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Investment treaties and climate change: Track 1 of Future of investment treaties

Background note for November 2022 meeting on Investment treaties and climate change

This note was initially prepared for discussion at a 29 November 2022 Track 1 meeting open to invited governments, stakeholders and experts.

It has been circulated to Track 1 participants for comments, in particular by government participants.

This final version reflects comments received.

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Table of contents

1. This note provides background for discussions at the November 2022 Track 1 meeting.[1] With strong support from governments, work on Track 1 is focused on investment treaties and climate change. Work to date with governments, experts and stakeholders has included a public consultation, a May 2022 Investment Treaty Conference and an on-going survey of governments.[2]

2. The November Track 1 meeting will consider three topics. Background information for discussion of each of these topics is provided below. First, the meeting will enlarge the Track 1 conversation about investment treaties and climate change to include the potential role of investment treaties (including investment provisions in trade agreements) in maintaining and improving market access for foreign investment and in particular for renewable energy and climate-friendly investment.

3. Second, the meeting will consider recent climate policy developments on the sectoral scope of investment treaty coverage and alignment with the Paris Agreement. Investment treaties typically provide covered investors and investments, as defined, with protection from certain government actions. While the nature of the government actions at issue has been debated at length, the scope of covered investment has attracted less attention until recently. Coverage of investment in investment treaties is typically limited by the nationality of the investor. However, it is otherwise broad.

4. The Paris Agreement and work on finance and climate have led to increased attention and concern about the scope of covered investment in investment treaties, and in particular coverage of new investment in coal and other fossil fuels. Issues of treaty coverage of investment in light of the Paris Agreement were discussed at the May 2022 Investment Treaty Conference. The November Track 1 meeting will follow up on issues of coverage and the Paris Agreement in light of relevant developments since the Conference.

5. Third, an on-going survey of Climate policies for investment treaties is the first-ever survey of its kind. The background note and survey questions have been made available to the public. The November meeting will provide an opportunity to discuss the survey and its questions.

1. Market access and investment facilitation for climate-friendly investment in trade and investment agreements

6. Work on investment treaties at the OECD since 2011 has focused primarily on the growing policy debates about investment protection and Investor-State Dispute Settlement (ISDS). This focus has reflected not only current debates, but also the absence of market access provisions from most investment treaties. Most investment treaties apply only to investment once made. As part of broad work on the Future of investment treaties, it is valuable to consider what contribution investment treaties could make to market access, in particular with regard to climate-friendly investment and renewable energy, and what types of treaties would be suitable for such a role.

7. Market access has a range of meanings. At the narrowest level, in the WTO General Agreement on Trade in Services (GATS), "market access" refers to the exclusion of certain quantitative restrictions in Art. XVI(2) of the GATS, such as limitations on the number of suppliers. At the broadest level, discussions of market access can extend broadly to include many factors affecting the attractiveness of investment.

8. For purposes of initial consideration here, an intermediate position is adopted, focused primarily on barriers to foreign entry into domestic markets. Through the elimination of regulatory barriers to investment based on nationality, reduction of barriers to foreign entry generates more potential investment

[1] This note does not necessarily reflect the views of the OECD or of the governments that participate in work on investment at the OECD, and it should not be construed as prejudging ongoing or future negotiations or disputes pertaining to investment treaties.

[2] Information about the work and documentation from past meetings is available at https://oe.cd/foit.

primarily based on market considerations. Increased potential investment can provide many benefits in terms of greater competition and the transfer of know-how. It is essential to addressing the sustainable development goals.

9. This section seeks to provide a preliminary and general basis for consideration of possible future roles for investment treaties in this area in particular with regard to climate investment and renewable energy. It first clarifies the initial focus on barriers on market entry by reference to the categorisations used in widely-used indices and tools that identify and evaluate a broad range of restrictions on foreign direct investment (FDI). The nature of provisions in current stand-alone investment treaties and preferential trade agreements (PTAs) that address some of these issues are identified. The general relation of these sections to some WTO instruments, domestic and other law, and other policy tools is considered. The section concludes by noting increased interest in recent treaties in investment facilitation and its possible relationship to climate-friendly investment.

1.1. Identifying the nature of barriers to market entry

10. The OECD has developed a number of indices and tools that provide insight into barriers to market entry for foreign investment. The OECD FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in 22 economic sectors across 84 countries, including all OECD and G20 countries, with further geographic expansion underway.[3] The FDI Index gauges the restrictiveness of a country's FDI rules by looking at the four main types of restrictions on FDI. The first two categories are directly related to market entry:

- Foreign equity limitations (exclusion of foreign participation, restrictions on majority holdings or limits on full foreign ownership)
- Screening or approval mechanisms (focused on the existence of discriminatory foreign investment approval mechanisms that explicitly mandate consideration of economic interests)

11. The other two categories are restrictions on the employment of foreigners as key personnel and operational restrictions. The discriminatory nature of measures is the central criterion to decide whether a measure falls within the scope of the index. Nevertheless, certain non-discriminatory measures are also covered when they are more burdensome for foreign investors.

12. A similar approach that also identifies market entry barriers can be found in the OECD Services Trade Restrictiveness Index (STRI).[4] There is considerable overlap between trade in services and foreign investment. The GATS, which applies rules to services markets, categorizes services trade into four "modes of supply". Mode 3 involves a commercial presence which typically entails foreign direct investment. A 2017 OECD study noted that Mode 3 "dwarfs the other modes of supply" of services.[5]

13. The STRI analyses regulations affecting trade in services including in Mode 3. The measures are organised under five policy areas. The first policy area addresses foreign entry:

- Restrictions on foreign entry. This include information on foreign equity limitations, requirements that management or board of directors must be nationals or residents, foreign investment

[3] See OECD, FDI Regulatory Restrictiveness Index.

[4] See OECD, Services Trade.

[5] See OECD, Services Trade Policies and the Global Economy (2017), p. 22 (citing studies); Eurostat, Services trade statistics by modes of supply (In 2018, 59 % of the EU services exports to non-member countries were supplied via commercial presence in the territory of the non-member countries).

screening, restrictions on crossborder mergers and acquisitions, capital controls, regulations on cross-border data flows and a number of sector-specific measures.[6]

14. Two other policy areas covered by the STRI (discriminatory taxes, subsidies and public procurement, and differing regulatory standards; barriers to competition) apply primarily behind the border. A fourth policy area involves restrictions on movement of people while a fifth (regulatory transparency) is relevant to investment facilitation as discussed below.

15. Additional indices, such as the WTO and World Bank Services Trade Policy Database, use similar approaches. Together, these indices and databases identify a wide range of regulations that can affect market access, broadly construed, and identify a range of market entry barriers at a general level.

16. The indices generally do not incorporate a degree of specificity sufficient to single out measures creating market entry barriers affecting investment in renewable energy specifically, but improvements are in progress. For example, the FDI Index applies to the electricity sector, but does not distinguish between energy sources used to generate electricity. The index is being updated to distinguish between such sources. Barriers that apply to foreign investment in electricity generally can also bar renewables so some information is already available.

1.2. Overview of relevant provisions in trade and investment agreements

17. A wide range of trade and investment agreement provisions have some impact on market access broadly defined. Two elements particularly relevant to foreign entry are noted in this section.

18. First, investment treaties can include national treatment (NT) and most-favoured nation (MFN) obligations that apply to investment at the pre-establishment stage. As noted, most older investment treaties are limited to post-establishment protection and do not include these provisions. A major exception is US investment treaty practice which has included pre-establishment obligations from the beginning. Pre-establishment obligations were also included in the 1994 NAFTA and the draft Multilateral Investment Agreement (MAI) in the 1990s. Such provisions are included in a still small but growing number of investment treaties.[7] Canada has included binding pre-establishment obligations in its bilateral investment treaties since the 1990s, for instance. Apart from a few bilateral investment treaty programs, however, such provisions are mainly found in plurilateral investment treaties – such as the 2009 ASEAN Comprehensive Investment Agreement – or chapters in PTAs.[8] In PTAs, they are generally included in investment chapters and mode 3 obligations in service chapters and are often limited by schedules on non-conforming measures.[9]

19. A second section found in PTAs in particular are "market access" provisions that typically resemble the market access provisions in the GATS. As noted, in the GATS, "market access" refers to the exclusion

6 There are minor differences in categorisation between the indices. For example, the FDI RRI categorises requirements that management or directors of companies must be nationals in the category of "Restrictions on key foreign personnel".

7 According to UNCTAD's International Investment Agreements Navigator, 167 out of 2584 mapped investment treaties extends national treatment to pre-establishment. Most of these were signed after 2000.

8 See Jonathan Bonnitcha Investment Wars: Contestation and Confusion in Debate About Investment Liberalization (2019), p. 639.

9 A specific commitment in a schedule is an undertaking to provide market access and national treatment for the activity in question on the terms and conditions specified in the schedule. When making a commitment a government therefore binds the specified level of market access and national treatment and undertakes not to impose any new measures that would restrict entry into the market or the operation of the activity.

of quantitative restrictions in Art. XVI(2). It is thus understood in a relatively narrow terms. The prohibition on quantitative restrictions applies to measures such as limitations on the number of suppliers or service operations, the total value of transactions or the participation of foreign capital by quantity.[10]

20. In the GATS and in PTAs, these market entry provisions are generally subject to schedules that define their scope of application. The approach to schedules is generally similar to that for national treatment provisions. They are also typically subject to general exceptions.[11]

21. Parties to treaties can register their commitments and exceptions in their schedules according to two different techniques – using a positive list or a negative list. When using a positive list, a jurisdiction explicitly ("positively") lists those sectors and subsectors in which it undertakes commitments. As a second step, it lists all exceptions or conditions to these commitments, stating the limitations it wants to apply. When using a negative list, the parties list the sectors or subsectors that they limit or exclude. All sectors or sub-sectors that are not listed are, by default, subject to the general provision at issue.[12] Some agreements include different listing techniques for different sectors.[13]

22. Available evidence suggests that most reduction of barriers to foreign entry is carried out through unilateral measures rather than treaties.[14] It appears that most PTA commitments at most bind domestic measures. A 2017 OECD study suggests that PTAs usually do not make commitments that go significantly beyond binding existing practices.[15] Domestic law as applied can thus often be more liberal than what is required under binding commitments in treaties. This difference between bindings and the applied regime

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[10] Market access provisions are often located in the services chapter in PTAs, but they can be specified to apply to covered investments relating to the supply of services. For example, in the USMCA chapter on Cross-border trade in Services, art. 15.5 on market access is made applicable by art. 15.2(2) to measures adopted or maintained by a Party relating to the supply of a service in its territory by a covered investment. In addition to barring quantitative restrictions, some provisions include prohibitions on requiring particular forms of legal entities. See USMCA, art. 15.5(1)(b).

[11] Both stand-alone investment treaties and PTAs can also include prohibitions and limitations on performance requirements. There is no universally adopted definition of performance requirements. In general, they can be described as a variety of regulatory measures imposed by host state governments on the activities of foreign investors or companies generally. Most performance requirements, such as requirements to use a specific amount of local content, apply to the operation of an investment rather than to market entry. Some early work on performance requirements included some market entry limitations such as local equity requirements. See Alexandre Genest, Performance requirements in international investment law (2017) (PhD thesis), pp. 70 et seq. It appears that such provisions applicable to market entry, however, are not included in the scope of articles on performance requirements in recent trade and investment agreements.

[12] Parties frequently use two different annexes to inscribe their reservations in a negative list. One addresses existing national legislation. A second lists the sectors and subsectors where the right to derogate in the future is retained, including in cases where no measures currently exist.

[13] Governments can also include so-called 'standstill' and/or 'ratchet' clauses that frame the scope for introducing restrictions in the future. A standstill clause means that governments cannot introduce any new barriers in addition to those listed as they are at the moment of taking commitments. A ratchet clause generally means that if, after entry into force of an agreement, a government unilaterally removes a barrier in an area where it has made a commitment, it cannot reintroduce it. These clauses can be of different scope of application and can be subject to exceptions.

[14] The EU internal market is an exception and is not addressed here.

[15] See OECD, Services Trade Policies and the Global Economy (2017), p. 36; see also Hildegunn Kyvik Nordås and Ronald Steenblik, Environmental Services in the APEC Region: Definition, Challenges and Opportunities (May 2021), p. 45 (suggesting use of treaty reservation lists and lists of non-conforming measures as a source of information about restrictions, but noting that they may overstate restrictiveness because "economies often have more liberal applied policies than their commitments in trade agreements").

is often called "water", similar to the "water" between applied and bound tariffs. A 2021 OECD study on services concluded that while modern PTAs appear to drain more of the "water" between GATS commitments and applied services regimes, the complexity of treaty provisions and schedules can make it difficult to evaluate their precise role.[16]

23. A qualification to the apparent limited reach of treaty provisions on market entry, at least over time, can apply where governments use a "negative list" approach to schedules. While the initial list may require limited or no change to domestic law, new economic activities that develop subsequently are not subject to any exclusions in the schedule. Consequently, the NT and MFN requirements apply to the new activities.

24. Unilateral action can be encouraged and supported through peer pressure type processes such as the OECD Codes and Investment Committee monitoring.[17] Regional and other processes can also support and encourage openness. Unilateral opening measures can involve generalised opening to all foreign economies. For actions involving services, unilateral opening is subject to GATS MFN requirements, encouraging generalised opening.

25. Government and other input in this area can provide further insight into the impact to date of trade and investment agreements on barriers to foreign entry in particular with regard to climate-friendly investment.

1.3. Investment facilitation

26. In addition to market entry barriers, business can face myriad obstacles to effective entry and success of its FDI in foreign markets. Many of these issues are day-to-day problems such as transfers for personnel, addressing different environmental and technical standards, a lack of transparency in regulatory procedures, or logistics issues. Many of these issues are often faced by domestic firms as well and have been traditionally addressed as part of a healthy investment climate in the OECD Policy Framework for Investment (PFI).

27. Recent years have seen increased interest in incorporating these types of provisions into new treaty forms and provisions. Brazil developed a new treaty model focused on facilitation of FDI, omitting portfolio investment. It seeks to promote active inter-governmental coordination to facilitate FDI, including by SMEs, and to prevent and resolve possible disputes. Recent WTO-hosted plurilateral negotiations over possible greater treaty attention to traditional PFI issues for FDI have attracted participation from over 100 countries. They have been accompanied by clear intent and efforts to insulate such broader provisions from market access, investment protection and ISDS.

16 See OECD, Services Trade Restrictiveness Index (STRI): Measuring Services Liberalisation and Commitments in the GATS and RTAs (2021); Juan Marchetti and Martin Roy, 'Services Liberalization in the WTO and in PTAs', in Juan Marchetti and Martin Roy (eds), Opening Markets for Trade in Services: Countries and Sectors in Bilateral and WTO Negotiations (2009).

The FDI Index and STRI do not take account of PTAs in their analysis of market access and national treatment policies, but they can be used to compare a PTA to existing law and evaluate its impact on liberalisation.

17 The OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations are legally binding for their adherents. They provide for the right of establishment and progressive, non-discriminatory liberalisation of capital movements and international financial and other services. The approach of the Codes involves unilateral rather than negotiated liberalisation. Their observance makes full use of the OECD's "peer pressure" method.

28. Investment facilitation is also under consideration in the context of the protocol on investment in African Continental Free Trade Area (AfCFTA).[18] Alongside the WTO process, some jurisdictions have also initiated bilateral negotiations over investment facilitation, such as the EU and Angola. As noted above, investment facilitation extends to some issues covered in the STRI such as regulatory transparency.

29. The meaning of investment facilitation can vary, however, and, as with market access, the relative value of treaty and unilateral approaches has been the subject of ongoing debate. In addition, efforts to connect investment facilitation with sustainability and in particular climate-friendly investment merit particular attention.

Issues for discussion

- ***Is more specific attention to market entry or investment facilitation for investment in renewables needed in trade and investment agreements?***
- ***What does the apparent preference for unilateral measures to liberalise market access mean for efforts to address climate change?***
- ***What market access issues could treaties address to improve the perspectives for climate-friendly investment?***

2. Recent climate policy developments on the sectoral scope of investment treaty coverage and alignment with the Paris Agreement

30. The May 2022 OECD Investment Treaty Conference focused on Paris Agreement and Net Zero alignment of investment treaties. It considered the scope of coverage of investment protection, in particular for fossil fuels. Since the Conference, there have been a number of important climate policy developments in this area. This section first briefly reviews some of the Conference discussions. It then gives preliminary consideration to issues arising from recent government and other views about the application of the Paris Agreement and climate policies to the scope of coverage of investment protection treaties.

2.1. Background

31. The May 2022 Conference focus on Paris alignment built on input in the January-March 2022 public consultation on Investment treaties and climate change[19], and the April 2022 Track 1 meeting. The Conference discussions took note of both the Paris temperature goals and the art. 2.1(c) aim to align finance flows with a low-carbon trajectory. The Secretariat noted the substantial high-carbon finance flows currently associated with investment treaties including in covered investment and in awards in investor-state dispute settlement (ISDS). For example, over 100 ISDS cases and seven of the top ten USD 1 billion-plus damages awards have involved fossil fuel interests.[20] Recent academic work on the potential scope for additional future high-value claims in ISDS by coal and fossil fuel investors was considered. Criticism of investment treaty coverage of fossil fuels by an IPCC Working group and in business press editorials was noted.

[18] See, e.g., Suzy H. Nikièma and Nyaguthii Maina, Negotiating the AfCFTA Investment Protocol: An Opportunity for Africa to Set its Own Investment Facilitation Agenda, AfronomicsLaw (2021).

[19] See OECD, Public consultation on investment treaties and climate change, Compilation of consultation submissions (compiled 13 April 2022).

[20] See Gaukrodger, D., Investment treaties and climate change: The Alignment of finance flows under the Paris Agreement (2022).

32. In addition to key elements in the text of the Paris Agreement, the discussion examined the commitments and action by financial actors to align portfolios of financed emissions with Net zero, and encouragement of such action by regulators. Similarities of investment treaty coverage to insurance were noted, as were some differences. It was noted that while the analogy to insurance was useful, it was not necessary because art. 2.1c refers to finance flows rather than insurance. Government emphasis on the urgency of climate action on finance flows under art. 2.1(c), and recent G20 and other government commitments to cease support for new coal or other fossil fuel projects abroad, were considered. The discussion also noted climate action by government export finance agencies including commitments to align their support with net zero and to report publicly on their progress.

33. It was emphasised that these Paris-related developments focus on the alignment of the scope and nature of activities being financed or supported.[21] Policy space is not at issue.[22] In this context, it was suggested that the Paris alignment of investment treaties may require attention in particular to the scope of covered investment. Because investment treaties create incentives for both investors and governments, claims that investment treaties adequately address government incentives, even if substantiated, may be insufficient in light of the general understanding of what is entailed by the Paris alignment of finance flows.

34. The Conference discussion also underlined the global nature of climate effects and interests: all GHG emissions anywhere across the globe have the same effects. Consequently, any investment treaty or other related treaty that unduly promotes such emissions is of concern to all governments and people with climate goals. Investment treaties and awards under them are no longer seen as of interest only to the governments party to the treaty.

2.2. Emerging and evolving government and other views about the application of the Paris Agreement to the coverage of investment treaties

35. There is increasing evidence that Paris Agreement Parties may have differing views about the application of the Paris Agreement to the scope of coverage of investment in investment protection treaties. The overriding importance of achieving the Paris Agreement goals makes it vital to achieve greater clarity in this area and to take action as appropriate.

36. Following extensive negotiations, Parties to the Energy Charter Treaty (ECT) announced in June 2022 completion of negotiations on the modernisation of the ECT. The draft agreed text has not been released publicly. However, the available information about the overall process, debates and recent events raise a number of issues for preliminary consideration.

37. First, while there is still limited information, there appear to be different views between Paris Agreement Parties about whether the Paris alignment of the scope of coverage of investment protection

[21] The need for clear exclusions of new investment in fossil fuels in climate policies is increasingly emphasised. For example, in a November 2022 report on voluntary climate initiatives, a UN expert group chaired by Catherine McKenna, a former climate and environment minister of Canada, concluded that "Net zero is entirely incompatible with continued investment in fossil fuels". UN Secretary-General Antonio Guterres presented the report, stating that "I also have a message to fossil fuel companies and their financial enablers. So-called 'net zero pledges' that exclude core products and activities are poisoning our planet;" "Using bogus 'net zero' pledges to cover up massive fossil fuel expansion is reprehensible. It is rank deception. The sham must end." GFANZ co-chair Mark Carney welcomed the report and stated that "[t]he world will not make enough progress without more effective government policies …" See Camilla Hodgson, COP27: UN urges Mark Carney-led climate initiative to meet higher standards, Financial Times (8 Nov. 2022).

[22] Bank loans or private company-supplied insurance for fossil fuel projects generally do not affect regulatory policy space. Nonetheless, commitments and action to align portfolios and reports on progress are encouraged or required. The activities being financed or supported are the issue.

treaties is necessary or what it entails. The EU has criticised the existing ECT as unaligned with climate goals and has sought a general exclusion of coverage of fossil fuels in the ECT in order to achieve alignment with the Paris Agreement. The European Union's public February 2021 additional submission of text proposals for the modernisation of the ECT included proposals to amend the scope of coverage of the treaty to reflect climate policies. In presenting its proposed reforms to exclude coverage of fossil fuels, the EU referred to efforts to align with the Paris Agreement and climate policies:

> *In line with the Paris Agreement and its long term decarbonisation and energy transition policies, the EU is bound to discourage all further investments into fossil fuel based energy infrastructure projects, unless they are fully consistent with an ambitious, clearly defined pathway towards climate neutrality in line with the long-term objectives of the Paris Agreement and best available science. The EU will support international efforts to reduce the environmental and GHG impact of existing fossil fuel infrastructure.*[23]

38. The ECT modernisation negotiations were very lengthy and involved 15 negotiating rounds. The available evidence suggests that notwithstanding lengthy discussions about the issue of Paris alignment and investment treaty coverage, a number of other ECT Parties, including both G20 economy Japan and others, would continue support in the modernised ECT for new fossil fuel investment for the foreseeable future (and, in the absence of further joint action, for 20 additional years after future action to terminate coverage for new investment).[24] These jurisdictions do not appear to have expressed views on Paris alignment in public but more information is necessary. The expected continued coverage of new investment in coal and other fossil fuels may or may not reflect implicit views about the Paris Agreement, but has climate impacts.

39. Other Paris Agreement Parties, including G20 economies, have not been party to the lengthy ECT negotiations. It also appears that there has been limited attention to evaluating Paris alignment in this group of countries although more information is needed. There has been little visible attention to addressing the scope of coverage of other investment treaties. Some major economies in this category, like China, have engaged in some processes that could potentially lead to accession to the ECT.

40. Government consideration of the Paris alignment of the coverage of investment treaties is growing rapidly, including at the level of Leaders and Ministers, but is still limited. (See Box 1) Attention to Paris alignment among only some countries or major interpretive discrepancies between governments would not appear to be conducive to achievement of the goals of the Paris Agreement.[25]

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23 See European Union text proposal for the modernisation of the Energy Charter Treaty.

24 A brief "Public Communication" describing reforms in the agreement in principle was made available in June 2022. See Decision of the Energy Charter Conference, Public Communication explaining the main changes contained in the agreement in principle (24 June 2022). Efforts to precisely analyse the draft modernised treaty based on the brief public descriptions are premature. Excerpts from the Public Communication addressing the application of the Agreement in principle to the coverage of fossil fuels are set out in Annex 1.

The modernised draft maintains coverage of fossil fuels in principle. It allows governments to opt out of coverage of inward investment in those sectors. The EU and reportedly the UK, under the modernised treaty, would opt to remove the protection granted to new inward investments in fossil fuels and limit the protection granted to existing inward fossil fuel investments. It appears that no other government has announced an exclusion of fossil fuels (although Switzerland has announced it is under consideration as noted below). Governments that maintain coverage of fossil fuels have some ability to opt out in the future.

The modernised draft would expand the range of covered energy investment to include the capture, utilisation and storage of carbon dioxide (CCUS) in order to decarbonise the energy systems. A range of additional energy materials and products would be covered by the investment protection provisions, including hydrogen, anhydrous ammonia and biomass.

25 While the discussion here focuses on government views, interest from the climate community in investment treaties also continues to increase following the IPCC expression of concern, with official bodies such as the French

41. The identical effects of any GHG emissions promoted by any investment treaty may reinforce the need for collective attention. The European Parliament recently called for consistency with internationally agreed climate objectives by excluding fossil fuels from coverage in bilateral and multilateral investment treaties generally:

> *The European Parliament …. Expresses concern at fossil fuel investors suing governments before investment tribunals, within the context of investment agreements, for pursuing policies on climate, the phasing out of fossil fuels or the just transition; calls for consistency between bilateral and multilateral investment agreements and internationally agreed upon climate objectives by excluding the protection of fossil fuel investments;*[26]

The European Parliament has also "[r]ecall[ed] that all Parties [to the Paris Agreement] must make financial flows – public and private, domestic and international – compatible with the path towards the 1,5 °C target in the Paris Agreement".[27]

42. A second related question also involves the overall network of 2500+ investment treaties in force and treaties under negotiation as well as substantial parts of the network. For governments that have opposed or omitted reform of the scope of coverage of investment treaties, and that have not otherwise set out their views on Paris alignment, the importance of clarity on views about Paris alignment and for action as appropriate arises generally, as noted above.

43. Other governments have now recognised alignment of an investment treaty with climate goals as a fundamental policy requirement. For example, the EU and all EU member states appear to agree that the existing ECT is not aligned, as set out by the European Commission on behalf of the EU. Where a government has recognised one of its treaties needs reform or termination because its coverage of fossil fuels is not aligned, the question of climate alignment of the scope of coverage may also arise in particular for the government's other investment treaties.[28] In particular, if governments carve out inward coal and other fossil fuel investments from coverage, questions may arise about their continued support for outward fossil fuel investments.

44. Selective application of the Paris Agreement to investment treaties may raise some concerns similar to those raised with regard to selective coverage of net zero commitments by financial actors. While there may be budgetary, economic or domestic policy space benefits for jurisdictions to focus initially on

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Haut Conseil pour le climat (High Climate Council) evaluating and criticising investment treaty alignment. See Haut Conseil pour le climat, Report on the Modernisation of the Energy Charter Treaty (19 Oct. 2022), also available in French and Spanish. See also "Statement on ISDS and climate" (Nov. 2022) in connection with UNFCCC COP 27 by over 350 civil society organisations.

26 European Parliament resolution of 20 October 2022 on the 2022 UN Climate Change Conference in Sharm El-Sheikh, Egypt (COP27) (2022/2673(RSP)), P9_TA(2022)0373, para. 61.

27 Id, para. 49. Other G20 governments have also emphasised the importance of aligning finance flows. For example, in May 2022, the United States and Japan agreed to "advanc[e] efforts to make financial flows consistent with the global achievement of net zero greenhouse gas emissions no later than 2050, with deep emission reductions in the 2020s and climate-resilient development". Fact Sheet: U.S.-Japan Climate Partnership (23 May 2022).

28 There is evidence that concern with Paris alignment is increasing, perhaps due to climate disruption, climate litigation or other factors. Some ECT Parties publicly recognising Paris alignment requirements for an investment treaty in 2022 have developed model investment treaties in recent years that do not reduce the coverage of fossil fuels.

Some recent proposals to address climate concerns about investment treaties do not address the scope of coverage. For example, in August 2022, Germany and the European Commission released proposals to seek to address climate concerns with regard to the CETA investment protection provisions. The proposals take the form of a proposed joint government interpretation and do not address the scope of covered investment. See Statement from the Commission on clarifications discussed with Germany regarding investment protection in the context of the CETA agreement (29 August 2022) the Paris alignment of the scope of coverage in treaties covering substantial inward investment, all of a government's treaties that promote emissions through coverage of fossil fuels, other high-carbon activities and their associated finance flows raise similar issues for emissions and climate policies.

Box 1. Growing consideration of Paris alignment and alignment criteria

The importance and the meaning of the alignment with the Paris Agreement of the scope of coverage of investment protection treaties has emerged with increasing prominence in public debates since the May 2022 Conference.

In a brief document released in June 2022, the European Commission stated that it considers that the modernised ECT treaty would align with the Paris Agreement. It described the modernised agreement but did not analyse alignment.[29] The Commission also indicated in October 2022 that of the EU member State governments that have taken a view in discussions in the Council of the EU to date, a majority support the modernisation text. However, there appears to be limited information about the number of governments in this group or their specific views, in particular about the Paris Agreement.

In recent weeks, senior officials in several jurisdictions have publicly announced exit from the ECT and have underlined a lack of alignment or coherence of the treaty with climate goals and the Paris Agreement. Coverage of fossil fuels is frequently cited.

President Macron stated at a 21 October 2022 press conference that France had decided to withdraw from the treaty, noting that withdrawal had been demanded by many and that exiting the ECT was coherent with the Paris Agreement.[30] The French Minister of the Economy also underlined the incompatibility of the treaty with the aims of the Paris Agreement, following input from the Haut Conseil pour le climat and the IPCC.[31]

Dutch consideration of the issues in public documents is the most detailed to date. In a parliamentary proceedings and documents, the Dutch Minister for Climate and Energy explained that the decision to exit the ECT was notably based on insufficient alignment of the proposed reforms with the Paris Agreement due to continued coverage of fossil fuels:

> *The government is of the opinion that the result achieved does not do sufficient justice to the sustainability objectives and that the Netherlands is insufficiently in line with the Dutch and European goals resulting from the Paris climate agreement. … [I]n this sector-specific treaty, investments in the fossil sector are still protected under the modernised ECT.*[32]

An annex included in the letter notes that "the aim of the EU proposal [to exclude fossil fuels from coverage] has not been fully achieved, now that the ECT will continue to be an organisation where the protection of investments in fossil fuels outside the EU remains possible. This is not in line with the

[29] See European Commission, Agreement in principle reached on Modernised Energy Charter Treaty (24 June 2022).

[30] Conférence de presse du President Macron (21 Oct. 2022); Perrine Mouterde, France withdraws from controversial Energy Charter Treaty to meet climate goals, Le Monde (English) 22 October 2022.

[31] Climat : quatre questions sur le retrait de la France du Traité sur la charte de l'énergie, FranceInfo (22 Oct. 2022).

[32] Letter from R.A.A. Jetten (Minister for Climate and Energy) to the President of the Second Chamber (House of Representatives) of the Dutch Parliament (2 Nov. 2022) (Dutch original, automated translation by Microsoft) ["Het kabinet is van mening dat het behaalde resultaat onvoldoende recht doet aan de duurzaamheidsdoelstellingen en voor Nederland onvoldoende in lijn is met de Nederlandse en Europese doelen die voortvloeien uit het klimaatakkoord van Parijs. … Ook is het zo dat in dit sectorspecifieke verdrag, investeringen in de fossiele sector onder het gemoderniseerde ECT nog steeds worden beschermd."]

commitment to phase out new investments in fossil production, especially coal-fired power stations, worldwide as quickly as possible, in connection with the climate goals."[33]

Spain was the first country to announce that it would be exiting the ECT due to its inconsistency with climate policies. The Third Vice-President and Minister for Ecological Transition and Demographic Challenge announced the decision to the press on 121 October 2022.[34] The decision is reportedly based on a lack of alignment of the modernised treaty with the Paris objectives and the European Green Deal. Italy exited the ECT in 2016 and Poland has also recently taken action towards exit from the treaty, including a government proposal and a first parliamentary vote in favour of exit.

On 9 November 2022, the Swiss Federal Council announced that Switzerland would approve the modernisation at an upcoming November ECT meeting.[35] The Council noted that the protection of investments in fossil fuels has been the subject of controversy during the negotiations and that Switzerland will decide whether to remain in the ECT or withdraw from it. This decision will be taken following an assessment by a federal Department charged with environment and energy policies, to be submitted in February 2023. The assessment will also allow Switzerland to decide, within the context of a modernised ECT, about whether to withdraw protection from new and existing investments in coal, gas, oil and carbon capture, utilisation and storage (CCUS) technologies.

The Council noted that the modernisation aims at alignment with the Paris Agreement but did not evaluate the degree of Paris alignment achieved in the modernised draft or the existing treaty. The press release includes brief references to possible elements such as assessment of the types of energy at issue in Swiss investment abroad.

On 10 November 2022, the Slovenian government announced that it will withdraw from the ECT. In a brief document explaining the decision, it characterised the treaty as a key obstacle to responsible climate, energy and environmental policies.[36]

On 11 November 2022, the German coalition government announced that Germany will exit the ECT.[37] The document stated that the modernised treaty does not sufficiently satisfy the requirements of the government's July 2022 trade agenda, noting that the European Commission was given an inadequate negotiating mandate. It stated that the modernised treaty falls short of the German and European ideas for achieving climate neutrality and adaptation to the Paris Agreement.

These developments reflect expanding attention to aligning with, adapting to, and being coherent with the Paris Agreement in the scope of coverage of investment treaties, closing the gap with some other policy areas noted during the May 2022 Conference.

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33 Annex 1 to Letter from R.A.A. Jetten (Minister for Climate and Energy) to the President of the Second Chamber (House of Representatives) of the Dutch Parliament (2 Nov. 2022) (Dutch original, automated translation by Microsoft) ["Daarmee is het doel van het EU voorstel niet volledig gerealiseerd, nu het ECT ook in de toekomst een organisatie blijft waar de bescherming van investeringen in fossiele brandstoffen buiten de EU mogelijk blijft. Dit sluit niet aan bij de inzet om nieuwe investeringen in fossiele productie, met name kolencentrales, wereldwijd zo snel mogelijk uit te faseren, in verband met de klimaatdoelen."]

34 See Karl Mathiesen, Spain pulls out of energy treaty over climate concerns, Politico (12 Oct. 2022).

35 Énergie: le Conseil fédéral adopte la nouvelle mouture du Traité sur la Charte de l'énergie (9 Nov. 2022).

36 See 23. redna seja Vlade Republike Slovenije [23d regular session of the Government of the Republic of Slovenia][(10 Nov. 2022).

37 Weiterentwicklung der Handelsagenda der Ampel [Further development of the trade agenda of the [government] traffic light coalition] (11 Nov. 2022).

In addition, some possible criteria for alignment may be emerging. The announcements of exit by Leaders and Ministers have generally omitted extensive analysis of the reasons, but have often focused on the coverage of fossil fuels. In light of the global impacts of treaty-promoted emissions noted above, the attention in the Dutch analysis to coverage of coal investment abroad is noteworthy, as is preliminary Swiss consideration of the climate characteristics of Swiss outward investment as a factual matter. While the modernised ECT apparently incorporates recent approaches to policy space, those provisions have apparently not been seen by exiting governments as sufficient for alignment of a treaty covering new fossil fuel investment.

45. Third, if investment treaties are not adapted as appropriate, the recognised importance of the Paris Agreement may lead to the enforcement regime for ISDS awards coming under public or political pressure. ISDS awards are currently enforced under multilateral treaties developed primarily for commercial or contract cases. If investment treaties seen as interfering with achievement of Paris Agreement goals are not addressed, the enforcement of awards under investment treaties seen as unaligned may be seen by some as contrary to international climate public policies. Current remedies under investment treaties also generally involve large financial payments. For enforcement jurisdictions that are Paris Agreement Parties, commitments to compel finance flows to fossil fuel investors with ISDS awards under unaligned investment treaties might also be seen as interfering with the finance flow alignment goal in art. 2.1(c) of the Paris Agreement.[38] More generally, lack of visible attention to climate alignment in the investment treaties of major jurisdictions may reduce public support for the investment treaty regime both in those jurisdictions and elsewhere. Public explanations of climate policies and their basis can help to address the concerns.

46. Government-led consideration of investment treaties and climate change at the OECD is well-placed to allow for more clarity and discussions about the Paris Agreement and investment treaties among a wide range of governments, stakeholders and experts. The importance of achieving the Paris Agreement goals and the vast reach of investment protection treaties over international investment and its associated emissions make it important for governments to develop and clarify where necessary their views about the Paris Agreement and investment protection treaties, to compare them with other views, and to seek to develop a degree of consensus on the issues. It is expected that the survey on Climate policies for investment treaties and future Track 1 work, following the survey, will assist in this area.

Issues for discussion

- ***What purposes are served in 2022 and into the future by continued unqualified long-term investment treaty coverage of all new investment in coal from one jurisdiction to another? Should such protection be eliminated or phased out and if so, when?***
- ***What impact would apparently different views, including between major economies, about the application of the Paris Agreement to investment treaty coverage of coal and other fossil***

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38 While the language in art. 2.1(c) of the Paris Agreement refers without limitation to the alignment of finance flows, it may relate with greater urgency or directness to finance flows compelled or promoted by government policies.

Concerns including about the automatic enforcement of ICSID awards and absence of review have recently arisen in other contexts. See, e.g., *Costello v. Government of Ireland*, Supreme Court of Ireland (11 November 2022) (finding that the automatic enforcement of ICSID awards violates the Irish Constitution). All seven Supreme Court justices wrote opinions in this constitutional law case, which Justice Hogan suggested “may yet be regarded as among the most important which [the] Court has been required to hear and determine in its almost 100-year history”. (Judgments available on the Court website). Cf. Letter from European Commission Legal Service to the Legal Department of the Ministry of Economic Affairs and Climate Policy, Germany (22 September 2021) (stating that national courts must disapply the ICSID Convention in some cases where it conflicts with other law).

fuels have on the achievement of Paris Agreement goals? How can such views be best clarified, compared and addressed as appropriate?

3. The survey of climate policies for investment treaties

47. As part of the 2022 work program, the first-ever survey on Climate policies for investment treaties commenced in October 2022. The survey will cast light on the steps governments are taking, or considering, to align their investment treaty networks with the Paris Agreement and net zero objectives. The introductory Secretariat note and survey questions have been made available as part of a commitment to stakeholder and public information about work on investment treaties, and to allow for input on them from experts and others.[39] Government responses to the survey are due on 14 December 2022. Responses to the survey will be confidential.

48. Reflecting the multiple climate aspects of investment treaties, the survey includes climate policy questions inspired by three sources. First, it includes climate policy questions similar to those increasingly asked of major suppliers of financial services like asset owners, banks or insurance underwriters. These surveys and reports are high-profile processes benefitting from increasing government support and attention, such as the Task Force on Climate Financial Disclosures (TCFD). Financial actors are widely recognised as having climate responsibilities for their portfolios and their financed emissions notwithstanding an absence of impact on policy space. The responsibilities arise from the capacity to influence the activities of operating companies and to redirect business incentives away from fossil fuels and other high-emission activities toward climate-friendly ones. Recognition of these responsibilities generates questions about whether commitments have been made to achieve Net Zero, whether climate criteria are applied for beneficiaries of such services and whether action is being taken in the short-term. Gathering data and public reporting are essential components.

49. While governments differ from private actors and have broader responsibilities, the fact that governments are the Parties to the Paris Agreement commitments, have duties to the public and can be seen as providing a form of financial services at promotional below-market cost through investment treaties may all be relevant to considering appropriate questions in this area. Recent uncertainties and possible new barriers to voluntary private sector climate action have reinforced calls for government action, as noted above.

50. Second, the survey includes questions about the impacts of investment treaties on climate policy space. These generally do not arise for private sector suppliers of financial services to operating companies. They are not included in the climate surveys and reports referred to above. Questions about policy space impacts are more familiar for investment policy makers. At the same time, key specificities of the climate crisis – such as the worldwide and identical consequences of GHG emissions anywhere or the Paris Agreement commitment to align finance flows -- raise important questions about new or stronger policy interests and policy responsibilities for home states in ensuring host state climate policy space in particular. This may be an important new climate policy factor in particular for investment treaties where stocks and flows are largely one-directional.

51. Third, the survey also reflects that fact that major economies have committed to integrate climate action across their foreign, security and trade policies in a range of unilateral and joint declarations and working groups. Governments have begun to take visible climate action in policy areas related to investment treaties, such as export finance. Climate action on investment treaties remains limited and the application of some recent climate commitments to investment treaties remains unclear, giving rise to an additional source of questions in the survey.

39 OECD, Survey of climate policies for investment treaties (2022).

52. Participants can provide input on these and other aspects of the survey note and questions, as well as suggestions for improvements including in light of broader practice on climate surveys. This item will also encourage the submission of comments and suggestions in writing with regard to the survey. Governments engaged in preparing responses, which are due on 14 December 2022, can provide input on their experience in responding and can ask questions of climate and other experts.

Annex 1

Excerpts from Public Communication on Modernisation Text of the Energy Charter Treaty

The Public Communication describes the partial fossil fuel carve-out in the modernised agreement in principle as follows:

> *A novel "flexibility mechanism" allows Contracting Parties, based on a Conference decision, to exclude investment protection for fossil fuels in their territories, considering their individual energy security and climate goals. For example, the EU and the UK have opted to carve-out fossil fuel related investments from investment protection under the ECT, including for existing investments after 10 years from the entry into force of the relevant provisions and for new investments made after 15 August 2023 as of that date with limited exceptions. The envisaged exclusions will not, as a matter of principle, affect investment protection in the territory of other Contracting Parties, unless they opt to apply them vis-à-vis investors from the aforementioned Contracting Parties reciprocally.*

The limited application of the carve-out can be addressed at five year intervals or sooner if the Energy Charter Conference so decides:

> *Pillar 3: Review mechanism Five years after the entry into force of the modernised ECT and thereafter at intervals of five years, or on an earlier date as determined by the Charter Conference, the list of Energy Materials and Products covered under the ECT as well as the application of the Flexibility Mechanism will be reviewed. This will give Contracting Parties the possibility to react to technological as well as political developments.*

Source: Decision of the Energy Charter Conference, Public Communication explaining the main changes contained in the agreement in principle (24 June 2022).