant, a moratorium on fracking, and a ban on offshore oil drilling.

While the record of ‘wins’ and losses is mixed, arbitrators in many cases have demonstrated a lack of understanding of the complexities of environmental governance. As noted by Bonnitcha and Williams, “Investors regularly characterize state conduct as ‘political’ in order to discredit the conduct in question” and “many tribunals regard influence of broad interest groups over executive decision-making processes as inherently illegitimate.” Despite overwhelming scientific evidence indicating the urgent need for action on climate change, there is no consensus on the best approach to reducing emissions. Addressing climate change is an inherently political process and governments will have to balance a number of competing interests when determining the best course of action.

The range of climate change related measures that will inevitably and necessarily affect energy and extraction businesses is extremely wide: removal of fossil fuel subsidies, introduction of carbon taxes, stricter emissions standards and electric vehicle mandates, denial of permits for exploration and development, transport or use of coal, gas or petroleum resources, and planned phase-out of certain energy sources. The arbitration industry has already recognized this as an area for future growth in legal practice.

Two recent cases have illustrated how investors in the fossil fuel industry may seek to use ISDS to discourage or halt climate-friendly policies, or to secure payouts as governments strive to move to a low carbon economy. In TransCanada v. United States, a Canadian company sued the United States over the Obama administration’s rejection of a proposal to build the controversial Keystone XL pipeline to transport oil produced from Alberta’s tar sands to various refineries on the Gulf Coast. The decision to reject the pipeline was influenced by a very significant grassroots campaign and a desire by the administration to demonstrate climate leadership in the run-up to the Paris conference in 2015. TransCanada argued that this meant the review process had been inappropriately “politicized”. The case was discontinued following President Trump’s executive order allowing construction of the pipeline project to move ahead.

Another case, Westmoreland v. Canada, is ongoing. Westmoreland invested in several ‘mine-mouth’ coal mines (which feed directly into coal-fired power stations) in the province of Alberta in 2013. At the time, many jurisdictions, including within Canada, were looking at ways to reduce their reliance on coal-fired power. Westmoreland would have been well aware of this. In 2015, Alberta’s New Democratic Party committed to phasing out coal-fired power by 2030. Without the infrastructure to export coal, the climate plan has also resulted in a de facto phase-out of local thermal coal mining. To

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13 Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania, ICSID Case No. ARB/15/31
14 Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/06
15 Lone Pine Resources Inc. v. The Government of Canada, ICSID Case No. UNCT/15/2
22 TransCanada Corporation and TransCanada PipeLines Limited v. The United States of America, ICSID Case No. ARV/16/21. TransCanada withdrew its claim case against the US following President Trump’s executive order allowing construction of the Keystone XL pipeline to move ahead
23 Ibid, at p.6.
ensure support for the plan, major utility companies (all Canadian-owned) in the province were provided with ‘transition payments’ to facilitate the switch to gas and renewable energy. As it was not an energy provider and was not being asked to convert its operations to gas and renewable energy as part of a transition plan, Westmoreland did not receive transition payments from the government. The company is arguing in its ISDS claim that this amounts to discrimination and unfair treatment from the Alberta government. The company is essentially aiming to transfer the cost of its poor business decision, which did not properly consider stranded asset risk, to the Canadian public.

Although these are both examples from the Global North, the risk of ISDS is particularly acute for developing countries which have less capacity and resources to fight lengthy and expensive ISDS cases. Data on existing ISDS cases indicates that the majority of claims are brought by investors from high-income countries (86.25%) against upper-middle-income (42.15%) and lower-middle-income (24.26%) countries. Data also indicates that oil, gas, and mining firms launch more cases than firms from any other sector.

Developing countries are also the most vulnerable to the effects of climate change and may be confronted by ISDS cases related to their efforts to adapt to sea-level rise and other impacts. For example, requiring foreign investors to relocate facilities or to purchase additional insurance to cover extreme weather events could result in ISDS claims.

2. Phase 3 of UNCITRAL Working Group III: consistency with other international obligations

The Working Group discussions are framed and organized around four broad categories of concerns requiring reforms: lack of consistency, coherence, predictability and correctness of arbitral decisions; arbitrators and decision makers; cost and duration of ISDS; and third-party funding.

The Working Group also noted the importance of taking into account a number of aspects raised during the discussion of other concerns during its 37th session. These cross-cutting issues will be considered in Phase 3 of the Working Group, as it explores and develops its tools for reform, so that the solutions will be considered legitimate by all relevant stakeholders:

- consideration of means other than ISDS to resolve investment disputes;
- exhaustion of local remedies;
- participation of local communities affected by the investment dispute to ensure that relevant issues are presented and considered, beyond submissions as third-parties;
- possibility to bring counterclaims where there is a legal basis for doing so;
- regulatory chill of ISDS as a guiding principle for the work of Phase 3 on solutions; and
- calculation of damages.

As noted by Van Harten, Kelsey, and Schneiderman, “Despite the breadth of the UNCITRAL mandate and the concerns expressed by Member States and others, the scope of this reform has so far been

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29 The Working Group reiterated that this conclusion “did not preclude other concerns to be identified and dealt with at a later stage of the deliberations”. See Report of Working Group III on the work of its 37th session, paragraph 39
30 Ibid, paragraph 29
31 Ibid, paragraph 30
32 Ibid, paragraphs 31–33, noting that some – but not all – of these concerns could be addressed as a matter of inconsistency and incorrectness
33 Ibid, paragraphs 34-35
34 Ibid, paragraphs 36-37
35 Ibid, paragraph 38
In particular, the discussions have failed to systematically address the potential for inconsistency between investment treaty protections and broader societal objectives and commitments found in other areas of domestic and international law. As Working Group III begins Phase 3, it is therefore important that states’ deliberations are guided by their obligations to protect the environment, including those laid out in the Paris Agreement.

On December 12, 2015, 197 parties (196 states and the European Union) demonstrated the need to take urgent and significant action by signing the Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC). Under this agreement, parties are required to take urgent climate action to keep global warming well below 2 degrees Celsius (°C) above pre-industrial levels. The legitimacy and effectiveness of the ISDS reform process will thus not only depend on UNCITRAL’s fulfilment of its mandate but also on states’ commitment to align the reform with their obligations to meet Paris Agreement targets.

Moreover, consistent with UNCITRAL’s status as a UN agency, any solutions arising from Phase 3 must advance the UN’s objectives, most recently articulated in the Sustainable Development Goals (SDGs). Specifically, SDG 13 requires urgent action to combat climate change and its impacts, notably through, *inter alia*, integration of climate change measures into national policies, strategies and planning. SDG 17 commits states to pursue policy and institutional coherence, including in the international economic environment, and to “respect each country’s policy space and leadership to implement policies for poverty eradication and sustainable development, while remaining consistent with relevant international rules and commitments.” A letter from seven UN independent experts and special rapporteurs on 7 March 2019, in advance of the Working Group’s April 2019 session, reminded Member States of these obligations.

Furthermore, in identifying credible, durable and effective solutions, the Working Group must ensure that it develops solutions that will effectively and legitimately address important concerns that have triggered the urgent calls and need for reforms – these concerns must not be ignored. In particular, the issues of the asymmetry of the system, the relationship of ISDS with national courts and regulatory chill must all be properly addressed.

In this context, ClientEarth has considered possible procedural reform options to address the negative impacts of ISDS on climate change policy, and align the reform process with the international obligations of states. The proposed options could be taken into consideration by the Working Group when developing tools for addressing the concerns about inconsistency and incorrectness of decisions. Each proposal falls within the mandate of Working Group III and is based on examples of ISDS reforms that have already been undertaken by individual states.

### 3. Options to address the negative impacts of ISDS on climate change policy and align the reform process with states’ international obligations

**Option 1 – Terminating investment treaties and moving away from ISDS**

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38 Paris Agreement, Article 2(1)(a)


42 See International Institute for Environment and Development (IIED) and CCSI, “Shaping the Reform Agenda: Concerns Identified and Cross-Cutting Aspects”, Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, July 2019
Working Group III should develop a mechanism to allow countries to easily move away from traditional investment treaties and ISDS.\(^\text{43}\) For example, the Working Group could recommend that states negotiate a multilateral “exit” agreement that allows the coordinated termination of investment treaties and the invalidation of “sunset” or “survival” clauses that could extend the life of treaties up to twenty years beyond termination.\(^\text{44}\) This latter aspect is critical in the context of climate change, given the very short timeline available for government action to keep warming well below 2°C.

States would still have the option to provide protection to investors through their domestic legislation, enforceable exclusively before domestic courts. The role of the international community would be to provide resources to help states develop their administrative, legislative and judicial capacities to ensure that domestic court systems can offer all parties fair and unbiased access to justice.

Alternatively, the multilateral instrument could provide a mechanism for states to withdraw consent to ISDS under existing investment agreements, leaving them bound by the substantive obligations and accountable through state-state dispute settlement. Preferably, this would be coupled with a requirement for investors to first exhaust local remedies. State-state dispute settlement is a less risky option from a climate change perspective, as states would arguably be less likely to challenge certain types of measures needed to achieve the goals of the Paris Agreement, particularly if they are party to it (as most are).

In addition to local remedies and state-state dispute settlement, political risk insurance is an obvious market-based solution for investors to guard against investment risks. Where an investor is concerned about the legitimacy and independence of a domestic court system, it should purchase risk insurance to underwrite any costs such as through the Multilateral Investment Guarantee Agency of the World Bank.\(^\text{45}\) This insurance can protect against costs incurred as a result of, amongst other things, political changes, legal uncertainty and expropriation within the host state.

These proposals may sound radical, but in reality, a substantial amount of termination and removal of ISDS from treaties is already occurring. Key global economies like Indonesia, India, and South Africa have overhauled their investment treaties. Other countries such as New Zealand and Brazil have a policy not to include ISDS in their international investment agreements. The renegotiated North American Free Trade Agreement largely removes the possibility of ISDS between Canada and the United States. ISDS is also unavailable in the Australia–United States FTA, the Australia-Japan FTA, the Japan–Philippines FTA, the EU–Japan FTA and the EU–Mercosur FTA. According to 2018 UNCTAD statistics, 107 investment agreements containing ISDS have been terminated and not replaced in recent years.\(^\text{46}\) A coordinated multilateral approach would be preferable to this time-consuming effort on the part of individual states.

**Option 2 – Adopting a legal tool-box**

For states that are not ready to withdraw consent or terminate their treaties, ClientEarth proposes the following five procedural options, which when combined should ensure that only responsible investors who respect international climate commitments can utilize ISDS. Protecting investment should not be an end in itself, but rather a step towards the achievement of the Paris targets and SDGs. It is crucial that states ensure that the ongoing UNCITRAL process is consistent with the spirit of and delivers on the fundamental objective reflected in the Preambles to many international investment agreements: to attract *quality* foreign direct investment that advances the development and wellbeing of host states, principally developing States and Least Developed Countries.

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\(^{43}\) See CCSI, “Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements”, submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, July 2019


\(^{45}\) The website of the Multilateral Investment Guarantee Agency can be found at https://www.miga.org/

\(^{46}\) UNCTAD IIA Issues Note, “Recent Developments in the International Investment Regime” (May 2018), http://investmentpolicyhub.unctad.org/Publications/Details/1186
1. Carve-out all government measures taken in pursuit of international obligations under the Paris Agreement on climate change from challenge under ISDS

Based on the evidence that a large number of ISDS cases have been brought in relation to environmental regulation, and the specific threat posed by fossil fuel industries challenging efforts to address climate change, it is of paramount importance to clarify that regulatory changes required to respond to the climate emergency cannot be interpreted as a breach of an investment treaty. Because of the longstanding scientific consensus around anthropogenic climate change and its impacts, as well as international action on it (1992 UNFCCC, 1997 Kyoto Protocol and Paris Agreement), investors can only have expected progressively more stringent national regulation in this area.

ClientEarth therefore recommends that the members of Working Group III develop a procedural mechanism similar to that proposed in respect of the dismissal of frivolous claims. A “climate carve-out” would require the dismissal of any claim that challenged a good-faith climate mitigation or adaptation measure, as determined by an independent panel of climate change experts. Such a mechanism would concern only the jurisdiction of arbitral tribunals. This proposal does not require changes to any substantive rules and therefore falls squarely within the procedural mandate of Working Group III.

The carve-out would apply to any measure linked to the objective and principles of or commitment to the UNFCCC. Relying on the language of UNFCCC would allow the climate carve-out to apply to a wide range of state measures relating to climate change mitigation and adaptation. By ruling out the possibility of ISDS cases on climate change measures, the carve-out would practically eliminate the risk of regulatory chill, including any cross-border chilling effect. The carve-out could also be expanded to include a broader set of public interest laws and policies.

2. Require exhaustion of local remedies

Working Group III should recommend that investors be required to exhaust local remedies. The ability of investors to challenge a state directly in an ISDS tribunal, without at least resorting to domestic courts first, is an anomaly in international law and inconsistent with the approach in international human rights law and customary international law.

In the context of climate change mitigation, governments will have to make difficult trade-offs when developing and implementing energy transition plans and compensation schemes for affected industries and workers. Having to do this against the backdrop of a possible ISDS claim makes it more difficult for governments to proceed and arrive at solutions tailored to their domestic situations. Requiring investors to exhaust local remedies will lead to better outcomes, because it will provide domestic courts with an opportunity to balance commercial and non-economic concerns in accordance with the domestic legal system.

In addition, Working Group III should recommend that if a domestic court finds that a law, rule, regulation or guideline is non-discriminatory and/or was issued in compliance with SDGs or obligations

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under the Paris Agreement, this finding should be treated as conclusive and bar the filing of an ISDS case before any international tribunal.

There are existing clauses on exhaustion of local remedies for the Working Group to draw on. US and Canadian investors in Mexico will have to exhaust local remedies prior to launching an ISDS dispute under the proposed United States–Mexico–Canada Agreement.\(^{51}\) Clauses on exhaustion of local remedies are also found in the Indian Model Bilateral Investment Treaty (BIT) and the Southern African Development Community Model BIT.

3. **Allow counterclaims and ensure full participation for affected third parties**

Working Group III should recommend procedural rules that facilitate states’ counterclaims and ensure participation rights of affected third parties, particularly in relation to the environmental impacts of investors, including their contribution to climate change.\(^{52}\)

Some tribunals have already recognized the right of states to bring counterclaims. For instance, arbitrators in the *Urbaer v Argentina* case interpreted the Spain–Argentina BIT as implicitly permitting counterclaims by the state on the basis of human rights violations.\(^{53}\) This tribunal not only accepted the procedural possibility for the host state to bring a counterclaim but also accepted that the cause of action of the counterclaim can be grounded in a separate legal regime. The *Aven v Costa Rica* dispute is also worth noting in this context. Although the tribunal in that case did not accept Costa Rica’s counterclaim, it did confirm the basis for counterclaims more generally and noted that the case for investors being subjects of international law was “particularly convincing when it comes to rights and obligations that are the concern of all states, as it happens in the protection of the environment.”\(^{54}\)

Unfortunately, rulings such as these are not the norm: counterclaims are generally unsuccessful in the absence of explicit language in the applicable investment treaty. Working Group III should recommend procedural rules authorizing the presentation of counterclaims by the host state even in the absence of express language in the investment treaty in order to avoid any ambiguity in this respect. These rules should make it clear that the domestic obligations of the investors, including with respect to the environment, form part of the law to be applied by the tribunal in assessing the merits of the counterclaims.

Furthermore, the Working Group should propose expanding the scope of jurisdiction of dispute settlement to allow tribunals to hear claims by investors and states, but also ensure full participation rights by affected third parties beyond amicus curiae. Although important and valuable, the submission of amicus briefs alone does not provide sufficient participation for affected parties to ensure that their rights and interests are properly accounted for in proceedings.

ISDS reforms should contribute to making investment arbitration fairer and more inclusive. Opening up the jurisdiction of tribunals in this way would also ensure that dispute settlement could cover breaches of investor obligations (e.g. related to environmental protection, human rights, and free prior and informed consent) that may be contained in future investment treaties.\(^{55}\) This is a necessary part of

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52 See also CCSI and IIED, “Third Party Rights in Investor-State Dispute Settlement: Options for Reform”, Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, July 2019


54 David Aven et al. v Republic of Costa Rica, Final Award, ICSID Case No UNCT/15/3, 18 September 2018 (Aven et al.) at 738.

55 The Report of Working Group III on the work of its 37th session noted that any work by the Working Group would need to take into account developments in investment treaties, so that the solutions developed by the Working Group are flexible enough to adapt to a rapidly changing international policy context. See Report., paragraph 40
making the system more balanced and making it a forum that protects the rights of all, not just those of corporations.56

4. Ban third party funding

A growing industry composed of speculative investors is financing the legal costs of corporations in ISDS cases in return for a share of the payout if the arbitration tribunal rules in their favour. So-called third-party financing is an emerging trend, although it remains difficult to estimate the exact scale of it in ISDS given the lack of rules around disclosure. ISDS cases involving extractive projects, including in the fossil fuel sector, are likely to be particularly attractive to third-party financiers due to the potential for large payouts.57

The main problem with third-party financing, as highlighted by Guven and Johnson, is that it “has the effect of facilitating and encouraging suits against governments” and is likely to “exacerbate current concerns about undue regulatory chill.” The Working Group should therefore propose a ban on third-party financing as a way to reduce the chilling effect of ISDS and exposure of states to costly proceedings where they may not recover their full costs even if they defeat the claim.58

5. Include climate change impacts in the calculation method for compensation

Finally, the Working Group should recommend the development of clear procedural rules and guidance for tribunals on how climate change should be taken into account in the calculation of damages. At present, in cases of (indirect or direct) expropriation, many BITs adopt the standard of “prompt, adequate and effective” compensation, which is typically considered equivalent to the notion of “fair market value”.59 However, as noted by Nikièma “In certain situations, compensation equal to the fair market value of the investment may be inappropriate or unjust.”60 ClientEarth believes that one such situation is when the investment is expropriated (or otherwise impacted) by a government in order to address climate change. This is particularly relevant in cases where the owner of the investment has made concerted efforts (e.g. lobbying, funding climate change denial, etc.) to delay action on climate change.

This issue is currently being debated in the UK, where the Labour Party has released a manifesto outlining plans to nationalise the energy network in order to speed the transition to a low carbon economy.61 The Labour Party has indicated that the British Parliament should determine the level of compensation paid to any companies that are nationalised and that it should consider issues such as stranded assets and state subsidies provided since privatisation. Such an approach would likely mean a payment for expropriation that is far below “fair market value.”62 Legal firms have been quick to point out that this would be challenged by investors in ISDS.63

60 Ibid
An alternative to the traditional compensation requirement for expropriation is found in the Southern African Development Community Model BIT, which clarifies that in calculating “fair and adequate” compensation, arbitrators should take into account all relevant circumstances and “must be based on a fair balance between the public interest and the interests of the injured parties.” Building on this model, procedural reforms should clarify methods for calculating damages by dictating that arbitrators must take into consideration the fact that the public interest in measures to address climate change far outweighs the interest of private investors. This is especially true in the case of fossil fuel investments, which have caused immense damage to the global environment at the same time as delivering extraordinary profits to firms.

More generally, the size of ISDS awards is at the heart of concerns over the chilling effect of ISDS on public interest regulation. With ISDS awards in the hundreds of millions (and even billions) of dollars, the sheer magnitude allows investors to “exert significant pressures on public finances and create potential disincentives for public-interest regulations.” Excluding expectation of gain or profit from recoverable damages would help to put foreign and domestic investors on a more equal footing. It would improve investment decision-making (i.e. by increasing the risk associated with investing in new carbon-intensive projects); and would also limit the ability of investors to use the threat of liability to prevent a country from implementing climate change measures.

Conclusion

We are running out of time to take the necessary action to completely transform our energy systems in order to avoid catastrophic climate change. Governments must therefore expeditiously remove any obstacles that could prevent or delay the adoption of emission reduction policies or other mitigation measures. Phase 3 of UNICTRAL Working Group III provides a unique opportunity for states to push for a systemic reform of ISDS so that it does not harm their efforts and international commitments to tackle climate change under the Paris agreement.

Ahead of the next Working Group meeting, governments should therefore carefully consider the proposals outlined above and encourage the identification of additional innovative solutions to deliver systemic reform.

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64 Southern African Development Community (SADC) Model BIT, Article 6.2; See also Schneiderman’s discussion of appropriate or flexible compensation in “Reviving the ‘Lost Art’ of Exit: Thinking About Substitutes for International Investment Law”, https://papers.ssm.com/sol3/papers.cfm?abstract_id=3382060

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