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Financing the Net Zero Transition: Opportunities and Limits of International Investment Law

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Outline

1. Clarification of terms
2. How much investment is needed to finance the net zero transition?
3. What kind of investment is needed?
4. The role of international investment treaties and/or national (investment) law
    1. Investment definition
    2. Market access conditions
    3. Investment facilitation
    4. Investor obligations

Learning objectives

- Understand the implications of the net zero transition for the global economy and international investment law
- Consider the role of international investment agreements (IIAs) in supporting the net zero transition
- Appraise the relationship between international investment law and national/unilateral FDI regulation

Climate objectives

SDGs and Paris Agreement

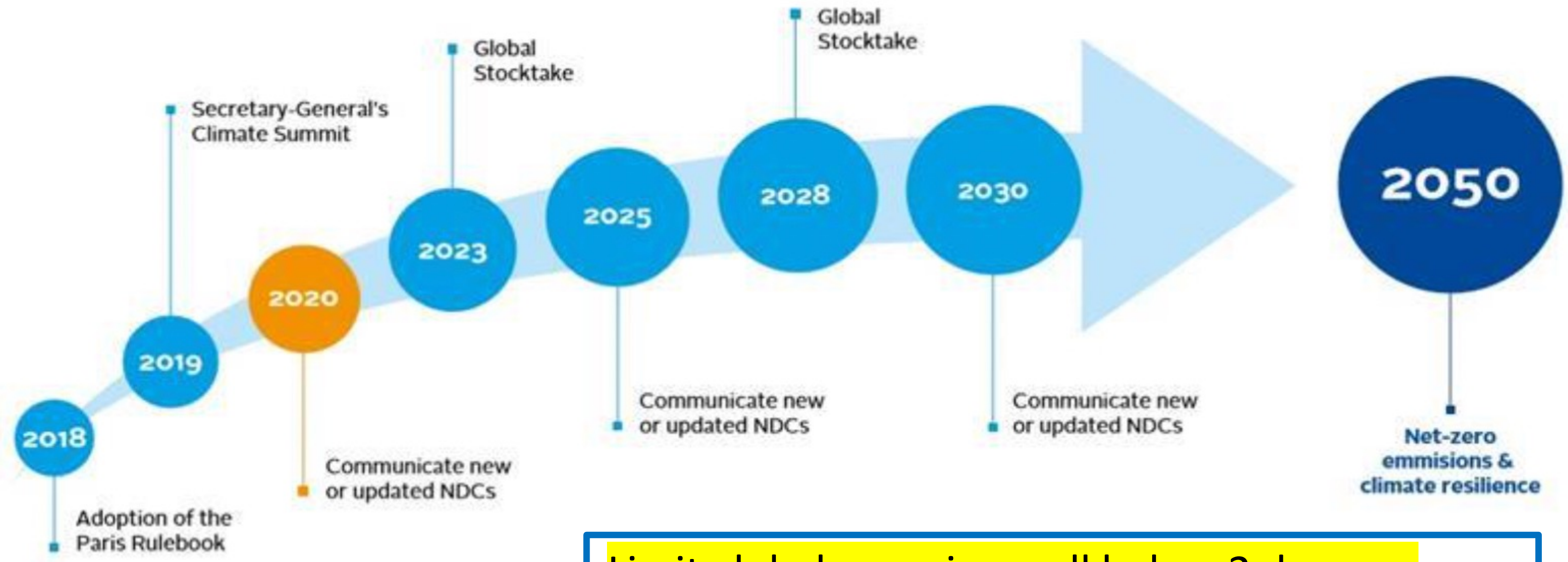
Climate action has two main dimensions:

- **Mitigation** by preventing and minimising the causes of climate change
- **Adaptation** by anticipating and taking measures to deal with the damages caused by climate change

United Nations Framework Convention on Climate Change

Climate objectives

Figure 3: Ambition mechanism in the Paris Agreement



Limit global warming well below 2 degrees Celsius but effort aimed at 1,5 degrees Celsius by the end of the century

Net zero

'Net zero' means achieving a balance between the amount of emissions produced and those removed from the atmosphere in order to reduce global warming.

Net zero is not zero carbon

→ Science has shown that human production of greenhouse gases, such as carbon dioxide, determines the overall extent of global warming. As a result, governments across the world have agreed to try and achieve net zero emissions by 2050 as part of the 2015 Paris Agreement.

Net zero and decarbonization

- Carbon dioxide (CO_2) is the primary greenhouse gas*
- The primary source of carbon dioxide emission is burning fossil fuels (i.e., coal, oil and gas)
- Decarbonisation involves increasing the prominence of low-carbon power generation, and a corresponding reduction in the use of fossil fuels.
- This involves the (increased) use of renewable energy sources like wind power, solar power, and biomass.
- The use of carbon power can also be reduced through large-scale use of electric vehicles alongside ‘cleaner’ technologies.

*Other greenhouse gases next to carbon dioxide are methane (CH_4), nitrous oxide (N_20), and fluorinated gases: Hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride are synthetic,

Getting to net zero carbon emissions by 2050

Suggested policy measures (top five)

1. Increase solar and wind capacity (renewable energy)
2. Eliminate most electricity generation from coal / promote clean fuels
3. Increase zero-emission vehicle sales share
4. All new buildings and appliances meet strict energy efficiency goals
5. R&D for carbon capture, sequestration and carbon-neutral fuels

https://newscenter.lbl.gov/2021/01/27/getting-to-net-zero-and-even-net-negative-is-surprisingly-feasible-and-affordable/

Financing climate action and energy transition

Renewable energy production and infrastructure

- Solar / Photovoltaic (PV)
- Water management
- Transmission & distribution
- Hydroelectric
- Biomass
- Wind
- Energy efficiency

The energy transition – a "green" transition?

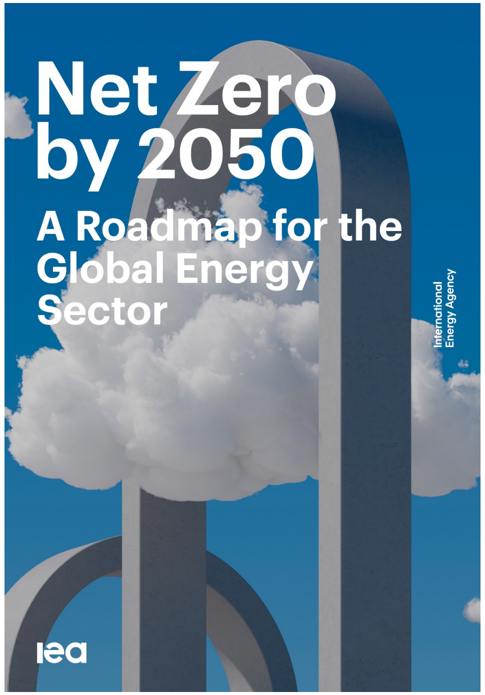
- The energy transition is a *pathway* toward transformation of the global energy sector from fossil-based to low-carbon.
- The energy transition brings about *significant structural change* in an energy system regarding supply and consumption.
- Renewable energy sources are at the center of the ongoing energy transition.

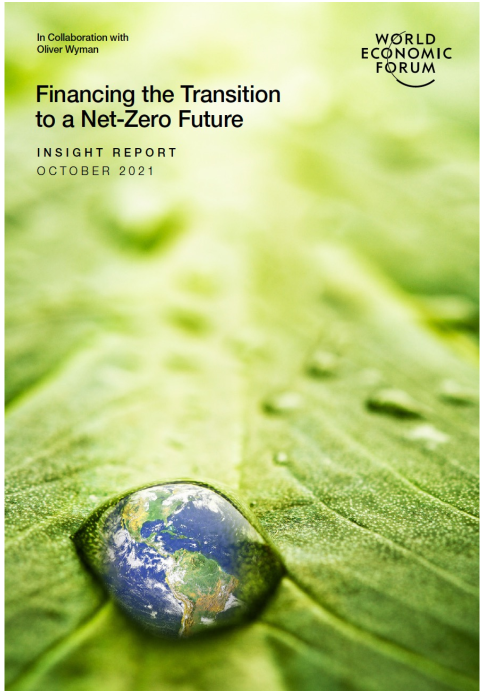
The energy transition – a “green” transition?

- The energy transition seeks growth opportunities by decoupling economic growth from fossil fuels.

- ”Green” growth is the idea that economic growth and development can be fostered, while ensuring that natural assets continue to provide the resources on which our societies rely.

Financing the Net Zero Transition





Financing the Net Zero Transition by 2050

- The goal of net zero by 2050, means **$125 trillion** of climate investment is required by 2050 (UN, 'Race to Net Zero')

- Approximately **$50 trillion** in investments is required by 2050 to transition the global economy to net-zero emissions and avert a climate catastrophe (Energy Transitions Commission, 2020)

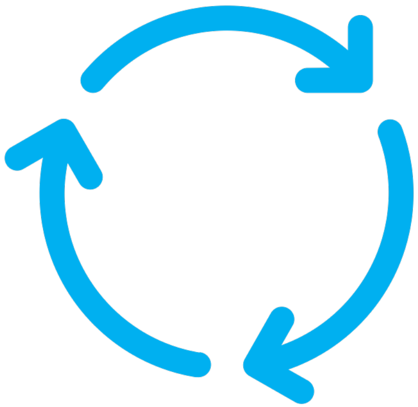
- **$275 trillion of spending on physical assets** would be needed over the next three decades to achieve net zero by 2050 (McKinsey, 2022)
- Approximately **$9.2 trillion per year**, would be needed between 2021 and 2050. This is equivalent to about **7.5% of GDP** over the period (McKinsey, 2022)

Financing the Net Zero Transition

- Much of the financing will come from the public sector but the private sector is central to finance higher investment needs.

- The Glasgow Financial Alliance for Net Zero (GFANZ) estimates that the private sector will provide 70% of the net zero financing.

- Improvements in regulatory and policy frameworks would facilitate the international flow of long-term capital to support the development of both new and existing clean energy technologies (International Energy Agency)



What is the role of international investment law?

Three functions of international investment agreements

1. Protecting foreign investment whilst safeguarding the right to regulate of States, namely regulatory measures to protect the environment or the climate.

2. Promoting sustainable investments. Hence not “subsidizing” unsustainable investments.

3. Cooperation between States international investment for the net zero transition.

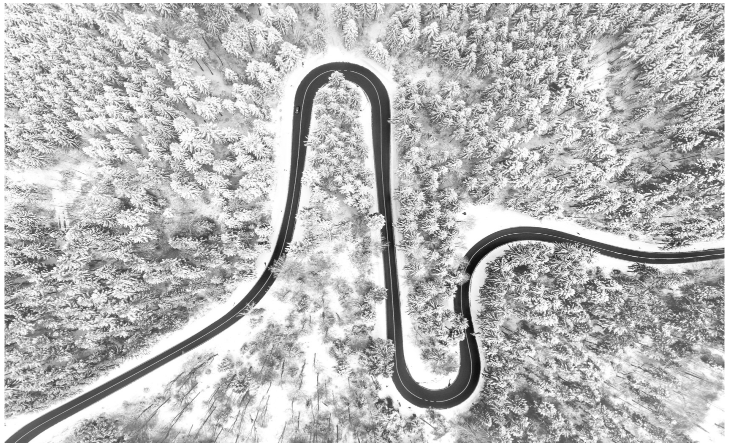
Harnessing investment for sustainable development

FDI does not automatically support sustainable development, it depends on the following factors:

- Type of investment
- Motives of investment
- Entry mode of investment
- Corporate culture of investor
- Institutional and regulatory framework of host state

Overview

- Investment definition
- Market access
- Investment facilitation
- Investor obligations



Investment definition

- E.g., EU IIAs, CETA, Art 8.1*
- Any investment is "good" investment

investment means every kind of asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, which includes a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

(a) an enterprise;

(b) shares, stocks and other forms of equity participation in an enterprise;

(c) bonds, debentures and other debt instruments of an enterprise;

(d) a loan to an enterprise;

(e) any other kind of interest in an enterprise;

(f) an interest arising from:

(i) a concession conferred pursuant to the law of a Party or under a contract, including to search for, cultivate, extract or exploit natural resources,

(ii) a turnkey, construction, production or revenue-sharing contract; or

(iii) other similar contracts;

(g) intellectual property rights;

(h) other moveable property, tangible or intangible, or immovable property and related rights;

(i) claims to money or claims to performance under a contract.

For greater certainty, **claims to money** does not include:

(a) claims to money that arise solely from commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to a natural person or enterprise in the territory of the other Party.

(b) the domestic financing of such contracts; or

(c) any order, judgment, or arbitral award related to sub-subparagraph (a) or (b).

Returns that are invested shall be treated as investments. Any alteration of the form in which assets are invested or reinvested does not affect their qualification as investment;

* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01)#d1e2889-23-1

Investment definition

Connecting the definition with (sustainable) development
E.g., Indian Model BIT (2015)

“investment” means an enterprise constituted, organised and operated in good faith by an investor in accordance with the law of the Party in whose territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the Party in whose territory the investment is made. An enterprise may possess the following assets: (...)

Connecting the definition with sustainable development

- Practical hurdles that appeared in arbitral case law
  - Uncertainty in how to determine whether an investment / FDI activity contributed to the host State's development → practical feasibility problem
  - Concept of development is very broad → legal predictability problem

- *Salini v Morocco*: Salini test "objective assessment"
- *Patrick Mitchell v Congo*: essential/jurisdictional criteria
- *Saba Flakes v Turkey*: three criteria sufficient
- *Ambiente Ufficio v Argentina*: flexible criteria
- Key question: are these *fixed* or *flexible* criteria?

Investment definition

”Revolutionary idea” 

- Imagine a treaty that allows each state party to choose which sectors, sub-sectors or activities qualify for that party as “sustainable investment” by outlining them in its schedule to Annex I.

- Similarly, each state party lists sectors, sub-sectors or activities it will consider as “unsustainable investment” for purposes of the treaty and outlines them in its schedule to Annex II.

Investment definition

TREATY ON SUSTAINABLE INVESTMENT FOR CLIMATE CHANGE MITIGATION AND ADAPTATION*

* This Treaty and the accompanying Argumentation were prepared as part of a submission to the Stockholm Treaty Lab prize, an innovation contest for the drafting of a forward-looking, innovative and workable model treaty that aims to encourage investment in climate change mitigation and adaptation. The contestant team *The Creative Disrupters* comprises international law advisers (Martin Dietrich Brauch, Nathalie Bernasconi-Osterwalder, Howard Mann, Mintewab Afework Abebe, Maria Bisila Torao Garcia, Temur Potaskaevi and Gus Van Harten), senior economists (Aaron Cosbey and Ivetta Gerasimchuk), policy advisers (Yanick Touchette, Lourdes Sanchez, Erica Petrofsky and Karin Treyer) and communications experts (Katherine Clark and Ziona Eyob). The opinions expressed, the arguments employed and the approaches adopted in this submission—including the draft Treaty and the accompanying argumentation document—do not necessarily reflect those of the International Institute for Sustainable Development (IISD) or other affiliations of team members.

https://www.iisd.org/publications/treaty-sustainable-investment-climate-change-mitigation-adaptation

- List of sustainable investments
- List of unsustainable investments
- Category of non-classified investments

Annex I: Sustainable Investment

1. The Schedule of a Party to this Annex sets, pursuant to Article 1.1: Definitions, the listed sectors or sub-sectors considered by that Party to meet the criteria for Sustainable Investment.

2. Each listing sets out the following elements:

   (a) **Sector** refers to the general sector in which the listing is made;

   (b) **Sub-sector** refers to the specific sector in which the listing is made;

   (c) **Industry classification** refers, where applicable, to the activity covered by the reservation according to domestic industry classification codes;

   (d) **Description** sets out the scope of the sector, sub-sector or activities covered by the listing.

Annex I: Schedule of Party A [illustrative example]

Sector:	Manufacture of electrical equipment
Sub-Sector:	Manufacture of batteries and accumulators
Industry classification:	ISIC Rev 4 2720

Investment definition

Pros and cons of investment classification in an IIA:

- Determination of what are sustainable and unsustainable investments are defined by the treaty parties
- In line with sustainable development and the bottom-up approach of the Paris Agreement
- Practical hurdles
  - Too restrictive, hard to be accepted
  - Level-playing field
- Fall-back option: legality requirement combined with investment definition
  - In order to be a "covered investment", the investment must be made in accordance with host state law

Investment definition

- E.g., EU IIAs, CETA, Art 8.1*
- If covered investment then IIA protection, including ISDS
- E.g., *Cortec Mining v Kenya:* Approved EIA

covered investment means, with respect to a Party, an investment:

(a) in its territory;

(b) made in accordance with the applicable law at the time the investment is made;

(c) directly or indirectly owned or controlled by an investor of the other Party; and

(d) existing on the date of entry into force of this Agreement, or made or acquired thereafter;

* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01)#d1e2889-23-1

Market access and investment liberalization

What is market access?

- Narrow meaning: GATS (Art. XVI(2))
- Broad meaning: any factor affecting the attractiveness of investment

Market access and investment liberalization

Which IIA provisions have an impact on market access?

- Market access rights
- Liberalization commitments in national treatment and most-favored nation clause (MFN)
- Prohibition of performance requirements

- Note:
    - Schedules define the scope of market access
    - Two approaches: negative list and positive list

EU CETA	CPTPP	Pan-African Investment Code
E.g., national treatment (art. 8.6) Each Party shall accord to an investor of the other Party and to a covered investment, treatment no less favourable than the treatment it accords, **in like situations** to its own investors and to their investments **with respect to the establishment**, acquisition, expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.	*E.g., national treatment (art. 9.6)* Same Plus footnote: “For greater certainty, whether treatment is accorded in “like circumstances” […] depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.	*E.g., national treatment (art. 9.3)* Same Plus list: “[…] examination, on a case-by-case basis, of all the circumstances of an investment, including, among others: a. its effects on third persons and the local community; b. its effects on the local, regional or national environment, the health of the populations […] ; c. the sector […] ; d. the aim of the measure […] ; …

Market access and investment liberalization

Most regulation of foreign entry is governed by national law, both the reduction of barriers and the conditions for entry (OECD, 2022)

National law

- Lower entry barriers for “green” investments
- Introduce barriers for “unsustainable” investments

Investment Act of Namibia (2016), Section 4 ('Powers and functions of Minister') provides in this respect:

"2) The Minister may approve the investment proposal after having considered and satisfied himself or herself that:

a. the conditions set out in section 14 have been met; and
b. a substantial number of the following requirements, as each case may require, are fulfilled or likely to be fulfilled in a specified period:

i. the joint venture with Namibians;
ii. the employment creation for Namibians;
iii. the contribution of the investment to the advancement of persons who have been socially, economically or educationally disadvantaged by past discriminatory laws and practices;
iv. the contribution of the investment to the implementation of programmes and policies aimed at redressing social and economic imbalances in Namibia, including gender-based imbalances;
v. the transfer of technology and technological skills;
vi. the development of managerial skills;
vii. the promotion of research, development and innovation;
viii. the value addition to the natural resources and manufacturing sector and procurement of goods and services;
ix. the environmental impact and contribution to environmental benefits; and other matters relating to the improvement of the economy and development benefits in the public interest as the Minister may prescribe."

Investment Canada Act, R.S.C. 1985, c. 28 (1st Supp.), §20.

a) the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;
b) the degree and significance of participation by Canadians;
c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
d) the effect of the investment on competition within any industry or industries in Canada;
e) the compatibility of the investment with national industrial, economic and cultural policies;
f) the contribution of the investment to Canada's ability to compete in world markets.

Investment Facilitation

What is investment facilitation?

- According to UNCTAD, "[i]nvestment facilitation is the set of policies and actions aimed at making it easier for investors to establish and expand their investments, as well as to conduct their day-to-day business in host countries".

- More concretely, investment facilitation measures can include improvements in transparency and information available to investors; more efficient and effective administrative procedures for investors; and enhanced predictability and stability of the legal and policy environment for investors.

Investment Facilitation

- Brazilian CIFAs
- WTO Investment Facilitation Framework for Development
- EU-Angola Investment Agreement

Investment facilitation typically done by states at the national level

Some question the added value of investment facilitation commitments at the international level?

Article 5.5 EU-Angola Investment Facilitation Agreement

1. The Parties recognise the importance of taking urgent action to combat climate change and its impacts, and the role of investment in pursuing this objective, consistent with the UN Framework Convention on Climate Change (UNFCCC), the purpose and goals of the Paris Agreement adopted by the Conference of the Parties to the UNFCCC at its 21st session, and with other MEAs and multilateral instruments in the area of climate change.
2. Each Party shall:

(a) effectively implement the UNFCCC and the Paris Agreement adopted thereunder, including its commitments with regard to its Nationally Determined Contributions;

(b) promote the mutual supportiveness of investment and climate policies and measures thereby contributing to the transition to a low greenhouse gas emission, resource-efficient economy and to climate-resilient development.

Article 2 of the Philippines Investment Law :

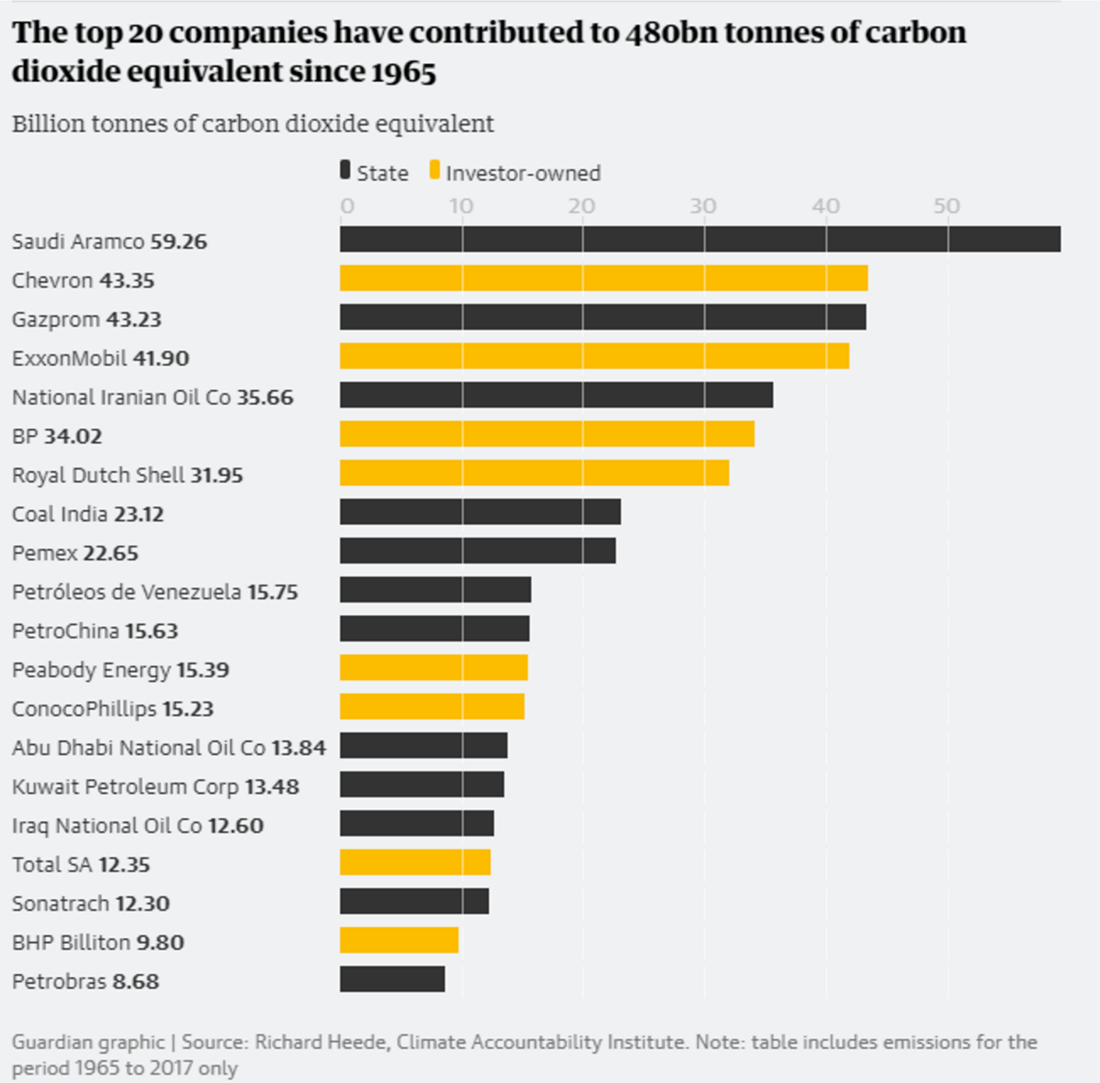
“Foreign investments shall be encouraged in enterprises that significantly expand livelihood and employment opportunities for Filipinos; enhance economic value of farm products; promote the welfare of Filipino consumers; expand the scope, quality and volume of exports and their access to foreign markets; and/or transfer relevant technologies in agriculture, industry and support services”.

Corporate responsibility

In your opinion, do companies have a responsibility in the fight against climate change?

SMU Classification: Restricted

Fossil fuel industry

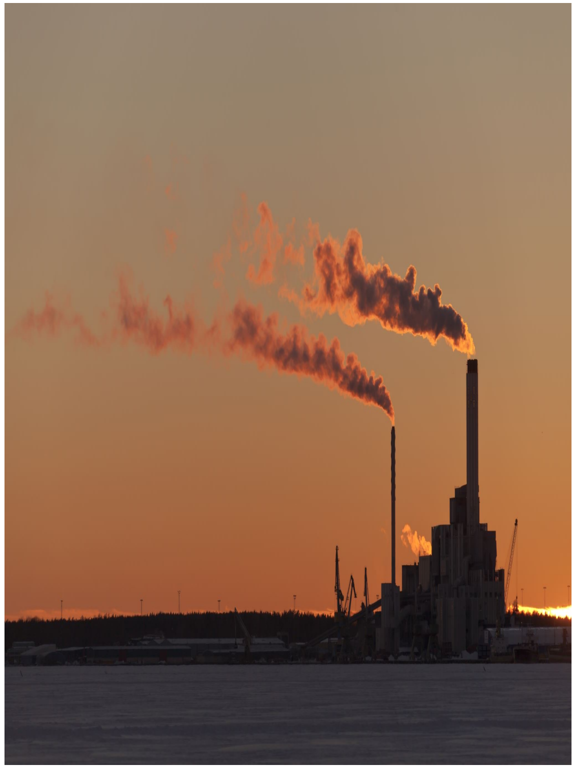


Regulatory gap

- Multilateral Environmental Agreements (MEAs)
  - Addressed to States
  - Few exceptions (e.g., 1960 Convention on Civil Liability for Oil Pollution Damage Ships oil spills)
- Human Right Treaties
  - Addressed to States
  - Potential exception: Legally Binding Treaty on Business and HR (ongoing negotiations)
- International Trade and/or Investment Agreements
  - Addressed to States
  - Very few of the international investment agreements that are in force contain obligations that are directly addressed to corporations/the investor

CSR in IIAs

- Direct obligations (not common in IIAs)
- Indirect obligations → best-endeavor commitments to promote:
  - OCED Guidelines for Multinational Enterprises
  - UN Global Compact:
  - UN Guiding Principles
  - ILO Tripartite Declaration



CSR in IIAs

Pan-African Investment Code

Art 23(1)
Investors **shall** not exploit or use local natural resources to the detriment of the rights and interests of the host State.

Art 22(3)
Investors **shall** contribute to the economic, social and environmental progress with a view to achieving sustainable development of host States.

OECD MNES Guidelines

- Two main legal obligations of adhering governments
  - to promote the Guidelines
  - to establish a national complaints mechanism: National Contact Points (NCPs)

- An individual, organisation or community may allege in a specific instance that a company has not observed the OECD Guidelines and may submit a formal request to an NCP
- Specific instances are not legal cases and NCPs are not judicial bodies
- Unless mandated by its government, an NCP cannot impose sanctions, provide compensation nor compel parties to participate in the resolution of issues
- NCPs are required to issue final statements upon concluding specific instance processes which may include recommendations to companies

Burlington v. Ecuador

- ISDS case on Ecuadorian windfall taxes
- Ecuador filed a **counterclaim** alleging that the companies' activities resulted in significant environmental harm.
- *The Burlington* tribunal held the investor liable.
- The investor's obligations were found in domestic law.
- USD 2.8 billion initially claimed by Ecuador.
- The tribunal ordered Burlington to pay USD 39.2 million for environmental remediation and a further USD 2.5 million for Burlington's breaches with respect to the maintenance of the infrastructure.

Limits of counter-claims

- Jurisdiction:
  - Unclear or missing language in IIAs to establish consent to arbitrate counterclaims
  - Counterclaim must be directly linked to the dispute
  - Counterclaim in Burlington and Ecuador was based on the investment contracts (including consent to counterclaims)
- Merits:
  - Not possible to invoke international environmental or human rights obligations (see *Urbaser* case)
- Practical:
  - States often do not make the argument before ISDS tribunals

MNEs' emerging obligations?

Report Human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment, UN Doc A/73/188, July 2018, para. 72

"The five main responsibilities of businesses specifically related to climate change are

- to reduce greenhouse gas emissions from their own activities and their subsidiaries;
- reduce greenhouse gas emissions from their products and services; minimize greenhouse gas emissions from their suppliers;
- publicly disclose their emissions, climate vulnerability and the risk of stranded assets;
- ensure that people affected by business-related human rights violations have access to effective remedies.
- In addition, businesses should support, rather than oppose, public policies intended to effectively address climate change."

MNEs' emerging obligations

National laws

- Disclosure regulations
- Due diligence laws, e.g., EU due diligence directive

Corporate initiatives

- Ongoing voluntary action by MNEs See Climate Pledge (more than 100 MNEs subscribed) https://www.theclimatepledge.com/ - however this is voluntary CSR

EU Due Diligence Directive (draft)

Article 15 Combating Climate Change

1. Member States shall ensure that companies referred to in Article 2(1), point (a), and Article 2(2), point (a), shall adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement. This plan shall, in particular, identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations.

Discussion

- Where do you see the opportunities of international investment law in supporting the net zero transition?
- Where do you see the limits of international investment law in supporting the net zero transition?
- In light of the limits of IIAs to support the financing of the net zero transition, why do we still need international cooperation?

Reasons for international cooperation

- Cooperation between States on sharing and disseminating information on opportunities for investment (investment facilitation)
- Cooperation between States on development, deployment, and diffusion of relevant technologies (e.g., technical and financial assistance)
- Agreeing to stop or to reduce state subsidies and other supports to climate unfriendly investments (e.g., in an IIA or other international treaty)
- Cooperation between States on Corporate Social Responsibility

Thank You!

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