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Investor–state dispute settlements: a hidden handbrake on climate action

Policy pointers

Climate Conferences of the Parties should provide clear policy guidance on realigning investment governance with climate goals.

States should deepen and accelerate reform of investment protection treaties and ISDS.

Options include: terminating old treaties; removing ISDS provisions from existing treaties; and excluding climate measures or fossil fuel investments from ISDS.

There is also a need to make contract-based ISDS more transparent and broaden ISDS reform debates to include contract-based proceedings.

To achieve the Paris Agreement's climate goals, states must move away from fossil fuels. But investor–state dispute settlement (ISDS) — a system that enables companies to take states to international arbitration — can increase the cost of this transition. Our research shows that fossil fuel companies have historically secured at least US$82.8 billion in damages and large sums continue to be invested in fossil fuels worldwide. To address this problem, investment governance must be harmonised with global climate goals.

To tackle climate change, the Paris Agreement sets the goal of keeping the global temperature rise well below 2°C above pre-industrial levels, with efforts to limit warming to 1.5°C. But if we are to limit the temperature increase to 1.5°C, we have already exhausted around four-fifths of the total carbon budget; and if we continue emitting at 2019 levels, we will deplete the remaining budget by around 2030.[1]

It is clear that addressing climate change will require comprehensive efforts to move away from fossil fuels. According to the United Nations, "fossil fuels — coal, oil and gas — are by far the largest contributors to global climate change, accounting for over 75 percent of global greenhouse gas emissions and nearly 90 percent of all carbon dioxide emissions".[2] And as the Intergovernmental Panel on Climate Change noted, continuing to operate existing fossil fuel infrastructure in line with historical patterns without extra abatement would generate enough emissions to breach the 1.5°C carbon budget.[3]

ISDS can make it more costly — and thus more difficult — for states to transition away from fossil fuels. Investment protection treaties require states to protect foreign investment within their territory. Most treaties allow foreign investors to bring disputes to ISDS if they consider the state has breached its treaty obligations. Many national laws and investment contracts also allow investors to bring disputes to arbitration, if they consider the state has breached contractual obligations or investment protections in national law. Arbitral tribunals can order states to pay investors large amounts in damages if they find violations.

This system enables foreign investors to challenge state conduct they claim adversely affected their interests. Our research finds that over the years, investors have brought at least 1,721 arbitrations under applicable treaties, contracts and laws. But this number is probably much higher, as the existence of arbitrations is not always publicly known. The overwhelming majority of investment protection treaties were concluded before the Paris Agreement.[4] These treaties protect both high- and low-emission investments. Meanwhile, petroleum contracts and national laws applicable to coal mining and hydrocarbon projects often include arbitration clauses.

ISDS can make it more costly — and thus more difficult — for states to transition away from fossil fuels

As a result, the system protects fossil fuel assets against state action. Fossil fuel companies have frequently resorted to ISDS and secured billions of dollars in damages.[5] Even without ISDS claims, the possibility of recourse to ISDS could enable fossil fuel businesses to secure greater compensation in negotiations with states — for example, in coal phaseouts.[6] States phasing out, restricting or regulating fossil fuel sectors face the risk of expensive compensation bills. Concerns about investor claims have already hindered progressive countries' ambitions to end oil and gas exploration.[7]

Towards a more fine-grained picture

This research follows from the 2021 report by Lea Di Salvatore, 'Investor–State Disputes in the Fossil Fuel Industry'.[5] It developed a dataset of all known ISDS cases, based on data from the United Nations Conference on Trade and Development's ISDS Navigator, complemented with data from the International Centre for Settlement of Investment Disputes (ICSID), the Energy Charter Treaty and the Investment Arbitration Reporter databases. Due to the large number of cases, we primarily relied on information from the databases, with minimal review of primary documents, but conducted additional research where the databases presented insufficient information.

Our dataset covers claims based on the treaties, as well as those based on contracts and national laws, but information about the latter two is substantially more limited than the former. We identified 349 investor–state disputes related to fossil fuel projects, constituting 20.3% of all arbitrations reviewed. In other words, one in five investor–state arbitrations is initiated to protect a fossil fuel investment.

Paying the biggest polluters

Our data show that, to date, ISDS has granted fossil fuel businesses at least US$82.8 billion: over US$74 billion in awards and close to US$8.7 billion through settlement. This is roughly equivalent to the gross domestic product of 45 of the world's poorest or smallest countries put together.[8]

These figures are likely to substantially underestimate the real scale of the challenge. Of the US$82.8 billion, US$77 billion were granted through claims based exclusively on an investment protection treaty, US$2 billion through arbitrations based exclusively on a contract or national law, and the rest relates to cases based on multiple legal instruments. But only 57% of the treaty-based awards listed in our dataset have been publicly disclosed. For claims based on a contract or a national law, this award disclosure rate is as low as 38%, while only 9% of the settlement agreements in our dataset have been publicly disclosed. There are also likely to be many other arbitrations which are not publicly known, particularly those conducted on the basis of contracts or under ad hoc rules. For some known arbitrations, the databases we consulted provide outcome and amount even if the award or agreement itself has not been publicly disclosed. But this lack of transparency means that our figures may not include substantial amounts paid in damages or settlements to the fossil fuel industry.

Participating in ISDS can itself be expensive. If we consider the average legal cost associated with participating in an arbitration (estimated at US$4.7 million for respondent states),[9] the cases would entail an additional US$1.6 billion in costs. Interests accrued after the awards will further increase the figures. In addition, the figures only include liabilities arising directly from ISDS cases; they do not include compensation that fossil fuel businesses may have secured through negotiations influenced by the (even implicit) threat of ISDS.[10]

Several 'carbon majors' are among the fossil fuel investors in our dataset. Defined as the world's 100 most-polluting fossil fuel companies, these businesses are together responsible for 71% of the global industrial greenhouse gases emitted since 1751.[11] Of the total amount awarded to fossil fuel investors, carbon majors or their subsidiaries have been granted US$20.5 billion through ISDS. This number only reflects the outcome of 23 cases for which the amount awarded or settled is publicly known; and just 40% of concluded case outcomes involving carbon majors in our dataset are publicly known. The figure is therefore likely to be a substantial underestimation of the total amount awarded to carbon majors.

Insights into trends in claims

Over half of these claims are initiated to protect an investment in the upstream segment of fossil fuel supply chains, which includes operations to find and extract new coal, gas and oil resources (Figure 1). Yet, extracting new fossil fuel

Figure 1. ISDS claims filed, by supply chain segment

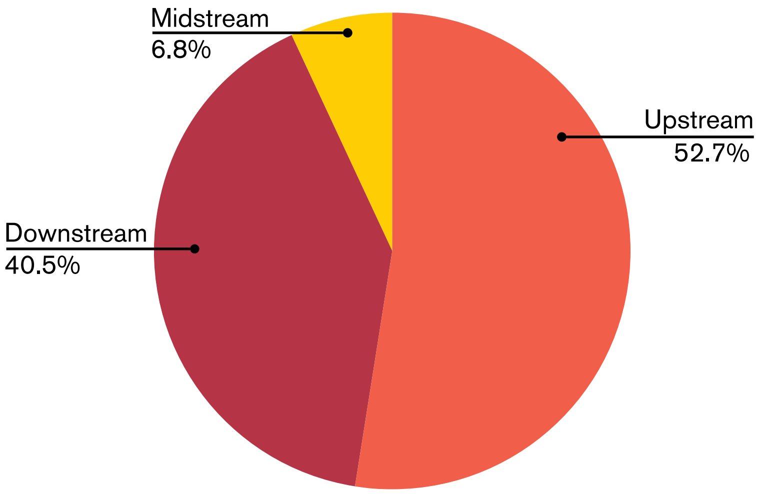


Figure 2. Top ten claimant home countries

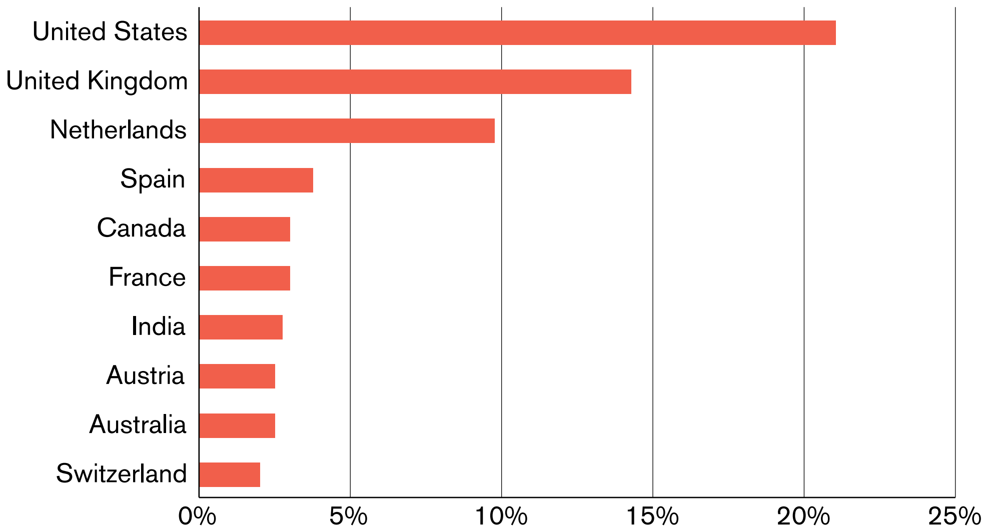
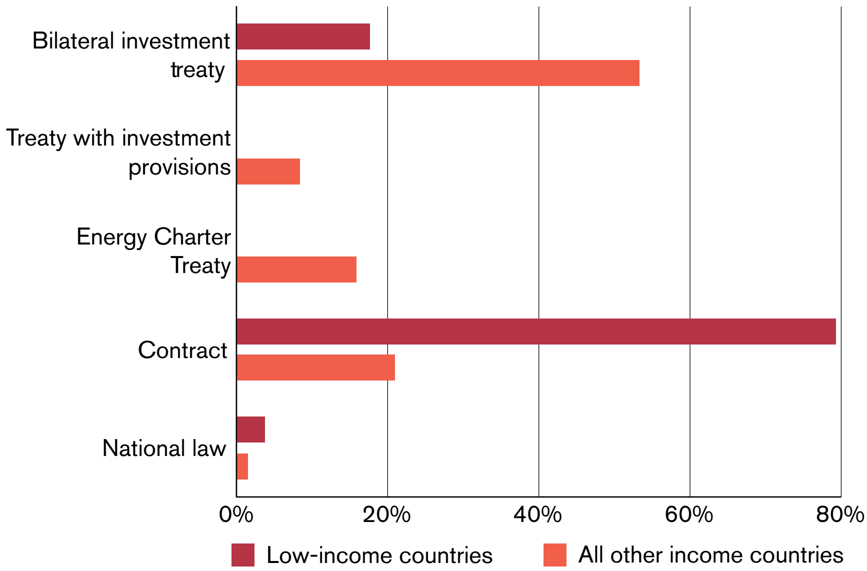


Figure 3. Legal instruments used in the claims



resources is incompatible with net zero pathways,[12] and as already noted even fully operating existing fossil fuel infrastructure would place the planet beyond the 1.5°C Paris target.

Looking at the geographical spread of the fossil fuel investors bringing claims against states, most are based in high-income countries, with businesses incorporated in just five of these — the United States, United Kingdom, Netherlands, Spain and Canada — accounting for 51% of fossil fuel claims, and US investors alone initiating more than 20% of the claims (Figure 2).

On the other hand, many of the states affected by these claims are low-income countries, particularly in contract-based proceedings. Nearly half of the claims are based on bilateral investment treaties, and almost 15% are based on the Energy Charter Treaty — the most-used international agreement. And although only 30% of ISDS claims are contract-based, almost 80% of these are initiated against low-income countries (Figure 3).

Fossil fuel investors have challenged a range of measures in proceedings, from taxation to nationalisation and environmental protection. As climate change becomes a more pressing policy priority, climate-related disputes are on the rise. For example, in a case against the Canadian government under the North American Free Trade Agreement,[13] a US company reportedly claimed US$20 billion for the cancellation of a project to build a natural gas liquefaction facility after the authorities denied environmental permits based on the calculation of greenhouse gas emissions.[14]

Of the 118 cases where an arbitral tribunal reached a merits decision, over 75% were decided in favour of the investor. None of the claims initiated by a carbon major has been decided in favour of the state; though in one case, liability was found but no damages awarded. In addition to the claims that failed on the merits, states managed to get an additional 28 arbitrations dismissed on jurisdictional grounds, and information is missing on whether a further four cases were dismissed based on jurisdiction or merits. Another 67 cases were settled and 92 are pending. The remainder have either been discontinued, abandoned or withdrawn, or there are no public data available for them.

Conclusion

The prior ISDS caseload provides insights into the scale of the challenge. But beyond past cases, the large sums invested in fossil fuels worldwide, the aggregate scale of potential investor claims and the narrow time window available for climate action present an unprecedented challenge in investment treaty policy.[15] The prospect of complex legal proceedings and the large amounts that may be awarded to fossil fuel businesses create a hidden handbrake on climate action, and any serious effort to tackle climate change must address ISDS.

There is a compelling case for deepening and accelerating reform of the international investment protection system. While much debate has focused on investment treaties and treaty-based ISDS, contract-based claims disproportionately affect low-income countries, highlighting the case for enhancing transparency in contract-based arbitration and broadening reform efforts to contract-based ISDS.

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Knowledge Products

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Notes

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