



Submission to the OECD Consultation on Aligning Investment Treaties with Climate Action

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We are grateful for the opportunity to comment on the OECD Secretariat's note 'Methods to align investment treaty benefits for energy investment with the Paris Agreement and Net Zero' (the Note).² As the impacts of climate change become increasingly evident and the window to prevent catastrophic climate harm narrows, the need for decisive policy action has never been more urgent. The Note is a step forward in aligning investment policy with climate objectives. We particularly welcome the sample text provided in the annexes, which offers tangible policy options grounded in existing treaty practice. In this submission, we highlight comments regarding the justification for reform, the need for a multilateral approach and the policy options identified in the Note.

The case for reform

Supporting implementation of the Paris Agreement and keeping the temperature increase below 1.5°C requires aligning with climate goals the global system of investment treaties and investor-state dispute settlement (ISDS).³ Investment treaties do not differentiate between high- and low-carbon investments. While there is no evidence that the treaties are effective in promoting investment,⁴ investment promotion is their stated policy aim, often reflected in the title of the treaties, their preamble and any objectives clauses. The treaties establish particularly stringent standards of investment protection, relative to those available in many jurisdictions, creating a preferential legal regime for foreign investment.⁵ In economic terms, the free availability of compensatory relief for political risks amounts to state-subsidised insurance. A global system of legal instruments aimed at promoting climate-harmful investments through special protections and subsidised benefits is inherently at odds with climate goals and the Paris Agreement.

¹ This submission was drafted by Lorenzo Cotula with inputs from Thierry Berger. Jesse Coleman provided helpful comments on an initial draft.

² *Methods to Align Investment Treaty Benefits for Energy Investment with the Paris Agreement and Net Zero* (OECD, 26 June 2024), [https://one.oecd.org/document/DAF/INV/TR1/WD\(2024\)1/REV1/en/pdf](https://one.oecd.org/document/DAF/INV/TR1/WD(2024)1/REV1/en/pdf).

³ UNCTAD and IIED, *International Investment Agreements and Climate Action* (2022), https://unctad.org/system/files/non-official-document/IIED_UNCTAD_IAs_climate_action.pdf.

⁴ Joachim Pohl, *Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence* (OECD 2018), <https://doi.org/10.1787/e5f85c3d-en>.

⁵ For a fuller discussion, see Lorenzo Cotula, 'International Investment Law and Climate Change: Reframing the ISDS Reform Agenda' (2023) 24(4–5) *Journal of World Investment & Trade* 766–791, https://brill.com/view/journals/jwit/24/4-5/article-p766_9.xml. See also Anil Yilmaz Vastardis, 'Justice Bubbles for the Privileged: A Critique of the Investor-State Dispute Settlement Proposals for the EU's Investment Agreements' (2018) 6(2) *London Review of International Law* 279–297.

The fossil fuel industry has been an active user and major beneficiary of the ISDS system, accounting over time for about a fifth of overall claims and having been granted at least US\$82.8 billion in awards and settlements.⁶ Worldwide, the investment treaty system protects extensive fossil fuel assets. In 2020, an IIED research report developed a methodology to map investment treaty coverage of fossil fuel assets and found that at least 75% of foreign-owned coal power plants worldwide are protected by at least one investment treaty with ISDS.⁷ Subsequent studies that further developed this methodology documented extensive investment treaty coverage across coal, oil and gas sectors.⁸ Besides enabling actual ISDS claims, the investment treaty system enhances leverage for fossil fuel businesses in negotiations with governments over the terms of energy transition measures; ‘as a result, more public funds may be spent on compensating the fossil fuel sector than would otherwise be the case, making it more costly — and thus more difficult — for states to take energy transition measures’.⁹

In 2022, the IPCC noted the potential chilling effect of investment treaties on climate action, with measures potentially shelved or delayed.¹⁰ In addition, the large amounts often awarded in damages to the fossil fuel industry can divert public funding from investments in the energy transition and climate resilience. They can also divert resources from relief for other actors, such as social protection for workers in industries that become obsolete, undermining prospects for a *just* energy transition.¹¹

The need for a multilateral approach

Reforming the over 2500 bilateral and regional investment treaties currently in force requires coordinated action at the *multilateral* level. Climate change is a global problem. As the Note correctly highlights, ‘any investment treaty that unduly promotes emissions affects everyone’,

⁶ Lea Di Salvatore, Lorenzo Cotula, Anirudh Nanda and Chloe Yuqing Wang, *Investor-State Dispute Settlements: A Hidden Handbrake on Climate Action* (IIED and Columbia Center for Sustainable Investment 2023), <https://iied.org/21971iied/>. The figures include known ISDS claims based on contracts as well as treaties. See also Lea Di Salvatore, *Investor-State Disputes in the Fossil Fuel Industry* (International Institute for Sustainable Development 2021), <https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf>.

⁷ Kyla Tienhaara and Lorenzo Cotula, *Raising the Cost of Climate Action? Investor-State Dispute Settlement and Compensation for Stranded Fossil Fuel Assets* (IIED 2020), <https://pubs.iied.org/17660IIED/>.

⁸ E.g. Kyla Tienhaara, Rachel Thrasher, B. Alexander Simmons and Kevin P. Gallagher, ‘Investor-State Disputes Threaten the Global Green Energy Transition’ (2022) 376 *Science* 701-703; Kyla Tienhaara, Rachel Thrasher, B. Alexander Simmons and Kevin P. Gallagher, ‘Investor-State Dispute Settlement: Obstructing a Just Energy Transition’ (2022) 23(9) *Climate Policy* 1197–1212; Eunjung Lee and Jordan Dilworth, *Investment Treaties Are Undermining the Global Energy Transition: Mapping the Global Coverage of ISDS-Protected Fossil Fuel Assets* (E3G 2024), <https://www.e3g.org/publications/investment-treaties-are-undermining-the-global-energy-transition/>.

⁹ Tienhaara and Cotula (2020), *supra*, p. 1. A similar framing is found in European Parliament Resolution of 23 June 2022 on the Future of EU International Investment policy (2021/2176(INI)), https://www.europarl.europa.eu/doceo/document/TA-9-2022-0268_EN.html, para. 24. See also Bart-Jaap Verbeek, ‘The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?’ (2023) 8(1) *Business and Human Rights Journal* 97-102; Alessandra Arcuri, Kyla Tienhaara and Lorenzo Pellegrini, ‘Investment Law v. Supply-side Climate Policies: Insights from Rockhopper v. Italy and Lone Pine v. Canada’ (2024) 24(1) *International Investment Agreements* 193-216.

¹⁰ IPCC, *Climate Change 2022: Mitigation of Climate Change: Working Group III Contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (Intergovernmental Panel on Climate Change 2022), https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf, section 14.5.1.3.

¹¹ Cotula (2023), *supra*.

meaning that ‘governments have climate policy interests in every investment treaty, not merely their own’ (para. 25). This shared global interest makes multilateral solutions particularly relevant. In addition, renegotiating and amending the many bilateral and regional treaties one by one would be impractical, time-consuming and in many cases politically difficult. On the other hand, a multilateral legal instrument can make it easier for states to participate in the reform – and remove or phase out investment treaty benefits from fossil fuel assets more swiftly and effectively.

As the Note recognises (para. 26), the legal technology for multilateral action to amend a large number of bilateral treaties is available and has already been used effectively in other policy areas. There is a compelling case for efforts aimed at aligning the investment treaty system with climate goals to harness this legal technology to its full potential. As climate change is a global concern and the investment treaty system links together states well beyond OECD membership, it is crucial that the process to develop a multilateral legal instrument is inclusive – open to states irrespective of OECD membership and with effective opportunities for non-state actors to contribute evidence and analysis.

Comments on the policy options

We welcome the exploration in the Note of a wide range of policy options, including the option of a multilateral legal instrument to terminate existing investment treaties (Annex C). Many treaties currently in force were negotiated in a different era; they do not reflect consideration of climate change or other pressing contemporary challenges, nor the evidence now available about the societal costs of existing treaties and the failure of those treaties to meet their stated development objectives.¹² Multilateral termination would enable states to systemically remove outdated treaties and develop a new system of international investment governance that responds to contemporary realities and challenges, including climate change.¹³ Existing state practice, for example within the European Union, highlights that termination is a legitimate policy option that OECD members have already been pursuing. Existing practice also offers insights from concrete experiences of coordinated action to terminate treaties. Deactivating the survival clauses contained in many investment treaties is a key part of effective termination.

Annex B outlines three options for a climate-related carve-out,¹⁴ focusing on the total or partial exclusion of fossil fuel investments from the application of investment protections and/or ISDS. This path reflects a narrower approach that does not fundamentally address the systemic issues associated with investment treaties and ISDS. While the science is clear on the key contribution of the fossil fuel sector to climate change, other economic activities are also major contributors

¹² Pohl (2018), *supra*.

¹³ Cotula (2023), *supra*; Martin Dietrich Brauch, Elena Klonsky, Fanny Marie Everard and Qiaozi Guanglin, with Tyler Alviano, Justin Cuddihy and Mary Wang, *An International Law Framework for Climate-Aligned Investment Governance* (Columbia Center on Sustainable Investment 2024), <https://ccsi.columbia.edu/sites/default/files/content/docs/publications/ccsi-international-law-framework-climate-aligned-investment-governance.pdf>; Josef Ostřanský and Jonathan Bonnitcha, *Rethinking Investment Treaties: A Roadmap* (International Institute for Sustainable Development 2024), <https://www.iisd.org/publications/report/rethinking-investment-treaties-roadmap>; Nicolás Perrone, *International Investment Agreements and Climate Change: What is the Role that International Investment Agreements Play in the Transition to a Green Economy?* (Asia-Pacific Economic Cooperation 2024), https://www.apec.org/docs/default-source/publications/2024/7/224_ieg_international-investment-agreements-and-climate-change.pdf?sfvrsn=180ff367_1.

¹⁴ Joshua Paine and Elizabeth Sheargold, ‘A Climate Change Carve-Out for Investment Treaties’ (2023) 26(2) *Journal of International Economic Law* 285-304.

of greenhouse gas (GHG) emissions.¹⁵ A fossil fuel carveout would not address concerns about ‘regulatory chill’ in sectors other than fossil fuels, which can also affect the pace and depth of broader climate action. More generally, a reform limited to carving out fossil fuel investments would not address the continued impact of ISDS on public budgets, which can indirectly undermine the ability of low- and middle-income countries to mobilise public resources for investments in climate adaptation and mitigation measures.

Option 1 excludes the application of ‘substantive investment protection provisions’ to fossil fuel investments. This option would require greater clarity on its precise scope (including through a more explicit definition of ‘substantive investment protection provisions’) and on its implications in a dispute settlement context (explicitly excluding the application of ISDS as well as of the substantive protections). Further, Option 1 does not expressly address issues related to the admission of foreign investment; insofar as some existing treaties provide access to ISDS in relation to pre-establishment obligations, this option could still expose states to potential claims from fossil fuel businesses.

Option 2 excludes the application of ISDS to fossil fuel investments, leaving open the possibility of state-state dispute settlement. This approach does not remove fundamental inconsistencies with climate goals, as the amended investment treaties would still be aimed at promoting investments that are climate harmful (as well as those that are not). However, the amendment would reduce the practical import of these inconsistencies, by removing access to the dispute settlement element. Applying the carveout to both substantive and dispute settlement elements would be a more coherent approach.

Option 3 restricts continued access to ISDS for fossil fuel investments to certain investment protection standards (direct expropriation, national treatment and most-favoured-nation treatment). Besides the problems of an even narrower approach to addressing climate change concerns, this option would require complementary text to safeguard its effectiveness, even within the narrow scope of its own parameters. For example, the inclusion of most-favoured-nation treatment within the scope of consent to ISDS, without commensurate caveats, might allow investors to rely on benefits from other investment treaties which would otherwise be excluded under the amended treaty. Existing treaty practice includes experience with addressing such problems. An alternative, stricter approach to Option 3 would limit ISDS to claims related to denial of justice under customary international law.

Across all the three options, a clear and comprehensive definition of the sectors covered is essential to ensure effectiveness of the reform and to avoid uncertainties that could lead to higher numbers of claims. In order for the definition clauses (Annex A; Annex B Article 10) to be effective, for example, they would need to expressly include both direct and indirect fossil fuel investments (e.g. direct and indirect shareholdings in companies holding fossil fuel assets). The OECD has conducted extensive analytical work on shareholder claims, which can provide a solid foundation for thinking through these issues.¹⁶

Clarity on the temporal application of the reform would also be essential, particularly the extent to which the amendments apply to existing fossil fuel investments, or only to investments made

¹⁵ IPCC, *Synthesis Report: Summary for Policymakers* (Intergovernmental Panel on Climate Change 2023), https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf, para. A.1.4.

¹⁶ David Gaukrodger, *Investment Treaties and Shareholder Claims for Reflective Loss: Insights from Advanced Systems of Corporate Law* (OECD 2014), <https://doi.org/10.1787/5jz0xvngn3-en>. See also Anil Yilmaz Vastardis, *The Nationality of Corporate Investors under International Investment Law* (Bloomsbury 2020); and Julian Arato, Kathleen Claussen, Jaemin Lee and Giovanni Zarra, ‘Reforming Shareholder Claims in Investor-State Dispute Settlement’ (2023) 14(2) *Journal of International Dispute Settlement* 242–258.

after the reform comes into effect between the relevant states. As currently formulated, the text is ambiguous on this point, though footnote 20 in the Note indicates that the text is intended to only apply to new fossil fuel investments made after the effective date. This approach would greatly reduce the effectiveness of the reform: scientific evidence shows that GHG emissions from operating *existing* fossil fuel infrastructure according to historical trend, without additional emission reduction measures, would exceed the 1.5°C carbon budget.¹⁷

¹⁷ IPCC, *Climate Change 2023: Synthesis Report* (Intergovernmental Panel on Climate Change 2023), https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_LongerReport.pdf, section 2.