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End fossil fuel investments protection to align financial flows with article 2.1.c of the Paris Agreement

Article 2.1(c) of the Paris Agreement calls on governments to « *make financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development* ». **All policy areas must be mobilized and revised to this purpose, including international investment policy.**

Current International Investment Agreements (IIAs)¹ and the Investor-to-State Dispute Settlement (ISDS) mechanism represent a major obstacle to climate mitigation and adaptation. IIAs² aim to protect, promote, and attract international investments with an underlying assumption that international investments benefit both home and host countries of investments and have spillover effects on societies at large, bringing jobs and economic growth³. But this assumption has been largely debunked⁴.

One of the measures needed to achieve the objective of article 2.1 (c) is to remove fossil fuel investments from the list of activities covered by investment protection as soon as possible. Investment-State Dispute Settlement mechanism (ISDS) and the colossal compensations regularly obtained by investors in the fossil fuel sector contribute to blurring the climate signals that investors should consider and keeping the sector attractive (or even making it more attractive). **That is why fossil fuel investment protection is a key topic to be addressed in the framework of the UNFCCC Sharm el-Sheikh dialogue**

¹ Whether under the form of Bilateral Investment Treaties (BITs) or Treaties with Investment Provisions (TIPs).

² The number of IIAs has grown rapidly during the past 60 years to reach 3 360 existing IIAs today of which 2,584 are in force

³ European Commission, "[Investment](#)", consulted 28 March 2024

⁴ Foreign investors do not attach importance to the existence of BITs when determining where, and how much, to invest abroad. Other key factors (market size and growth, availability of natural resources, quality of hard and soft infrastructure) play a far more significant role than BITs in the decision to invest. Furthermore, some countries have sustained levels of investment flows without having any IIA. And countries which have terminated all or part of their BITs or adopted new BIT models less protective of investments (e.g South Africa, Indonesia, India) do not seem to have suffered losses of Foreign Direct Investments. Investment flows do not automatically nor entirely translate into job creation or economic growth. (See L. Johnson et al., [Costs and Benefits of Investment Treaties: Practical Considerations for States](#), Columbia Center on Sustainable Investment, 2018)

1. IIAs and ISDS represent a major obstacle to climate mitigation and adaptation

- **Investor–State dispute settlement (ISDS) is being used to challenge climate policies.**

Through these disputes, fossil fuel investors seek to delay or obtain substantial financial compensation for all measures aimed at stranding the sector's assets.

Over the 1987-2021 period, many ISDS cases were related to measures or sectors of direct relevance to climate action:

- Investors brought at least 175 ISDS cases in relation to measures taken for environmental protection⁵.
- On all disputes initiated up to December 31, 2020, nearly 20% of known cases concern investments in or related to the fossil fuel industry⁶. At the merits stage, investors were successful in 72% of cases⁷. The average amount awarded in fossil fuel cases - over USD 600 million - is almost five times higher than that awarded in other disputes⁸.

Given that keeping global warming below 2°C by the end of the century requires liquidating all the fossil fuels activities and infrastructure, the pool of potential lawsuits from fossil fuel investors in an attempt to shift the cost of transition to society is enormous: the value of what will become stranded assets in the oil and gas sector is estimated to amount to US\$ 3-7 trillion; this figure is US\$ 1.8 trillion in the power sector alone⁹.

- **Mere threats of litigation from investors (or their anticipation by public authorities) can delay or reduce the ambition of climate action (“regulatory chill”).**

Several governments, notably in Denmark, Germany and New Zealand, have acknowledged that some of their recent fossil-fuel phase-outs were designed in part to minimize the risk of litigation¹⁰. In France, in 2017, a bill to end hydrocarbon exploration and exploitation in France by 2040 had also been threatened by the Canadian oil company Vermilion before the Conseil d’Etat¹¹. The pressure paid off as the final version of the law allowed the renewal of oil licenses to continue beyond 2040.

- **ISDS diverts colossal sums of public money that could be used to finance climate action and the green transition.**

In 2019, a report estimated that the total amount of compensation paid by States in the framework of ISDS was \$88 billion, on a total of \$623 billion claimed by investors¹². This sum only takes into account cases that have been made public and for which information is

⁵ UNCTAD, [Treaty-based Investor-State Dispute Settlement Cases and Climate Action](#), 2022.

⁶ L. Salvatore, [Investor–State Disputes in the Fossil Fuel Industry, IISD, 2021](#).

⁷ Ibid.

⁸ Ibid.

⁹ K. Tienhaara, L. Cotula, [Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuels assets](#), Institute for Environment and Development, 2020

¹⁰ Baldon law firm, *Regulatory chill*, Note annexed to the claim lodged by 5 young climate victims at the ECHR against twelve States for their participation in the ECT, filed in June 2022., https://www.exitect.org/sites/default/files/2022-06/Summary_Note_on_Regulatory_Chill.pdf See also, K. Tienhaara, “Regulatory chill in a warming world: The threat to climate policy posed by investor state dispute settlement”, 2018 Transnational Environmental Law.

¹¹ [Comment la menace d’arbitrage a permis aux lobbys de détricoter la loi Hulot \(lemonde.fr\)](#)

¹² Friends of the Earth Europe, Friends of the Earth International, Transnational Institute, Corporate Europe Observatory, « [Red Carpet Courts : 10 stories of how the rich and powerful hijacked justice](#) », June 2019

available. In addition, arbitration proceedings are costly in themselves. States spend an average of 4.7 million dollar per dispute in defence costs¹³. The larger the amount claimed by the investor and the longer the procedure, the higher are generally the costs.

IAs and ISDS will significantly increase the costs of taking climate measures. States will have to pay billions of euros of public money to multinational companies instead of dedicating these resources to the investments necessary for the transition. In some cases, the compensations received by investors may even be reinvested in fossil projects¹⁴.

2. Growing recognition by international and national bodies of the incompatibility of the investment protection regime with the Paris Agreement goal

- This issue was first raised in the report of the IPCC's third working group in 2022 on climate change mitigation. The IPCC recognizes that international investment treaties, in particular the Energy Charter Treaty, constrain the ability of states to adopt ambitious policies to combat climate change¹⁵.
- The UN Special Rapporteur on Human Rights and the Environment called on States to unilaterally or jointly terminate international investment treaties that contain an ISDS, in his report warning of "*the explosion of ISDS cases filed by fossil fuel investors*" using investment treaties, in particular the ECT¹⁶.
- The OECD has launched a dialogue aimed at revising its investment protection policy in the light of the Paris Agreement, and in particular its article 2.1. c) requiring financial flows to be aligned with climate objectives¹⁷. In this framework it conducted a survey of the climate-related policies and practices that have been implemented or are under consideration by governments with regard to their investment treaties¹⁸. Among the interesting results: 78% of respondents consider it very important to make financial flows associated with investment treaties consistent with Art 2.1 of Paris Agreement. More than a fifth (22%) admits having received more than one threat of ISDS claims regarding their climate policies and admits considering more than once the potential of ISDS claims regarding their climate/environmental policies.

¹³ M. Hodgson, Y. Kryvoi, D. Hrcka, [Empirical Study: Costs, Damages, and Duration in Investor-State-Arbitration](#), [British Institute of International and Comparative Law](#), June 2021

¹⁴ *Rockhopper v. Italie*, ICSID, Case ARB/167/14, Award of 23 August 2022

The court awarded over 240 million euros in compensation to Rockhopper, well beyond the tens of millions invested so far. And the company announced that it would reinvest this sum in the development of another oil project off the coast of the Falkland Islands.

<https://www.theguardian.com/business/2022/aug/24/oil-firm-rockhopper-wins-210m-payout-after-being-banned-from-drilling>

¹⁵ <https://www.ipcc.ch/report/ar6/wg3/>

¹⁶ Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment, [Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights](#), A/78/168, 13 July 2023.

¹⁷ [9th Investment Treaty Conference - OECD](#)

¹⁸ [pdf \(oecd.org\)](#)

- In its resolution of 23 June 2022 on the future of the EU international investment policy, the European Parliament "*urges the Commission and the Member States to ensure consistency between IIAs and the European Green Deal, environmental policies, labour rights and human rights, by excluding from treaty protection investments in fossil fuels or any other activities that pose significant harm to the environment and human rights*"¹⁹. However, for the time being, there is a complete lack of alignment between the recommendations of the European institutions and the content of the agreements²⁰.
- In October 2022 the French High Council on Climate Change issued an opinion calling for an exit from the ECT²¹. France played a pioneering role in this area: MEPs and the French Government were at the forefront of the process to modernize the TCE. France was the first member state to withdraw from the ECT at the end of the negotiation process, bringing with it an exit from the EU.
- The UK Council on Climate Change, in June 2023, also stressed that participation "*in obsolete treaties like the TCE risks delaying the low-carbon transition*"²².
- Five young climate victims have filed a lawsuit in 2022 with the European court of Human Rights against 12 States for allowing the ECT to impede their transition away from fossil fuels²³.

III. Fossil fuel investment protection: a key topic to be addressed in the framework of the UNFCCC Sharm el-Sheikh dialogue

The workshops should provide an opportunity to discuss the following topics

- **Promote a multilateral solution to exclude fossil fuel investments from the scope of protection of international investment treaties and climate change and adaptation measures²⁴, as well as an automatic review of all existing treaties by States Parties to the UNFCCC.**
- **Examine how the issue of protecting investments in fossil fuels can be included on the COP29 agenda and in the discussions on the Fossil Fuel Non-Proliferation Treaty.**

¹⁹ European Parliament, [resolution](#) of 23 June 2022 on the future of EU international investment policy.

²⁰ This is even the case with the agreements recently renegotiated with Chile and Mexico, which contain new provisions on investment that would offer protection for fossil fuel investments (See Veblen Institute, [Making trade agreements conditional on climate and environmental commitments](#), 2023).

²¹ <https://www.hautconseilclimat.fr/publications/avis-sur-la-modernisation-du-traite-sur-la-charte-de-lenergie/>

²² <https://www.theccc.org.uk/publication/2023-progress-report-to-parliament/>

²³ Soubeste and 4 other applications v. Austria and 11 other States (nos. 31925/22, 31932/22, 31938/22, 31943/22, and 31947/22) <https://hudoc.echr.coe.int/app/conversion/pdf/?library=ECHR&id=003-7566368-10398533&filename=Status%20of%20climate%20applications%20before%20the%20European%20Court.pdf>

And [The Case | Exit ECT](#)

²⁴ See for instance the proposal of Joshua Paine, Elizabeth Sheargold, A Climate Change Carve-Out for Investment Treaties, *Journal of International Economic Law*, Volume 26, Issue 2, June 2023, Pages 285–304, <https://doi.org/10.1093/jiel/jgad011>