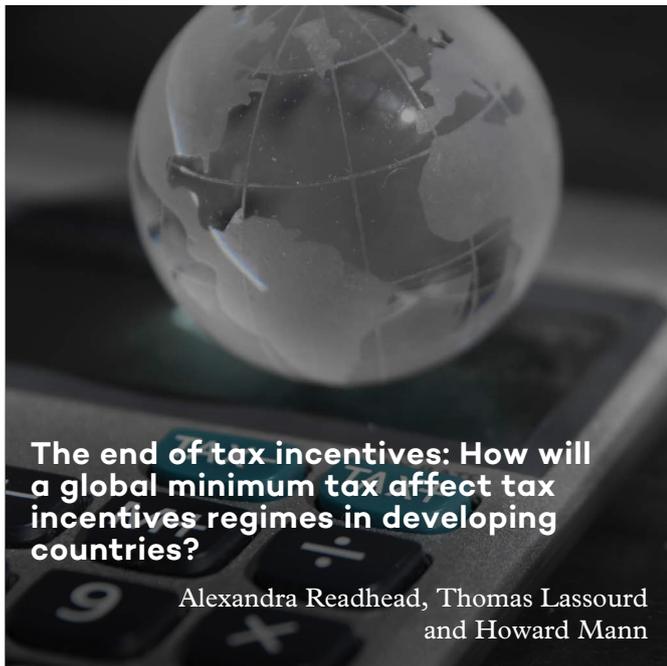




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**The end of tax incentives: How will a global minimum tax affect tax incentives regimes in developing countries?**

Alexandra Readhead, Thomas Lassourd and Howard Mann



**An interview with Esmé Shirlow on *Judging at the interface: Deference to state decision-making authority in international adjudication***

Esmé Shirlow



**The “trade-related” conundrum of the EU–Korea FTA Expert Panel: Are FTAs a novel forum to enforce sustainable development goals?**

Rebecca Walker



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Lea Di Salvatore, Nathalie Bernasconi-Osterwalder and Lukas Schaugg



**From transparency to prohibition: UNCITRAL WGIII considers options to regulate third-party funding**

Brooke Guven, Lise Johnson, H. Suzy Nikiéma and Daniel Uribe





# Contents

<b>INSIGHT 1</b> The end of tax incentives: How will a global minimum tax affect tax incentives regimes in developing countries? .....	4
<b>INSIGHT 2</b> An interview with Esmé Shirlow on <i>Judging at the interface: Deference to state decision-making authority in international adjudication</i> .....	8
<b>INSIGHT 3</b> The “trade-related” conundrum of the EU–Korea FTA Expert Panel: Are FTAs a novel forum to enforce sustainable development goals? .....	12
<b>INSIGHT 4</b> Despite consensus on the ECT’s incompatibility with the global climate agenda, claims that it is well-suited for the clean energy transition persist .....	16
<b>INSIGHT 5</b> From transparency to prohibition: UNCITRAL WGIII considers options to regulate third-party funding .....	21
<b>NEWS IN BRIEF</b> .....	26
ECT modernization negotiations continue with two rounds over the summer as opposition mounts .....	26
Structured discussions on investment facilitation continue at the WTO .....	26
UNCITRAL WGIII to consider proposals on various elements of ISDS reform while the outcome of the request for additional funding remains to be seen .....	27
Ecuador rejoins the ICSID Convention .....	28
Spain and Colombia sign new BIT .....	29
Pakistan terminates 23 BITs .....	29
UNWG on Business and Human Rights releases 2021 report .....	29
<b>AWARDS AND DECISIONS</b> .....	30
ECT tribunal finds Italy’s modifications to its renewable energy incentive scheme reasonable, foreseeable, and proportionate .....	30
Ad hoc tribunal rules in favour of German energy investor .....	33
The ICSID tribunal in <i>Infinito Gold v Costa Rica</i> upholds several claims but declines to award damages. The majority of the tribunal found breaches of the FET standard but damages too speculative .....	35
<b>RESOURCES AND EVENTS</b> .....	40

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## LIST OF ACRONYMS

<b>ASEAN</b>	Association of Southeast Asian Nations
<b>BIT</b>	Bilateral Investment Treaty
<b>CETA</b>	Comprehensive Economic and Trade Agreement
<b>CJEU</b>	Court of Justice of the European Union
<b>COMESA</b>	Common Market for Eastern and Southern Africa
<b>CPTPP</b>	Comprehensive and Progressive Trans-Pacific Partnership
<b>CSR</b>	Corporate Social Responsibility
<b>EAC</b>	East African Community
<b>EC</b>	European Commission
<b>ECJ</b>	European Court of Justice
<b>ECOWAS</b>	Economic Community of West African States
<b>ECT</b>	Energy Charter Treaty
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investment
<b>FET</b>	Fair and Equitable Treatment
<b>FTA</b>	Free Trade Agreement
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>ICC</b>	International Chamber of Commerce
<b>ICS</b>	Investment Court System
<b>ICSID</b>	International Centre for Settlement of Investment Disputes
<b>ICSID Convention</b>	Convention on the Settlement of Investment Disputes between States and Nationals of Other States
<b>IIA</b>	International Investment Agreements
<b>IISD</b>	International Institute for Sustainable Development
<b>ILO</b>	International Labour Organization
<b>ISDS</b>	Investor–State Dispute Settlement
<b>ITN</b>	Investment Treaty News
<b>MFN</b>	Most-Favoured Nation
<b>MIC</b>	Multilateral Investment Court
<b>NAFTA</b>	North American Free Trade Agreement
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>PCA</b>	Permanent Court of Arbitration
<b>PPP</b>	Public–Private Partnership
<b>RCEP</b>	Regional Comprehensive Economic Partnership
<b>SADC</b>	Southern African Development Community
<b>SCC</b>	Stockholm Chamber of Commerce
<b>SDG</b>	Sustainable Development Goal
<b>TFEU</b>	Treaty on the Functioning of the European Union
<b>UNCITRAL</b>	United Nations Commission on International Trade Law
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>USMCA</b>	United States–Mexico–Canada Agreement
<b>VCLT</b>	Vienna Convention on the Law of Treaties
<b>WTO</b>	World Trade Organization



## INSIGHT 1

# The end of tax incentives: How will a global minimum tax affect tax incentives regimes in developing countries?

Alexandra Readhead, Thomas Lassourd and Howard Mann



## Introduction

In early June, the G7 reached a deal to make multinational companies pay more tax.<sup>1</sup> They agreed in principle to introduce an overall global minimum corporate tax rate of at least 15% with the aim of preventing tax competition. Some G7 countries view this rate as too low, with the United States advocating for 21%. However, agreement must now be sought at a meeting of the G20 at the end of the month and among the 139 countries involved in the OECD/G20 Inclusive Framework.

If adopted, a global minimum tax will apply to all sectors of the economy. Countries will have to repeal tax incentives in domestic law and investment agreements in order to bring the effective tax rate in line with the global tax rate. While tax incentives in the law can be undone unilaterally by amendment of the legislation, some are subject to stabilization provisions in law or contracts which may prevent the full implementation of a global minimum tax. This briefing investigates the impact of a global minimum tax on the use of tax incentives in developing countries, and what transitional arrangements are needed to protect countries from a transfer of tax revenue. It reflects the authors' experience in the extractive industries but applies to other types of investments in large-scale, capital-intensive

projects in developing countries, such as energy and transport infrastructure.

## How a global minimum tax would affect tax incentives

A global minimum tax aims to reduce tax competition and profit shifting in all economic sectors. It does this through rules that, if adopted, would ensure all global profits of multinational enterprises are taxed at least at a minimum effective tax rate (ETR).

Under the current proposal, a global minimum tax would apply to multinational companies with gross revenues above EUR 750 million. The ETR is calculated annually on a country-by-country basis. It is the total taxes on corporate profits paid to government authorities, or “cash tax” (the numerator), as a proportion of the tax base, which is based on accounting profits (the denominator) expressed as a fraction (see the equation below).

$$\text{ETR} = \frac{\text{Covered taxes (current year cash tax paid)}}{\text{Tax base (accounting profits)}}$$

In each income year, if a subsidiary's ETR is below the minimum globally agreed rate, its parent company must pay a “top-up tax” on its proportionate share of the income of the low-taxed subsidiary to the country where it is located (usually referred to as the home or residence country). Under certain circumstances, the liability for the top-up tax shifts to one or more other members of the multinational group. As a result, the primary beneficiaries of a global minimum tax would be capital-exporting countries, where multinational companies are typically headquartered, who are given first priority to tax undertaxed profits. The proposal includes three other rules, two of which could benefit developing countries, but they are unlikely to generate substantial revenue.<sup>2</sup>

<sup>1</sup> Inman, P., & Savage, M. (2021, June 5). Rishi Sunak announces historic agreement by G7 on tax reform. *The Guardian*. <https://www.theguardian.com/world/2021/jun/05/rishi-sunak-announces-historic-agreement-by-g7-on-tax-reform>

<sup>2</sup> OECD/G20 Base Erosion and Profit Shifting Project. (2020). *Tax challenges arising from digitalisation – Economic impact assessment*. <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-economic-impact-assessment-0e3cc2d4-en.htm>



Practically, what would this mean for a corporation located in three jurisdictions, with subsidiary 1 in Country A, subsidiary 2 in Country B, and the parent company in Country C? In all three jurisdictions, the corporation pays taxes according to each country’s tax rules. However, if subsidiaries 1 and 2 do not pay tax at the level of the global minimum rate, then the top-up tax—the difference between the ETR and the global minimum rate—is collected by Country C under the income inclusion rule.

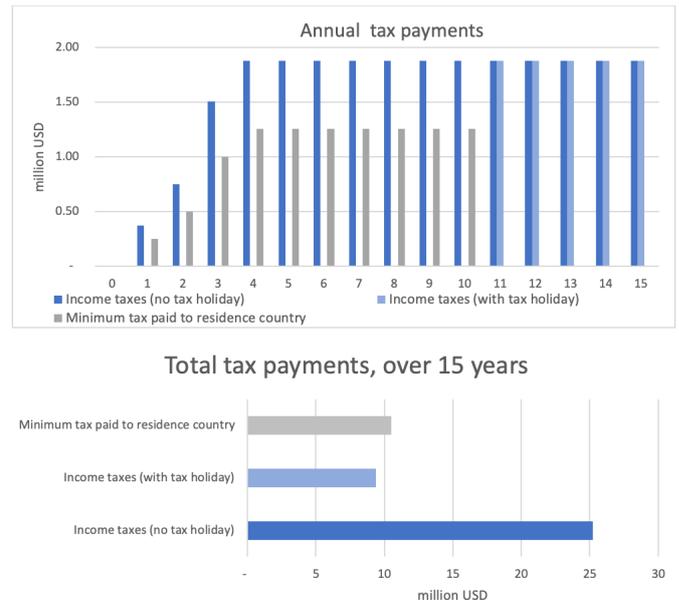
Once the reform is enacted, any subsidiary of a multinational company will therefore be expected to pay a corporate income tax of at least the minimum tax rate—15%, according to the G7 proposal. In principle, this should be easy to reach, as most developing countries have much higher statutory corporate tax rates, ranging from 20% to 40%. However, companies may pay less than the minimum tax rate when they benefit from tax incentives. There are two categories of tax incentives that developing countries often grant to foreign investors.

The first one is incentives that create temporary, or timing, differences between companies’ financial statements, which declare profits according to international accounting standards (“accounting profits”), and their taxable income, calculated based on domestic tax rules—e.g., accelerated depreciation of capital assets. These incentives do not reduce the total amount of taxes owed; they merely postpone them. They tend to be efficient in attracting investment: they lower the cost of capital and so make less-profitable investments viable. The Inclusive Framework is committed to finding a workable solution to prevent these types of incentives from triggering a top-up tax, although the details are yet to be determined (see IGF-ATAF report).<sup>3</sup>

The second category of tax incentives plainly reduces or eliminates taxes paid on profits, often for a set period of time—e.g., tax holidays, preferential tax rates, tax credits, investment allowances, or income exemptions.<sup>4</sup> These incentives are considered less efficient than the first category of tax incentives and more likely to result in profit shifting.<sup>5</sup> They are the types of incentives

targeted by the reform. The minimum tax will make many of them ineffective because any multinational company that benefits from an incentive such that its tax rate is less than the minimum rate will simply have to pay the balance to a foreign jurisdiction (often the residence country of the company that receives the incentive). The example below shows the impact of a 10-year tax holiday under the global minimum tax.

**Illustration: Impact of a 10-year tax holiday under the global minimum tax**



Source: Authors’ calculations, based on a simplified 15-year investment described in Appendix A of IGF and ATAF, 2021.

The global minimum tax will only affect taxes calculated on the profit of multinational companies. This would include corporate income taxes, withholding taxes on cross-border payments of dividends or interest, and any profit-based levy such as a profit-based mineral royalty or tax on economic rent. It will have no impact on taxes and charges not based on corporate income such as VAT, customs duties, payroll taxes, revenue-based taxes such as mineral royalties, production sharing arrangements, and no impact on any incentives granted by governments on these revenue streams. This prompts the question of whether countries will compete for investment by lowering these types of taxes in the future. It would be advisable not to, especially considering that these taxes are more reliable and easier to collect than taxes on income.

<sup>3</sup> Intergovernmental Forum on Mining, Minerals, Metals, and Sustainable Development (IGF), and the African Tax Administration Forum (ATAF). (2021). *Global digital tax reforms and mining: The issue of timing differences*. <https://www.iisd.org/system/files/2021-04/global-digital-tax-reforms-mining-en.pdf>

<sup>4</sup> UNCTAD-CIAT. (2018). *Design and assessment of tax incentives in developing countries*. [https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives\\_eng.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives_eng.pdf)

<sup>5</sup> Platform on Tax Collaboration. (2015). *Options for low-income countries’ effective and efficient use of tax incentives for investment: A report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank*. <https://www.imf.org/external/np/g20/pdf/101515.pdf>



## How should developing countries amend their tax incentives regimes to benefit rather than lose from the global minimum tax?

The objective of the global minimum tax is to combat the race to the bottom. All countries are encouraged to take action to benefit from less tax competition and to avoid tax revenues to be collected elsewhere under the global minimum tax.

First, countries will have to ensure their headline corporate income tax rate is higher than the globally agreed minimum rate. The United States, for instance, proposed a corporate income tax rate of 28% and a global minimum tax rate of 21%.<sup>6</sup> The reason is that the global minimum tax is based on the ETR, which is the total (covered) taxes paid to the government divided by accounting profits.<sup>7</sup> The ETR in some years may be lower than the headline tax rate. Even a relatively high corporate tax rate of 30% may lead to an ETR below the global minimum in some years.

Second, source countries should remove from their tax codes and investment laws all tax incentives from the second category described in Section 2 that reduce or eliminate taxes paid on profits. Not only have these types of incentives been shown to have limited effectiveness at attracting investment in developing countries,<sup>8</sup> but with a global minimum tax, they would not even reach their intended objective, only leading to a transfer of tax from source states to the residence states of multinational companies.

An alternative would be for countries to introduce a domestic minimum tax, either on gross revenues or modified profits, to ensure that no company pays less than the new global minimum rate in their jurisdiction. Domestic minimum taxes are increasingly common, with one IMF study finding that in 2018, 52 countries levied this type of tax.<sup>9</sup> Rather than relying on corporate

income tax to achieve the global minimum rate, countries would apply a minimum tax on gross revenue instead, or in addition to the corporate tax rate. This option would likely be easier for developing countries to design and legislate than to wind down each tax incentive in law and contracts.

## What can developing countries do if some tax incentives are locked in stabilization clauses under Investment agreements or laws?

In most cases, tax incentives are found in investment and tax laws and can be lawfully unwound or phased out unilaterally by governments. However, many developing countries have entered into modified tax agreements for large investment projects, either through special provisions in the applicable domestic law or in investment contracts with foreign investors. They are particularly common in the extractive industries.<sup>10</sup> These agreements often contain tax incentives that are locked in by fiscal stabilization clauses. While stabilization provisions vary, they typically freeze the fiscal terms in the law or contract at the time a project begins so that changes in tax law may not be applicable to existing investment projects, at least for a defined period of time.

To align with the new global minimum tax, countries will need to amend such laws and renegotiate contracts, whether stabilized or not. Otherwise, these tax incentives may create untaxed income and a potential transfer of tax to the residence countries of foreign investors. Where the incentives are subject to a stabilization agreement, countries that choose to address this challenge unilaterally could end up in arbitration with companies, which is costly and uncertain.

Some bilateral investment treaties include provisions that analogize FET to stabilization clauses. These could be interpreted by some arbitral tribunals as requiring the stability of the legal framework and therefore potentially broaden the number of tax incentives that cannot be changed unilaterally by host governments. Countries may also need to review their treaties for overly broad FET clauses.

<sup>6</sup> The White House. (March 2021). *The American Jobs Plan, factsheet* [Press release]. <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>

<sup>7</sup> IGF and ATAF, *supra* note 3.

<sup>8</sup> Van Parys, S., & James, S. (2009). *Why tax incentives may be an ineffective tool to encouraging investment? The role of investment climate* (SSRN Scholarly Paper ID 1568296). Social Science Research Network. <https://papers.ssrn.com/abstract=1568296>

<sup>9</sup> Aslam, A. & Coehlo, M. (2021). *The benefits of setting a lower limit on corporate taxation* [Blog]. International Monetary Fund. [https://blogs.imf.org/2021/06/09/the-benefits-of-setting-a-lower-limit-on-corporate-taxation/?utm\\_medium=email&utm\\_source=govdelivery](https://blogs.imf.org/2021/06/09/the-benefits-of-setting-a-lower-limit-on-corporate-taxation/?utm_medium=email&utm_source=govdelivery)

<sup>10</sup> Nakhle, M. (2016). *Fiscal stabilization in oil and gas contracts – Evidence and implications*. Oxford Institute for Energy Studies. <https://www.oxfordenergy.org/publications/fiscal-stabilization-in-oil-and-gas-contracts-evidence-and-implications/>



Countries must call on the Inclusive Framework to find a global solution. If not, the outcome will be politically unsustainable for governments and put at risk investors' social licence to operate.

The solution should address the following objectives:

- i. Prevent a transfer of tax revenue from host countries to home countries arising from stabilized tax incentives.
- ii. Enable countries to modify their laws, treaties, and investment agreements to adjust to the impact of a minimum tax, regardless of stabilization provisions. This would not be a wholesale cancellation of stabilization provisions, but a limited revision of stabilized tax incentives that lead to a contravention of the new global minimum tax rules.<sup>11</sup>
- iii. Protect countries that choose to remove tax incentives from stabilized agreements with the express aim of bringing the ETR in line with the minimum global rate from arbitration proceedings being filed against them

Rather than paying the tax elsewhere, it is likely that most companies will be open to addressing this issue with their host state. Therefore, companies should state their support for a limited revision of stabilized provisions to take into account the new global minimum tax and lay the conditions under which they will not challenge a government that revises stabilized tax holidays to bring them up to the minimum ETR.

## Conclusion

Depending on its final design, a global minimum tax could serve to reduce profit shifting across all sectors. It may also provide protection against the pressure felt by many developing country governments to offer tax breaks and incentives to investors, which can deprive governments of much-needed fiscal revenue. However, for this to work, developing countries need support from the international community to unwind tax incentives that are subject to fiscal stabilization in laws, treaties, and contracts. Otherwise, countries

stand to lose twice: first, by foregoing taxes from the incentive, and second, by losing tax to developed countries. The Inclusive Framework should resolve this issue as a matter of priority.

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<sup>11</sup> This would be similar to legitimate anti-avoidance measure, accepted by the OECD's Guiding Principles for Durable Extractive Contracts.



## INSIGHT 2

## An interview with Esmé Shirlow on *Judging at the interface: Deference to state decision-making authority in international adjudication*

Esmé Shirlow



### What prompted you to write this book? What gap in our understanding of deference does the book fill?

This project grew out of my work in international adjudication, including my work as a government lawyer in the Australian Government’s Office of International Law. Through this work, I realized that many different approaches to assessing the role and relevance of domestic decisions in international adjudication have been classified as “deferential” (for example, the “margin of appreciation” doctrine, or “standards of review” analysis). However, the connection between these approaches—and how approaches differ either over time or before different international courts and tribunals—is less well understood. I also realized through working with different governments that it was also not well understood what different approaches to deference reveal about the nature and structure of international adjudication itself, including the relevance of deference to the “interface” between the international and domestic legal systems.

One of the cases I worked on during my time in the Office of International Law was the Philip Morris tobacco plain packaging claim. The issue of “deference” came up in quite disparate ways across that case. For instance, the High Court of Australia had ruled that the tobacco plain packaging measure did not result

in an “appropriation” of Philip Morris’ intellectual property under the constitution, which meant that—had the case proceeded to the merits—the international tribunal would have had to consider whether the High Court’s ruling was relevant in any way to its decision about whether an “expropriation” of property had occurred under the treaty. Australia also asked the tribunal to defer to its policy assessments that tobacco plain packaging would be effective in cutting smoking rates. It submitted that it was for Australia—and not an international tribunal—to make public policy assessments of that type. This is just one of many international disputes which raise these questions around whether an international court or tribunal should defer to domestic decisions and, if so, how to achieve such deference. These are the types of cases and questions I investigate in the book.

In the book, I explore how adjudicators in four different international regimes (the Permanent Court of International Justice, the International Court of Justice, the European Court of Human Rights, and investment treaty tribunals) have approached issues of deference in 1,700 decisions concerning alleged state interference with private property rights across a 95-year time period (1924 to 2019). I reviewed these decisions to identify instances where domestic decisions were referred to by international adjudicators and sought to identify whether the international adjudication deferred to these domestic decisions to give them some relevance; how they structured the giving of that deference; and the reasons they provided for giving deference to these decisions.

Based on this analysis, the book identifies a large number of techniques capable of achieving deference to domestic decision-making in international adjudication. I explore the function and manifestation of deference in international adjudication and what different approaches to deference in different times and contexts reveal about the nature of international law and its changing relationship to domestic legal orders.



## **In the book, you develop a taxonomy of deference that builds on different understandings of authority. In broad strokes, what are these different approaches to deference, and how do they relate or respond to domestic decision-making authority?**

In Chapter 1 of the book, I define deference as arising in situations in which international adjudicators recognize the decision-making authority of domestic officials. Specifically, I argue that approaches to deference represent three different views as to the relationship between the decision-making authority of domestic and international actors. I refer to these as “conclusive,” “suspensive,” and “concurrent” approaches to authority and deference.

In “conclusive” approaches, one of the decision-makers is considered to have exclusive competencies or a form of supremacy over the other. Deference here operates as a controlling reason for an adjudicator’s decision. In the Philip Morris example, Australia’s view about the effectiveness of the plain packaging measure would take conclusive effect and be treated as dispositive of the question before the adjudicator. Such approaches to deference rely on principles of trumping to regulate interactions between domestic and international decision-making authority.

Other deference-achieving devices operate instead by according the domestic decision-maker some priority, suspending the capacity of the international adjudicator to determine the matter either at all or for a certain time. Adjudicators using these approaches to deference avoid determining conflicting claims to authority by delaying or denying conflict; they analyze authority in “suspensive” terms.

By contrast, a third set of approaches envisage “concurrent” authority for both the domestic decision-maker and the international adjudicator. Adjudicators using these approaches view authority as conditional, and seek to balance or mediate—rather than override or foreclose—conflicting claims to authority. An international adjudicator might, for example, defer to a state’s claim that a public health measure will be effective, so long as that conclusion is shown to be “reasonable” or reached in “good faith.” Such approaches to analyzing authority lead to an analysis of deference along a spectrum (more/less deference). By contrast, the analysis of authority according to both the “conclusive” and “suspensive” structures prompts

particularly categorical approaches to deference (defer/not defer).

Using this taxonomy, I argue that analyzing how a deference-achieving device operates is more important than assessing it by reference to its label. In fact, labels can obscure a lot. References to, for example, “justiciability,” “self-judging clauses,” or the “margin of appreciation” can describe reasoning that is actually structured in quite distinct ways. Using that insight, in the second part of the book I develop a taxonomy of approaches to deference in international cases by reference to how deference functions and is structured in practice rather than by reference to how it is labelled. The taxonomy is based on the difference between the conclusive, suspensive, and concurrent views of authority I’ve just outlined.

## **You compare investment arbitration tribunals to several other international adjudicatory fora. When it comes to approaches to deference taken by investment arbitrators, how does this regime compare to the others included in your study?**

In the book, I make various comparisons between approaches to deference in the different adjudicative regimes. To take one example, the empirical analysis reveals differences between the particular approaches to deference preferred by adjudicators in each regime. The European Court of Human Rights (ECtHR) and investment tribunals, for example, disclosed a preference for relatively more conditional approaches to conceptualizing decision-making authority, viewing it as concurrent more frequently than adjudicators in the other regimes. The ECtHR adopted this view of authority in 82% of its observed applications of deference and investment tribunals in 73% of applications. The Permanent Court of International Justice and International Court of Justice, by contrast, adopted a concurrent view of authority in only 45% and 55% of observed applications of deferential reasoning. They displayed a greater tendency than adjudicators in the other two regimes to apply modes of deference reflecting conclusive or suspensive views of authority. In the book, I suggest that these different “profiles” reveal differences in how each of these adjudicators conceptualizes the interface between domestic and international decisions (and the domestic and international legal systems), as well as differences in institutional and procedural design. Investment treaty tribunals, for example, disclose an overall more



mixed profile to structuring deference relative to other adjudicators, which is perhaps to be expected given the ad hoc nature of that adjudicative regime.

Another interesting finding emerging from the analysis is that international adjudicators frequently pierce the state's veil in analyzing whether to defer to domestic decision-makers. As I explore in the book, this impacts how these adjudicators consider and appraise state decision-making authority, and impacts the specific approaches to deference that they adopt in practice.

### **Have modes of deference deployed in ISDS cases changed significantly over time? If so, what do these changes tell us about the development of the regime?**

Previous studies of deference have treated it as a fixed phenomenon and have rarely considered its dynamic qualities. So, it was important for me in the book to investigate whether—and if so how—deference changes over time. Overall, I found through the empirical analysis that deferential reasoning has become more frequent over time. Across the four regimes, applications of deference in majority decisions peaked between 1984–1989 and again in 1993–1995. Applications of deference began to rise once more from 2004 onwards, dropping off again in more recent decisions. Since 2011, however, international adjudicators have applied some form of deference on average once in each majority decision.

Using this temporal analysis, I make various comparisons between the different regimes in the book. For example, I note various differences in the tendency of investment arbitrators—compared to judges at the ECtHR—to adopt “substantive” versus “procedural” approaches to deference. I also show changes over time in how authority is being analyzed in the various regimes. For example, whereas the approach of the ECtHR shows a strong preference for concurrent approaches to authority (averaging 71% of applications from 1975–2019; and 80% from 1990–2019), this preference appears less strong for investment tribunals (averaging 50% of applications from 1990–2019, but 70% from 2008–2019). The temporal analysis also shows that approaches to authority (as concurrent or as categorical/suspensive) began to diverge in investment arbitration decisions from 2005–2007, whereas they diverged earlier in the decisions of the ECtHR (1991–2001).

These temporal findings reflect evolutions in how adjudicators are analyzing the domestic/international interface, including in response to broader debates about their role vis-à-vis domestic decisions and ongoing reforms to their institutional features. Adjustments to the jurisdictional competences of international adjudicators will, for instance, impact their relative legitimacy and expertise vis-à-vis states. As adjudicators become more acquainted with particular types of disputes, their authority to deal with them may also improve. Procedural adjustments may similarly impact deference. Party appointments of arbitrators may introduce particular skills, knowledge, or legitimacy to the panel deciding a given dispute. Such adjustments will impact the balance of authority between adjudicators and domestic officials and thus the likelihood—and structure—of deference in a given case.

### **What lessons does your analysis hold for government officials working in areas that may find themselves at the “interface” of domestic and international authority?**

The book aims to assist government officials to navigate complex questions about deference as litigants, policy-makers, and as creators and reformers of international courts and tribunals. It aims to shift the discussion from the identification of decisions or particular approaches as deferential or non-deferential, to a more specific and nuanced enquiry in order to assist litigants to frame their submissions on deference in specific cases. In essence, a key message is that approaches to deference are necessarily malleable, which opens up scope for litigants to be quite creative in crafting their pleadings to bring in (or exclude) deference in a given case. The final chapter of the book develops a framework to guide this exercise, presenting what I call “levers” for deference that litigants can use to increase or decrease the relevance of deference in their own submissions.

In addition to providing this guidance for litigants, the book also highlights how officials might structure their own domestic decision-making processes and outcomes to maximize the chances of their decisions attracting deference from actors like international courts and tribunals. The book also offers insights into how the design of international courts and tribunals and reform processes might influence the propensity of different courts or tribunals to adopt different approaches to deference.



## **You mention state submissions to the UNCITRAL WGIII in Chapter 10. In what ways are the approaches to deference discussed in your book relevant to attempts to reform ISDS?**

The book addresses several themes of relevance for ongoing discussions about the reform of particular adjudicative regimes, including UNCITRAL WGIII's work. The book illustrates the value of examining deference conceptually and systemically for what it reveals about international adjudication and the international/domestic interface.

As I show in the book, ostensibly technical debates about deference reflect more fundamental debates about the appropriate balance between the decision-making authority of international and domestic actors. In the book, I argue that the question of whether deference should or shouldn't apply in a given regime is not the right question: deference is an inherent component of international adjudication. It is instead more productive to ask *how* deference should be structured and applied. I argue that deference is necessarily malleable, so "fixing" or directing approaches to deference is unlikely to be a feasible (or desirable) reform option. However, I show how reforms to the features of international courts and tribunals will impact approaches to deference. Approaches to deference depend heavily upon how international courts and tribunals conceive of their role, legitimacy and expertise relative to that of domestic actors. This indicates that deference is likely to differ depending on a range of factors, including historical context, geographical factors, the background and skills of adjudicators, the claim structure and caseload of international courts, and the procedural features of international courts and tribunals. Many of these features are currently open for discussion and reform, including as part of the WGIII reform process. In this sense, the book illustrates just how interconnected individual reforms to international courts and tribunals can be, including to show how even exclusively procedural reforms can have far-reaching substantive implications.

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## INSIGHT 3

# The “trade-related” conundrum of the EU–Korea FTA Expert Panel: Are FTAs a novel forum to enforce sustainable development goals?

Rebecca Walker



On January 20, 2021, a Panel of Experts established under the EU–South Korea Free Trade Agreement (FTA) found that South Korea was in breach of the FTA’s sustainable development chapter. Under Article 13.4.3 of the agreement, the EU and South Korea “commit to respecting, promoting and realising” fundamental labour rights, including the freedom of association, “in accordance with the obligations deriving from membership of the [International Labour Organization] ILO.”<sup>1</sup> The EU–Korea agreement is a new-generation FTA that includes a unique dispute settlement mechanism: following a 90-day consultation period, the parties may file a complaint to an ad hoc panel determining a potential breach of the FTA’s sustainability chapter. In line with the EU’s novel approach to promoting its sustainable development agenda with trading partners, the EU filed a complaint that Korean labour laws were inconsistent with Article 13.4.3 of the FTA.<sup>2</sup> In the recent Panel of Experts’ report, the three panellists adjudicated two sets of EU claims: firstly, that Korean legislation does not adhere to the minimum standards of freedom of association as

expressed in the ILO Constitution, and secondly, that Korea has not made continued and sustained efforts to ratify the ILO Conventions on the freedom of association (Conventions 87 and 98), as specified in the agreement.

The decision created waves among practitioners and academics alike as it amounted to the EU’s first victory in challenging the Trade and Sustainable Development (TSD) obligations of a contracting party under the FTA dispute settlement mechanism.<sup>3</sup> The lack of freedom of association rights under Korean legislation has been on the EU Members’ radar for quite some time, as similar concerns surfaced during Korea’s accession process to the OECD.<sup>4</sup> The EU–Korea FTA provided a forum through which the EU could voice these concerns and subsequently challenge Korean labour laws by subjecting them to international review. The panel held that Korea was in breach of Article 13.4.3, as its domestic labour legislation fails to grant certain collective bargaining rights and the freedom of association in accordance with ILO standards as reflected in the core conventions. Strikingly, the panel held that the EU’s claims regarding Korean domestic labour laws were well-founded despite having no connection to trade under the FTA.

This article unpacks the panellists’ decision and draws parallels to the only other decision concluded concerning labour commitments under an FTA: *Guatemala – Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA–DR*. This article examines the Panel of Experts’ procedures and the issues arising with respect to FTAs as a source of future litigation to enforce sustainability

<sup>3</sup> Melin, Y. & Kim, J. W. (2021). *EU–Korea FTA panel ruling and a challenge for its effective implementation* (EU Law Live 2021). <https://eulawlive.com/op-ed-eu-korea-fta-panel-ruling-and-a-challenge-for-its-effective-implementation-by-yves-melin-and-jin-woo-kim/>

<sup>4</sup> The Nordic countries and Austria were particularly active in pressing Korean labour reform during Korea’s accession process. OECD Members further “tended to coalesce informally around Korea ratifying ILO Conventions 87 and 98” as a prerequisite to Korea’s accession to the OECD. Salzman, J. (2000). Labor Rights, globalization and institutions: The role and influence of the Organization for Economic Cooperation and Development. *Michigan Journal of International Law*, 21(4), 769–848.

<sup>1</sup> EU–South Korea Free Trade Agreement, Article 13.4.3.

<sup>2</sup> The EU requested three other consultations under FTAs. Bondy, C., & Shin, K. (2021). *The EU–Korea FTA labor dispute: Comparing labor provisions under the EU–Korea FTA and the KORUS FTA* (Steptoe & Johnson LLP Global Trade Policy Blog). <https://www.lexology.com/library/detail.aspx?g=cb3811a2-1f3d-45a1-9517-b53b5ef37106>



objectives. These considerations are also relevant with respect to international investment agreements and FTAs including investment chapters. Increasingly, labour issues are addressed not only in FTAs but also in international investment agreements.

## A summary of the Panel of Experts' report

### The panellists firstly uphold their jurisdiction over the EU's claims

The scope of the sustainable development chapter reads as follows: "Except as otherwise provided in this Chapter, this Chapter applies to measures adopted or maintained by the Parties affecting trade-related aspects of labour."<sup>5</sup>

The panel rejected Korea's position that the claims brought by the EU have no connection to trade under the EU–Korea FTA (i.e., they are not "trade-related") and fall outside the scope of the agreement. The panel read that the commitments of the parties to respect, promote, and realize fundamental labour rights assumed under Article 13.4.3 represented an exception to the "trade-related" requirement, as determined by the phrase "except as otherwise provided in this Chapter." According to the panel, obliging a contracting party to adhere to fundamental ILO labour standards only for some sectors that are related to trade with the EU "is clearly antithetical to the unambiguous meaning" of the labour rights embedded in Article 13.4.3.<sup>6</sup> For example, Article 13.4.3(c) refers to the obligation to eliminate all forms of forced labour and not simply within particular sectors.<sup>7</sup> The interpretation was justified through an *a contrario* comparison of Articles 13.4.1 and 13.4.2 and through a broader reading of the object and purpose of the agreement.<sup>8</sup> The object and purpose of the EU–Korea FTA was interpreted as not simply to facilitate the free flow of trade under equally competitive conditions (as was interpreted to be the object of the CAFTA–DR by the panel in *Guatemala*), but rather the parties' national labour laws adhere to the standards enshrined

in the parties membership obligations to the ILO.<sup>9</sup> The panel emphasizes that the FTA was constructed so as to provide a strong connection between trade and the promotion of fundamental labour rights, and concludes: "national measures implementing such rights are therefore inherently related to trade as it is conceived in the EU–Korea FTA."<sup>10</sup>

The panel's approach differs from the arbitral panel's decision of *Guatemala* in a dispute between the United States and Guatemala.<sup>11</sup> Here, the phrase "in a manner affecting trade" of the CAFTA–DR was interpreted as a narrow requirement that must confer a competitive advantage on the employer or enterprise engaged in trade with the parties to the FTA.<sup>12</sup>

### The EU's first set of claims that the Korean Trade Union and Labor Relations Act (TULRAA) fails to adequately ensure the freedom of association

The panel firstly determined whether Article 13.4.3, in which the contracting parties "commit to respecting, promoting and realising, in their laws and practices, the principles concerning the fundamental rights, namely: (a) freedom of association and the effective recognition of the right to collective bargaining" amounted to a legally binding obligation to implement the principles of freedom of association as expressed in the ILO core conventions (87 and 98). Despite Korea's lack of ratification of these conventions, "the principles concerning the fundamental rights" was understood in the context of the labour obligations expressed in the ILO Constitution (arising from ILO membership obligations).<sup>13</sup> According to the panel, the parties' membership of the ILO creates an obligation to adhere to the principles of the freedom of association as explained by the ILO supervisory bodies and the ILO Committee on Freedom of

<sup>5</sup> *Supra* note 1, article 13.2.1.

<sup>6</sup> Panel of Experts Proceeding Constituted under Article 13.15 of the EU–Korea Free Trade Agreement, para 66.

<sup>7</sup> *Supra* note 6, para. 65.

<sup>8</sup> Peers, S. (2021). Free trade v freedom of association? The EU/South Korea free trade agreement and the panel report on the EU challenge to South Korean labour law (EU Law Analysis). <http://eulawanalysis.blogspot.com/2021/01/free-trade-v-freedom-of-association.html>

<sup>9</sup> *Ibid.*

<sup>10</sup> *Supra* note 6, para. 95..

<sup>11</sup> As the Panel suggested, the context of the EU's claims differ to those previously raised by the United States in *Guatemala*, as they were concerned with the failure to enforce collective bargaining rights and not with national laws meeting such minimum labour standards as prescribed in international agreements, as was the issue in the EU–Korea Panel report. See Peers, *supra* note 8.

<sup>12</sup> *Guatemala – Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA-DR* (2017), para 190.

<sup>13</sup> *Supra* note 6, para. 107.



Association (CFA).<sup>14</sup> Furthermore, the panel held that the term “commit” provides for the legally binding link with these fundamental principles, rather than being a purely aspirational term.<sup>15</sup>

In examining the freedoms of association granted under Korean national employment legislation, the TULRAA, the panel upheld three of the EU’s four claims. The following provisions of the TULRAA were found to be inconsistent with the fundamental principles concerning freedom of association as embedded in Article 13.4.3:

1. The legal definition of “workers” under Article 2(1) of the TULRAA fails to encompass self-employed, dismissed, and unemployed persons, who are therefore not permitted to enjoy freedom of association rights.
2. Article 2(4)(d) of the TULRAA disallows non-workers (dismissed, unemployed, and self-employed persons) to join a trade union.
3. Article 23(1) of the TULRAA only permits members of the trade union to be elected as trade union officials, *ex officio* excluding non-members and prohibiting full freedoms in electing trade union officials.

However, the EU failed to demonstrate that the discretionary certification procedure for the establishment of a trade union under the TULRAA results in “an impermissible constraint on the free formation of trade unions.”<sup>16</sup>

## The EU’s second claim concerning Korea’s ratification of the ILO Conventions

The EU also contended that Korea failed to “make continued and sustained efforts towards ratifying the fundamental ILO Conventions” in compliance with the last sentence of Article 13.4.3. Despite the panel’s remarks that the proposed bills to ratify only three of the ILO core conventions in Korean Parliament in 2019 was “less-than-optimal,” they concluded that these endeavours did not fall below the legal standard of making “continued and sustained efforts.”<sup>17</sup>

<sup>14</sup> *Supra* note 6, para. 108 et 110

<sup>15</sup> *Supra* note 6, para. 125 et 127.

<sup>16</sup> *Supra* note 6, para. 234.

<sup>17</sup> *Supra* note 6, para. 292.

## The institutional mechanism of the Panel of Experts

The establishment of an Expert Panel under an FTA is an innovative institutional mechanism to enforce TSD provisions.<sup>18</sup> Both parties to the dispute select one expert panellist, while the two appointed co-experts select a chairperson.<sup>19</sup> Laurence Boisson de Chazournes was appointed by the EU, Jaemin Lee was appointed by Korea, and these experts selected Jill Murray as the chairperson. A key task of the panel is to “seek the advice of the Domestic Advisory Groups [DAGs] and competent international organisations.”<sup>20</sup> DAGs are set up under the EU–Korea FTA. They “comprise independent representative organisations of civil society in a balanced representation of environment, labour and business organisations,” and provide advice concerning the implementation of TSD provisions.<sup>21</sup> The panel also refers to the general principles of the ILO Committee on Freedom of Association’s *Compilation of Decisions* in its interpretation of the fundamental principle of the freedom of association.<sup>22</sup>

The decision rendered by the panel adopts the form of recommendations, and the parties must “make their best efforts to accommodate advice or recommendations of the panel of experts.”<sup>23</sup> The decision rendered by the panel is not legally binding, nor can the EU suspend their tariff concessions if the recommendations are not implemented.<sup>24</sup> In this respect, this mechanism differs from the U.S. approach to enforcing TSD obligations within its FTAs. For example, parties to the KORUS (the South Korea–U.S. FTA) can impose trade sanctions or fines when TSD obligations are breached.<sup>25</sup>

<sup>18</sup> Brown, C. M. (2011). The European Union and regional trade agreements: A case study of the EU–Korea FTA. In C. Herrmann and J. P. Terhechte (Eds.), *European Yearbook of International Economic Law*, 305.

<sup>19</sup> *Supra* note 1, article 13.15.2.

<sup>20</sup> European Commission. (2009). *EU–South Korea Free Trade Agreement: A quick reading guide* [Report]. [https://trade.ec.europa.eu/doclib/docs/2009/october/tradoc\\_145203.pdf](https://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145203.pdf)

<sup>21</sup> European Economic and Social Committee. (n.d.). *The EU–Republic of Korea Domestic Advisory Group*. <https://www.eesc.europa.eu/en/sections-other-bodies/other/eu-republic-korea-domestic-advisory-group>

<sup>22</sup> *Supra* note 6, para. 116 à 118.

<sup>23</sup> *Supra* note 1, article 13.15.2

<sup>24</sup> Melin & Kim, *supra* note 3.

<sup>25</sup> Bondy & Shin, *supra* note 2.



Despite the non-legally binding nature of the decision, a Committee on Trade and Sustainable Development, which is established under Article 15.2(1)(e), monitors the implementation of these recommendations.<sup>26</sup> It is therefore too soon to say whether the non-legally binding Trade and Sustainability Chapter of the EU–Korea FTA can succeed despite lacking teeth, as the decision exerts pressure on the parties to comply with the recommendations. On February 26, 2021, the South Korean government proposed bills to ratify the ILO conventions pertaining to the freedom of association.<sup>27</sup> Recent panel decisions such as the one established under the EU–Korea Panel FTA signal the development of a new practice in which policing sustainable development objectives is outsourced to ad hoc panellists under “a special *sui generis* arbitration system.”<sup>28</sup>

### Looking ahead: What does the decision mean for FTAs with trade and sustainability obligations?

The panel’s report represents a landmark in its suggestion that trade and fundamental labour rights are intrinsically linked: unlike the *Guatemala* decision, no competitive advantage for the parties or impact on trade is examined. A new practice is thereby created in which the review of Korean labour legislation is outsourced to three panellists by virtue of an FTA regardless of its relationship with trade. Some commentators have suggested that “the panel has mistaken its role as arbiters under trade agreements as ILO enforcers.”<sup>29</sup> In contrast, the narrow approach taken in the *Guatemala* decision was criticized by senior politicians and trade unions representatives for making such labour provisions “unworkable.”<sup>30</sup> For example, the *Guatemala* decision has shown that the evidence required to prove the competitive advantage conferred upon the employer engaged in trade under the FTA is a significant hurdle for claimants.<sup>31</sup>

The Korea panel decision shows this ongoing tension between upholding sustainable development goals in exchange for market access via FTAs on one hand, and the resulting convergence of employment standards on the other. The panel had, however, rejected Korea’s concerns that its reading results in a harmonization of labour standards, but rather that the parties intended to set a common “floor” of universal labour rights inherent in the FTA’s obligations to be members of the ILO.<sup>32</sup>

The panel report feeds into a larger discussion on the role of FTAs in enforcing labour provisions. While TSD obligations in trade agreements are a significant step in promoting sustainable development goals, including the legislative freedoms of association, the lingering question is whether or not dispute settlement processes under FTAs or investment agreements are the way forward as opposed to strengthening other multilateral processes and institutions, such as the ILO. As long as such developments do not materialize, the political constituencies in major powers such as the United States and the EU will continue to push for including these types of mechanisms in trade and investment agreements.

From a policy perspective, the panel seems to have found itself caught between a rock and a hard place: the rock being encroachment on domestic legislation by large Western trading partners; the hard place resembling the pressing need to promote sustainable development goals that are not impeded by the “trade-related” constraint.

The decision is a precedent that has opened a gateway for states to invoke TSD obligations in future disputes. What is emerging from this dispute is the linkage of sustainable development goals in FTAs to improvements in legal protections for workers towards international norms whether or not there is a trade advantage. As trade plus provisions become more frequently included in FTAs, it is likely that litigation involving ad hoc panellists adjudicating on compliance with minimum international standards to further sustainable development will continue to grow.

<sup>26</sup> Croquet, N. A. J. (2015). The climate change norms under the EU–Korea Free Trade Agreement: Between soft and hard law. In J. Wouters, A. Marx et al. (Eds.), *Global governance through trade: EU policies and approaches*. Edward Elgar Publishing. 124–157.

<sup>27</sup> Korea: Unions welcome government’s move to ratify ILO core conventions after thirty years. (2021). *Uni Global Union*. <https://www.uniglobalunion.org/news/korea-unions-welcome-governments-move-ratify-ilo-core-conventions-after-thirty-years>

<sup>28</sup> Brown, *supra* note 18, p. 305.

<sup>29</sup> LeClercq, D. (2021). *The Panel Report under the EU–Korea trade agreement concerning labor practices: What are the purposes of trade agreements as they relate to the ILO’s fundamental labor rights?* [International Economic Law and Policy Blog]. <https://ielp.worldtradelaw.net/2021/02/guest-post-the-panel-report-under-the-eu-korea-trade-agreement-concerning-labor-practices-what-are-t.html>

<sup>30</sup> Harrison, J. (2019). *The labour rights agenda in free trade agreements*. *The Journal of World Investment & Trade* 20(5), 705–725.

<sup>31</sup> Claussen, K. (2020). Reimagining trade-plus compliance: The labor story. *Journal of International Economic Law* 23(1) 25–43.

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<sup>32</sup> *Supra* note 6, para. 82 et 85..



## INSIGHT 4

## Despite consensus on the ECT's incompatibility with the global climate agenda, claims that it is well-suited for the clean energy transition persist

Lea Di Salvatore, Nathalie Bernasconi-Osterwalder and Lukas Schaugg



There is scientific consensus that in order to limit global warming as defined in the Paris Agreement states must swiftly phase out fossil fuels and transition to low-carbon energy systems.<sup>1</sup> However, given the continued dependency of economies on fossil fuels, such phase-outs and the pursuit of a clean energy transition at a global scale are complex tasks that demand that all institutions and levels of governance work in this direction.<sup>2</sup>

Due to its outdated investment protection provisions and the option for fossil fuel investors to challenge sovereign climate action, the ECT is widely recognized to be a key obstacle to the clean energy transition.

In 2021 alone, energy giants RWE<sup>3</sup> and Uniper<sup>4</sup> have used the ECT to commence ISDS proceedings against the Dutch government's decision to phase out coal power plants by 2030.<sup>5</sup> In light of these and other concerns inherent to the ECT's investment and ISDS provisions, the 56 contracting states of the ECT unanimously decided in 2018 to “modernize” the treaty.<sup>6</sup> Currently, an agreement on how it should be modernized is far from agreed, and some states are considering withdrawing from the treaty altogether,<sup>7</sup> as Italy has already done.<sup>8</sup>

In an attempt to show the ECT's continued relevance, supporters of the treaty—who can generally be grouped into four sets of actors (the ECT Secretariat [“Secretariat”]), law firms and arbitrators, energy companies, and the government bodies that have tight economic links with the energy industry)<sup>9</sup>—argue that the ECT is necessary for—and indeed has been successful in—protecting and promoting renewable energy investments (“RE investments”). This conclusion is frequently based on statistics from ECT-based ISDS claims brought by investors in renewable energies (“RE

<sup>1</sup> See Masson-Delmotte, V., Zhai, P., Pörtner, H.O., Roberts, D., Skea, J., Shukla, P.R., Pirani, A., Moufouma-Okia, W., Péan, C., Pidcock, R. & Connors, S. (2018). *Global warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty*, pp. 1-9. [https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15\\_Full\\_Report\\_Low\\_Res.pdf](https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_Low_Res.pdf); International Energy Agency (IEA) (2021). *Net zero by 2050: A roadmap for the global energy sector*. <https://www.iea.org/reports/net-zero-by-2050>; see Allen, M. R., Frame, D., Frieler, K., Hare, W., Huntingford, C., Jones, C., Knutti, R., Lowe, J., Meinshausen, M., Meinshausen, N., & Raper, S. (2009). The Exit Strategy. *Nature Reports Climate Change* 56. [https://www.researchgate.net/publication/31939315\\_The\\_exit\\_strategy](https://www.researchgate.net/publication/31939315_The_exit_strategy); see Allen, M., Frame, D. J., Huntingford, C., Jones, C. D., Lowe, J. A., Meinshausen, M., & Meinshausen, N. (2009). Warming caused by cumulative carbon emissions towards the trillionth tonne. *Nature* 458, 1163.

<sup>2</sup> See Driesen D.M. (2014). Phasing out fossil fuels. *Nova Law Review* 38(3), 523; Pirani, S. (2018). *Burning up: A global history of fossil fuel consumption*. Pluto Press.

<sup>3</sup> See *RWE v. The Netherlands* (ICSID Case No. ARB/21/4).

<sup>4</sup> See *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands* (ICSID Case No. ARB/21/22).

<sup>5</sup> See Braun, S. (2021). Multi-billion euro lawsuits derail climate action. *Deutsche Welle*. <https://www.dw.com/en/energy-charter-treaty-ect-coal-fossil-fuels-climate-environment-uniper-rwe/a-57221166>.

<sup>6</sup> See Energy Charter Secretariat. (2018). *Decision of the Energy Charter Conference*. [https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201821\\_-\\_NOT\\_Report\\_by\\_the\\_Chair\\_of\\_Subgroup\\_on\\_Modernisation.pdf](https://www.energychartertreaty.org/fileadmin/DocumentsMedia/CCDECS/CCDEC201821_-_NOT_Report_by_the_Chair_of_Subgroup_on_Modernisation.pdf)

<sup>7</sup> See Simon, F. (2021). *France puts EU withdrawal from Energy Charter Treaty on the table*. Euractiv, <https://www.euractiv.com/section/energy/news/france-puts-eu-withdrawal-from-energy-charter-treaty-on-the-table/>; Aarup, S. A., & Mathiesen, K. (2021). *Energy pact divides EU as Spain threatens walkout*. Politico. <https://www.politico.eu/article/eu-split-over-energy-charter-treaty-as-spain-floats-unilateral-withdrawal/>.

<sup>8</sup> See ECT country page on Italy at <https://www.energycharter.org/who-we-are/members-observers/countries/italy/>.

<sup>9</sup> See Flues, F., Eberhardt, P. & Olivet, C. (2020). *Busting the Myths around the Energy Charter Treaty: A Guide for Concerned Citizens, Activists, Journalists and Policymakers*. p. 7. <https://www.tni.org/en/ect-mythbuster>



cases”). The Secretariat, for instance, regularly highlights that a large percentage of ECT-based ISDS claims—approximately 60%—concern RE investments.<sup>10</sup>

These statistics have led the ECT’s supporters to draw a set of inferences that converge around certain central statements.<sup>11</sup> It is alleged that the number of initiated RE cases is a strong indicator of the capacity and effectiveness of the ECT to protect and promote RE investments among the 56 contracting parties of the treaty. Furthermore, it is stated that such ISDS proceedings act as an incentive for ECT contracting states to actively promote foreign investment in renewable energies. In this sense, they infer that the ECT’s ISDS provision acts as a deterrent for states to adversely interfere with such foreign RE investments. In addition, it is submitted, such investors would be left without an adequate legal remedy to challenge state interference with their investments.<sup>12</sup>

In sum, supporters see the ECT as an instrument that fosters a more stable regulatory framework for RE investments and therefore incentivizes them. Further, some commentators claim that the ECT promotes RE investments *to a greater extent* than investments in fossil fuels.<sup>13</sup>

On the basis of these arguments, supporters of the ECT conclude that the treaty is an instrument that is well-suited to protect foreign RE investments and to accompany signatories in the clean energy transition. But to what extent does the data on the number of RE cases cited by the ECT’s supporters indeed allow the drawing of such inferences?

To answer this question, this article assesses these inferences by analyzing data on ECT-based ISDS cases related to RE investments. We have based our analysis on case-related data gathered from UNCTAD’s *Investment Dispute Settlement Navigator*<sup>14</sup> and the ICSID database.<sup>15</sup> The sample comprises a total of 133<sup>16</sup> publicly known ECT-based investment arbitration cases, of which 76 are related to an RE investment. The data sample includes publicly known ECT-based cases initiated before July 31, 2020. For the purpose of the classification of an investment as investment in “renewable energies,” we applied the definition of the IEA, according to which, renewables “include ... bioenergy, geothermal, hydropower, solar photovoltaic (PV), concentrating solar power (CSP), wind and marine (tide and wave) energy for electricity and heat generation.”<sup>17</sup> To gather the sample, all the ISDS cases initiated under the ECT were collected, and each case was classified as relating to either fossil fuel or RE investments. Of the 133 cases samples, 12 arbitrations could not be labelled since the energy source is unknown.<sup>18</sup>

<sup>10</sup> See Energy Charter. (2020). *Even more renewable energy investors rely on treaty protection: updated statistics of investment arbitration cases under the Energy Charter Treaty*. <https://www.energycharter.org/media/news/article/even-more-renewable-energy-investors-rely-on-treaty-protection-updated-statistics-of-investment-arb/>; Vail, T. (2021). *The Energy Charter Treaty supports investment in renewables*. Euractiv. <https://www.euractiv.com/section/energy/opinion/the-energy-charter-treaty-supports-investment-in-renewables/>

<sup>11</sup> See, for example, Thomas, W., Davies, E., & Brennan, A. (2021). *The Energy Charter Treaty: First rounds of negotiations to modernize the ECT take place*. Freshfields Bruckhaus Deringer. <https://sustainability.freshfields.com/post/102gder/the-energy-charter-treaty-first-rounds-of-negotiations-to-modernise-the-ect-take>; Vail, *supra*, note 10; See Rusnák, U. (2021, February 28). *The Energy Charter Treaty supports investment in renewables* [Tweet]. <https://twitter.com/SecGenEnCharter/status/1366141443195219968>; Umbach, F. (2021). *The Energy Charter Treaty makes the transition easier. Don’t scrap it, reform it*. Energypost.eu <https://energypost.eu/the-energy-charter-treaty-makes-the-transition-easier-dont-scrap-it-reform-it/>; Rack, Y. (2021). *Energy treaty reform could see investors in fossil fuels, renewables lose cover*. SPGlobal.com. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/energy-treaty-reform-could-see-investors-in-fossil-fuels-renewables-lose-cover-62782061>.

<sup>12</sup> Anatole Boute suggests that “Investment arbitration has the potential to considerably limit the instability that currently affects the implementation of climate change mitigation policies” by limiting regulatory risks. He also analyzes how the current regime (including specifically the ECT) is not apt to effectively protect RE investments and suggests the integration of “a specific low-carbon investment regime in a future international agreement on climate change.” p. 657. Boute, A. (2021). *Combating climate change through investment arbitration*. *Fordham International Law Journal*, 35(3), 613.

<sup>13</sup> See Mete, G.M., & Pei-Ru, J. G. (2021). *The role of the Energy Charter Process in accelerating the energy transition and ensuring energy security in South East Europe in line with the Energy Union*. In M. Mathioulakis (Ed.), *Aspects of the Energy Union: Application and effects of European energy policies in SE Europe and Eastern Mediterranean*. Springer International Publishing; Rivkin, D. W., Lamb, S. J. & Leslie, N.K. (2015). *The future of investor-state dispute settlement in the energy sector: Engaging with climate change, human rights and the rule of law*. *The Journal of World Energy Law & Business* 8(2), 130.

<sup>14</sup> See UNCTAD. (2020). *Investment dispute settlement navigator: Full data release as of 31/07/2020* (Excel Format).

<sup>15</sup> Available at <https://icsid.worldbank.org/cases/case-database>.

<sup>16</sup> The dataset does not include the following cases: *Prairie Mining Limited v. Poland, Mitsui & Co., Ltd. v. Kingdom of Spain* (ICSID Case No. ARB/20/47), *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands* (ICSID Case No. ARB/21/22) and <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/21/4>. These arbitrations were not included in the dataset collected for this research because they are too recent.

<sup>17</sup> Since the ECT neither differentiates between low- and high-carbon investments nor gives a precise definition of RE investment, we adopted the IEA definition, according to which, renewable energy “includes bioenergy, geothermal, hydropower, solar photovoltaic (PV), concentrating solar power (CSP), wind and marine (tide and wave) energy for electricity and heat generation.” IEA. (2020). *World Energy Outlook*, p. 436.

<sup>18</sup> For example, in the case *Libananco Holdings Co. Limited v. Republic of Turkey* (ICSID Case No. ARB/06/8), it is not possible to assess the energy source of this project since the dispute is related to a distribution company, which is hardly classifiable as either low- or high-carbon sector.



## Does the ECT effectively protect renewable energy investments?

At the outset, it is important to note that Article 1(6) of the ECT currently covers investments in renewable energies at several stages of the value chain. According to Article 1(5) of the ECT, “Economic Activity in the Energy Sector’ means an economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products.” These energy materials and products are set out in Annex EM I of the treaty and specifically include any energy investment aimed at the production of electrical energy, including RE investments. Therefore, subject to certain conditions, renewable energy investors indeed have the standing to commence ISDS proceedings against contracting states of the ECT.

However, the mere option to bring such a claim can hardly be considered a decisive factor for the promotion and protection of RE investments. Such a conclusion requires additional proof of actual recourse to ISDS, as well as effectiveness of this use for the promotion and protection of such investments. While 76 out of 133 (60%) of ECT-based ISDS are indeed related to RE investments, our research shows that out of these 76 cases, 46 were brought against Spain to challenge the same legislative measures, i.e., the Spanish government’s decision to alter its feed-in tariffs for renewable energy producers in the wake of the financial crisis in 2008. The remaining 30 proceedings were brought against only nine different respondent states: Albania (1), Bosnia and Herzegovina (1), Bulgaria (3), Croatia (1), Czech Republic (6), Germany (2), Italy (12), Romania (3), and Slovenia (1). No RE case has been brought against the 46 remaining contracting parties of the ECT, which include both economies with significant investment in renewable energy capacity—such as the Netherlands, the United Kingdom, France and Sweden<sup>19</sup>—and economies with virtual absence of such investment, such as Kazakhstan and Azerbaijan.<sup>20</sup>

By contrast, there are 41 ECT-based ISDS cases relating to investments in fossil fuels, involving a far greater geographic variety of 22 different respondent states, with cases spread relatively evenly. The Russian Federation has been the most frequent respondent state, defending six ECT-based ISDS cases brought by fossil fuel investors. In contrast to the 46 RE cases brought against Spain, this number again emphasizes the much greater diversity of respondents in ECT-based fossil fuel ISDS cases when compared to RE cases.

It is hence difficult to conclude that the ECT effectively protects RE investments relative to fossil fuel investments. Not only have there been fewer measures brought to arbitration than in the fossil fuels industry, but these have been very concentrated in just a few countries.

Furthermore, any consideration of the effectiveness of this regime in protecting RE should be based on the decisions awarded. Nonetheless, at the time of publication, 49 of the 76 (65%) RE cases are still pending. Since more than half of the cases have yet to be decided, it would be hasty to conclude that the ECT indeed protects RE investments.

Lastly, research shows that there is no clear evidence of the protection granted by existing investment treaties.<sup>21</sup> The numbers are in line with this outcome. Of the RE cases that have been concluded (27), arbitral tribunals rejected investor claims in 12 cases, and one case was discontinued. In addition, cases in which investors prevailed were geographically concentrated, further eroding the assumption of broad, widespread protection: Of the remaining 14 cases in which investors prevailed, 12 were brought against Spain alone, reaffirming the existence of the interference of specific measures with RE investments in the country, rather than a widespread protection. In fact, considering the non-Spanish cases, nine cases were decided in favour of the state while only two were decided in favour of the investor.

<sup>19</sup> See Frankfurt School FS-UNEP Collaborating Centre. (2020). *Global trends in renewable energy investment*. [https://www.fs-unesp-centre.org/wp-content/uploads/2020/06/GTR\\_2020.pdf](https://www.fs-unesp-centre.org/wp-content/uploads/2020/06/GTR_2020.pdf).

<sup>20</sup> See Index Mundi. (n.d.). *Countries ranked by fossil fuel consumption*. <https://www.indexmundi.com/facts/indicators/EG.USE.COMM.FO.ZS/rankings>.

<sup>21</sup> Selivanova, Y. S. (2018). Changes in renewables support policy and investment protection under the Energy Charter Treaty: Analysis of jurisprudence and outlook for the current arbitration cases. *ICSID Review* 33(2), 433–455, p. 452; Boute, *supra* note 12, p. 656



## Is the ECT the right instrument to foster the energy transition?

A related question concerns the effectiveness of the ECT in *promoting* RE investments. In this context, supporters of the ECT claim that the treaty is well-suited to promote RE investments, especially in developing countries.<sup>22</sup> These claims heavily rely on the assumption that by signing IIAs, states attract a greater amount of FDI. However, several recent studies on this topic have been inconclusive, finding little or no evidence on the correlation between investment agreements and investment flows.<sup>23</sup>

In the specific case of the ECT, no tailored empirical research aimed at understanding the motivation of RE investors' choices has been conducted and, so far, there is no evidence of a link between the existence of the ECT and an increase in FDI among its contracting states.

Furthermore, in the period from 2013 to 2018, an average of 75% of global investment in renewable energy was domestic rather than foreign.<sup>24</sup> As the ECT applies exclusively to foreign investments among its contracting states, it cannot be said to promote such domestic investment.

Moreover, supporters of the ECT claim that without ISDS, RE investors would often be left without an adequate legal remedy to hold host states accountable for the breach of promises made.<sup>25</sup> This interpretation disregards the availability of domestic remedies such as the option to challenge regulatory measures in the national courts of the host states. Indeed, as a reaction to the Spanish government's measures altering the country's feed-in tariff system, many investors commenced litigation in the Spanish courts.<sup>26</sup>

There are two further weaknesses in the assumption that the availability of ECT-based ISDS as a legal remedy is a key factor in promoting RE investment: Firstly, it is based on the erroneous notion that access to ISDS is equal for *any type of investor*, and secondly, it fails to explain why the majority of RE investment actually stems from domestic sources.

When assessing the equality of investor access to ISDS, it is crucial to take into account the particular nature of RE investments that, in light of the recent drop in RE costs,<sup>27</sup> can be much smaller and scattered than fossil fuel investments.<sup>28</sup> The average cost for investors to bring an ISDS claim is USD 6.4 million, and the average arbitral tribunal's fees are USD 1 million. Access to ISDS therefore depends on the financial means of the investor in question, and the procedure is often unavailable to the small investors that are increasingly investing in RE projects.<sup>29</sup>

Lastly, if the availability of ISDS were such an important factor in the promotion of RE investment, how can the importance of *domestic* RE investments be explained? Indeed, while domestic investors have no standing to bring an ISDS claim based on the ECT, this does not seem to have been an obstacle for the willingness to invest. A recent scientific analysis of ECT-based cases brought by RE investors against Spain stated that "the only domestic firms that have been able to pursue cases are large multinationals, such as Abengoa and Isolux, who have used their foreign affiliates to gain access to the ECT."<sup>30</sup>

<sup>22</sup> Mete & Pei-Ru, *supra* note 13.

<sup>23</sup> Tienhaara, K., & Downie, C. (2018). Risky business? The Energy Charter Treaty, renewable energy, and investor-state disputes. *Global Governance* 24(3), 451; Jacobs, M. (2017). Do bilateral investment treaties attract foreign direct investment to developing countries? A review of the empirical literature. *International Relations and Diplomacy* 5, p. 583; Yackee, J. W. (2011). Do bilateral investment treaties promote foreign direct investment? Some hints from alternative evidence. *Virginia Journal of International Law*, 51, p. 397

<sup>24</sup> See IRENA. (2020). *Global landscape of renewable energy finance 2020*. [https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2020/Nov/IRENA\\_CPI\\_Global\\_finance\\_2020.pdf](https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2020/Nov/IRENA_CPI_Global_finance_2020.pdf), p. 32.

<sup>25</sup> see Vail, *supra* note 10.

<sup>26</sup> See Schmidl, M. (2021). *The renewable energy saga. From Charanne v. Spain to The PV Investors v. Spain: Trying to see the wood for the trees*. Kluwer Arbitration Blog. <http://arbitrationblog.kluwerarbitration.com/2021/02/01/the-renewable-energy-saga-from-charanne-v-spain-to-the-pv-investors-v-spain-trying-to-see-the-wood-for-the-trees/>

<sup>27</sup> IEA. (2020). *World energy investment 2020*; UNCTAD. (2020). *World investment report 2020*.

<sup>28</sup> Daintith, T. (2017). Against "Lex Petrolea." *Journal of World Energy Law and Business*, 10(1), p. 1.

<sup>29</sup> In a forthcoming IISD report, Lea Di Salvatore explores the degree of entanglement of the fossil fuel industry with the ISDS. The results show that global oil corporations, including several carbon majors, have the monetary power to recur easily to ISDS. Di Salvatore, L. (forthcoming). *Global trends in fossil fuel arbitrations*. International Institute for Sustainable Development.

<sup>30</sup> Tienhaara & Downie, *supra* note 23



## Conclusion

Upon closer analysis, it becomes clear that no inferences on the ECT's capacity to protect and promote RE investments can be drawn from the number of ECT-based ISDS cases concerning renewable energies. The mere option of commencing ISDS proceedings is not a factor in protecting or promoting RE investment in ECT contracting parties.

While the treaty's capacity to protect and promote RE investment in a way that is sufficient to meet the Paris objectives is uncertain at best, ECT-based ISDS cases relating to fossil fuel investments continue to emerge. These cases serve as a stark reminder that the treaty serves as a key obstacle for its contracting parties' efforts to address the climate crisis.

Instead of trying to pursue reform of the ECT, states may wish to adopt more suitable tools in line with their obligations under the Paris Agreement. ECT contracting parties may, for instance, commit to a definitive schedule for the phasing out of fossil fuels and explore more viable incentives to increase investment in renewable energies.

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## INSIGHT 5

# From transparency to prohibition: UNCITRAL WGIII considers options to regulate third-party funding

Brooke Guven, Lise Johnson, H. Suzy Nikiéma and Daniel Uribe



In June 2021, the tribunal in *Infinite Gold v. Costa Rica* found Costa Rica liable for a breach of fair and equitable treatment but rejected the investor's request for roughly USD 100 million and awarded no damages.<sup>1</sup> This case, which also involved allegations of corruption by the investor, may have been successful on liability but reflects a weak claim on causation and damages.

This outcome from that early phase extractive industry project is similar to patterns and outcomes in some other ISDS disputes. In *South American Silver v. Bolivia*, the tribunal found that the claimant mining company had acted wrongfully in its engagement with local Indigenous communities, threatening critics and inflaming tensions and violence. Though the tribunal agreed with the investor that the host state violated the applicable treaty, the tribunal awarded the investor only a fraction of its claimed damages—less than USD 20 million out of the roughly USD 300 million sought.<sup>2</sup> In *Cortec Mining v. Kenya*, the tribunal rejected the investors' claim for over USD 2 billion based on the absence of adequate environmental authorizations for

the mining project.<sup>3</sup> That case also involved allegations of corruption on the part of the investor. In *Churchill Mining and Planet Mining v. Indonesia*, the tribunal similarly dismissed the investors' claims for over USD 1 billion based on concerns about fraudulent conduct in the operation and expansion of the investment.<sup>4</sup>

These cases all raise questions about the “quality” of investors and investments invoking investment treaties. And they are all ISDS cases in the extractive industries in which the investors' claims either proved wildly inflated and/or were being pursued by investor claimants that allegedly engaged in substandard, if not illegal, activities far from the conduct expected of good corporate citizens.

Notably, all of these claimants, and their problematic claims, were financed by third-party funders.

These cases weaken narratives that third-party funding (TPF) is a tool for enabling access to justice by deserving companies wrongfully harmed by opportunistic host state conduct; they raise doubts about assertions that funders do robust due diligence on investors and their cases; and they align with allegations that TPF is enabling and driving marginal, speculative, and high-stakes claims that, even when unsuccessful, are still costly to respondent host states.<sup>5</sup>

<sup>3</sup> ICSID Case No. ARB/15/29, Award, 22 October 2018.

<sup>4</sup> ICSID Case Nos. ARB/12/14 and 12/40, Award, 6 December 2018.

<sup>5</sup> In *Cortec Mining*, the respondent had to bear half of its legal costs in the underlying arbitration, and another USD 1 million due to a subsequent annulment proceeding. See Charlotin, D. (2021, May 9). Revealed: ICSID ad hoc committee in *Cortec v. Kenya* opines that supplementary decision mechanism is the proper remedy for infra petita awards and dismisses bid to annul finding that investment treaties contain an implicit legality requirement. *IA Reporter* <https://www.iareporter.com/articles/revealed-icsid-ad-hoc-committee-in-cortec-v-kenya-opines-that-supplementary-decision-mechanism-is-the-proper-remedy-for-infra-petita-awards-and-dismisses-bid-to-annul-finding-that-investment-treaties-contain-an-implicit-legality-requirement/>. In *Infinite Gold* and *South American Silver*, Costa Rica and Bolivia, respectively, had to each bear millions of dollars in defense costs; in *Churchill Mining and Planet Mining*, even though the claimant had to cover the majority of Indonesia's legal fees and expenses, that still left the country with millions it had to pay itself. See Hepburn, J. (2019, December 9). Analysis: Unreasonable ‘willful blindness’ as to business partner's fraudulent misconduct stymies mining claim in Indonesia. *IA Reporter* <https://www.iareporter.com/articles/analysis-unreasonable-willful-blindness-as-to-business-partners-fraudulent-misconduct-stymies-mining-claims-against-indonesia/>

<sup>1</sup> ICSID Case No. ARB/14/5, Award, 3 June 2021.

<sup>2</sup> PCA Case No. 2013-15, Award, 22 November 2018.



It is against this background that UNCITRAL's Working Group III (WGIII) is pursuing reform of TPF, tasking the Secretariat with preparing draft language to address different issues and concerns delegates had raised, many of which were based on their own experiences with funded claims. As we discuss below, the Secretariat's draft regulatory provisions are now out and open for comment until September 15, 2021.

## The process

States participating in UNCITRAL's WGIII are proposing to regulate the funding of ISDS claims, with many particularly focused on regulation of for-profit, commercial funding of claims against states. Some, such as Argentina, the Dominican Republic, Honduras, India, Indonesia, Kenya, Morocco, Nigeria, South Africa, Uruguay, and Vietnam, have called for or supported further analysis of fully restricting for-profit commercial funding of ISDS claims. Others favour a lighter touch. For instance, the United Kingdom—which is home to a strong arbitration industry, a number of ISDS funders, and outward investors that are relatively frequent users of ISDS and TPF—appears not to share the more profound concerns regarding TPF. Instead, it seems to favour a more narrow focus on increased transparency and has stressed the importance of consulting the funding industry in developing any regulations.<sup>6</sup>

At the WGIII session in October 2019, delegates instructed the Secretariat to prepare sample text reflecting possible regulatory solutions to address identified concerns. In line with those instructions, the Secretariat has now provided “Draft Provisions on Third-Party Funding” (the “Draft”). After September 15, 2021, when the period for comments on the Draft concludes, next steps presumably include a process of reviewing and incorporating input received and making time on WGIII's agenda to discuss the revised draft provisions. But it is unclear how exactly that process will be managed.

For instance, it is uncertain when the topic of TPF reform will again be addressed in WGIII itself. WGIII currently anticipates its work proceeding into 2026.<sup>7</sup> It divides its formal sessions and informal “intersessional” meetings along eight main groups, including a catch-all “ISDS Procedural Rules Reform” pillar encompassing such diverse topics as damages, claims for reflective loss, parallel proceedings, counterclaims, dismissal of frivolous claims, and exhaustion of local remedies. TPF is presumably integrated within this catch-all category, but it is unclear how much formal and/or informal time will be spent on the topic, reviewing and debating the different options reflected (or not) in the Draft or its revision.

It is also unclear whether the comments received will all be made public. When the Secretariat does not make comments it receives public, it is impossible to know how different delegations and other commenters reacted to different aspects of a proposal. This lack of transparency also obscures whether and to what extent comments of different stakeholders are meaningfully addressed. The legitimacy of the drafting process calls for clarity on who is asking for what—and the extent to which suggestions received, and from whom, are incorporated. But it is not yet known whether and with whom that information will be shared.

The Columbia Center on Sustainable Investment (CCSI), along with the International Institute for Sustainable Development (IISD) and the International Institute for Environment and Development (IIED), are among those who submitted comments and annotated suggestions to the Draft and have posted our joint submission on our respective websites.<sup>8</sup> Additionally, funders on their own behalf, and through a recently created industry association, have submitted and posted comments critiquing the WGIII process and reform proposals, and advocating against any kind of

<sup>6</sup> States' oral submissions on this topic were made during the 37th and 38th Sessions of WGIII. Recordings of the sessions are available at <https://uncitral.un.org/en/audio#03>.

<sup>7</sup> A basic overview of the WGIII's work and timeline is available at [https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/210825\\_status\\_of\\_work\\_wg\\_iii.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/210825_status_of_work_wg_iii.pdf).

<sup>8</sup> IISD, IIED, & CCSI. (2021). *Submission on third-party funding*. [https://ccsi.columbia.edu/sites/default/files/content/docs/IISD%20IIED%20CCSI%20Submission%20to%20UNCITRAL%20on%20TPF%20initial%20draft%20-%20July%2030%20\(1\).pdf](https://ccsi.columbia.edu/sites/default/files/content/docs/IISD%20IIED%20CCSI%20Submission%20to%20UNCITRAL%20on%20TPF%20initial%20draft%20-%20July%2030%20(1).pdf), and <https://ccsi.columbia.edu/content/third-party-funding-investor-state-dispute-settlement>. See also IISD, CCSI, & IIED. (2019). *Draft text providing for transparency and prohibiting certain forms of third-party funding in investor-state dispute settlement*. <https://ccsi.columbia.edu/sites/default/files/content/docs/our%20focus/extractive%20industries/UNCITRAL-submission-Third-Party-Funding.pdf>.



significant reform.<sup>9</sup> Given the stakes for states, funders, and others, it is likely that many more submissions have been or will be made.

## The substance

The Draft sets forth a menu of options and suggested language to implement them. The options range from disclosure requirements to a complete prohibition on use of all forms of TPF. The draft also discusses options for enforcement and sanctions.

### Disclosure model

The “disclosure model” (Draft Provision 7), contemplates requiring funded parties to reveal (at least to the tribunal and the disputing parties, and potentially to the public) the existence and identity of funders, which could require not only the legal funding vehicle but its beneficial owner. It also contemplates requiring disclosure of the funding agreement itself, or certain terms thereof. It then provides a list of items that the tribunal *may* require the funded party to disclose, some of which may have also been covered by disclosure of the funding agreement.

Disclosure is proposed as a stand-alone model or one that would be combined with some of the regulation models also proposed. Notably, partial disclosure is the model that ICSID appears to favour in its proposed rule revisions. While disclosure of the existence and identity of funders can allow actors to better identify actual or perceived conflicts of interests, it would not change the ways in which TPF is used, or address its impacts on cases or the system more broadly. For many delegations,

disclosure is a necessary start, but does not fully address concerns about the role or effects of TPF on ISDS claims, outcomes, or incentives.

### Regulation models

In addition to TPF disclosure, there are four general regulatory approaches outlined in the Draft: two approaches to limiting the use of TPF and two sets of exceptions to those limits.

The first proposed regulatory model, the “prohibition model” (**Draft Provision 2**), provides several avenues by which states could aim to prohibit all forms of TPF. In addition to restricting private investment in cases and award proceeds, this approach, as drafted, would also bar grants from non-profit organizations, contingency fee arrangements with counsel, and possibly certain types of loans or insurance.

A second regulatory model, the “restriction list model” (**Draft Provision 5**) proposes to *allow* TPF as a general matter but restrict certain forms of funding, such as funding provided “on a non-recourse basis in exchange for a success fee and other forms of monetary remuneration or reimbursement wholly or partially dependent on the outcome of a proceeding or portfolio of proceedings.” This approach seeks to address particular concerns about for-profit investments in damages claims against governments, concerns that allowing such financing introduces a new stakeholder into the ISDS equation with its own interests in—and ability to advocate for—broad interpretations of jurisdictional provisions and substantive obligations, and liberal approaches to damages. Concerns about giving such funders a permanent place in the ISDS system are not similarly raised by other forms of TPF, including funding for states, contingency fee agreements based on legal services performed, and non-profit funding. While disclosure of those other forms of TPF may be warranted so as to protect against conflicts of interest or other reasons, those forms of TPF would not be prevented.<sup>10</sup>

<sup>9</sup> Woodsford Litigation Funding Limited has submitted comments stating that it “respectfully disagrees with the Working Group’s belief that further regulation of third-party funding is necessary.” [https://woodsfordlitigationfunding.com/us/wp-content/uploads/sites/3/2021/08/Woodsford\\_UNCITRAL\\_submission\\_Final.pdf](https://woodsfordlitigationfunding.com/us/wp-content/uploads/sites/3/2021/08/Woodsford_UNCITRAL_submission_Final.pdf). The International Legal Finance Association believes that any “prohibition or restriction of legal finance would weaken the rule of law, create a significant gap between the express goals of the U.N. and UNCITRAL and the achievement of these goals, and fly in the face of strong support for third-party funding by the corporations that are in a position to build the infrastructure and make the other direct investments needed by many States.” In ILFA’s submission, it notes that it “stands ready to assist the Secretariat, and to that end, will shortly seek permission to become an Observer to the UNCITRAL WGIII.” See [https://uploads-ssl.webflow.com/5ef44d9ad0e366e4767c9f0c/61088589e63c5979a9f22599\\_ILFA%20comments%20UNCITRAL%20WG%20III%20TPF%20Reform%20Proposals%20FINAL.pdf](https://uploads-ssl.webflow.com/5ef44d9ad0e366e4767c9f0c/61088589e63c5979a9f22599_ILFA%20comments%20UNCITRAL%20WG%20III%20TPF%20Reform%20Proposals%20FINAL.pdf). For a broader discussion of the financialization of TPF in ISDS and the role of the funding industry, see generally Dafe, F. & Williams, Z. (2020). Banking on courts: financialization and the rise of third-party funding in investment arbitration. *Review of International Political Economy*.

<sup>10</sup> IISD, CCSI, & IIED, *supra* note 8.



As between the two approaches—a broad prohibition and a more tailored restriction—it is not clear that there were many supporters in WGIII for the broad prohibition model. Thus, it seems that the key issues will not be whether to opt for the prohibition or the restriction model, but where, in a regulation model, to draw the line between what is and is not allowed.<sup>11</sup>

The Draft also contemplates two approaches whereby TPF would be generally disallowed but then makes exceptions for funding in certain circumstances or for certain kinds of claimants. Either or both of these two exceptions could be combined with a broad prohibition on TPF or the more targeted restriction model. Each exception, however, raises questions and challenges.

One of the possible exceptions, which is reflected in **Draft Provision 3**, would permit funding to support investors who would otherwise lack “access to justice.” Setting aside the practical questions of how this condition would be assessed (e.g., who has the burden of proof and what is the standard, what is the relevance of cost and accessibility of other dispute fora and remedies, and are there any prohibitions on asset-stripping or use of special-purpose vehicles), it is crucial to question the underlying premise that access to ISDS can be characterized as an access to justice issue. Most stakeholders, including domestic investors, must pursue other remedies to secure redress for any alleged harm, including but not limited to domestic courts. The fact that in such circumstances legal claimants are not able to access ISDS does not mean that they lack access to justice. The equation of access to ISDS with access to justice is a largely incomplete and misleading one. While it is essential to ensure that those whose rights have been violated have access to justice to protect those rights, ISDS is not a prerequisite to access to justice, and it is not clear

that using TPF to support ISDS in this context is the correct or appropriate approach.<sup>12</sup>

The other possible exception, which is reflected in **Draft Provision 4**, suggests that TPF could be permitted for investors who can establish compliance with certain, as yet unidentified, sustainable development provisions or objectives. As with the “access to justice” model, this approach raises a number of conceptual and practical issues. There are, for instance, concerns that funding itself introduces or drives distortions in the ISDS system in a way that undermines sustainable development objectives.<sup>13</sup> These distortions will exist irrespective of whether the underlying investment project aligns with sustainable development aims. Additionally, from a practical perspective, the standards and processes for determining whether any investment project is “sustainable” would need to be designed and implemented with great care. Presumably, the standard for sustainability would also need to be set at a high bar because the implication is that investors who do not meet the standard for TPF could still bring claims (albeit without TPF). Thus, any such standard for TPF would need to be beyond the rather porous approaches that have been used in investment law to date to determine the “legality” of investments and their “contributions to economic development in the host state.”

Overall, we consider that (1) the restriction model reflected in Draft Provision 5, (2) along with public disclosure requirements for other forms of TPF, and (3) without either the “access to justice” or “sustainable development” exceptions, is the combination best able among the options presented to address, and avoid, case-specific and systemic concerns about funding in ISDS.

<sup>11</sup> The line could be drawn in the definition of TPF used, or with respect to the scope of application of certain regulations. Thus, there could be a broad definition of TPF, and disclosure requirements for all forms of funding falling within that definition, but more targeted regulation of and restrictions on a narrower subset of TPF. For more on the policy implications raised by different forms of funding, see, e.g., IISD, CCSI, & IIED, *supra* note 8; Guven, B. & Johnson, L. (2019). *The policy implications of third-party funding of investor-state dispute settlement*. <https://ccsi.columbia.edu/sites/default/files/content/docs/our%20focus/extractive%20industries/The-Policy-Implications-of-Third-Party-Funding-in-Investor-State-Dispute-Settlement-FINAL.pdf>.

<sup>12</sup> Other approaches to ensuring access to justice include efforts to support and strengthen domestic courts. There are also questions about whether TPF in ISDS adequately protects claimants’ interests. Disputes between claimants in funded cases and their counsel and funders indicate there are tensions. See, e.g., Bohmer, L. (2021, June 15). After Vietnam pays hefty UNCITRAL BIT award, investor-claimant files suit against his lawyers accusing them of collusion with third-party funder to take greater share of winnings. *LA Reporter*. <https://www.iareporter.com/articles/after-vietnam-pays-hefty-uncitral-bit-award-investor-claimant-files-suit-against-its-lawyers-accusing-them-of-collusion-with-third-party-funder-to-take-greater-share-of-winnings/>

<sup>13</sup> In Guven & Johnson (*supra* note 11), the authors consider systemic policy implications that TPF may be introducing into the ISDS system.



## Sanctions and enforcement

Finally, possible sanctions are set forth for consideration (Draft Provision 6, and part of Draft Provision 7). The current list provided in the Draft, coupled with the discretion given to tribunals to select (or not) from among them, is poised to be an ineffective deterrent to funders' and claimants' attempts to circumvent funding restrictions. While this list was apparently curated from existing approaches to TPF regulation, the wide-ranging concerns identified by WGIII demand a more comprehensive and extensive approach to punishing those who circumvent (or try to circumvent) the rules. These could include (1) requirements that the tribunal dismiss (or annul) a claim (or award) in certain egregious circumstances; (2) rules requiring claimant (and its counsel) to certify that the claim (and) or legal counsel is not benefiting from TPF; (3) mandatory suspension of proceedings for a set period of time so that any deficiencies (particularly related to transparency or certification) can be remedied; and (4) instructions on cost and expense orders in cases of regulatory violations. In all cases, the rules should be clear under what circumstances a tribunal should have discretion, and when a sanction is mandatory.<sup>14</sup>

## Conclusion

As *Infinito Gold*, *Cortec Mining*, *South American Silver*, and *Churchill and Planet Mining* illustrate, third-party funders are supporting marginal claims against states, seeking inflated amounts, and contributing to the dynamic whereby states are forced to engage in high-stakes arbitration. While some of these weak but costly claims may be brought without TPF, the existence of TPF can make them more likely. TPF reduces the risk to claimants of pursuing cases, and funders also have their own interests, separate and potentially conflicting with funded investors' aims, to push cases and seek and recover high damage claims.

In this context, states are contemplating action, and funders are pushing back. The UNCITRAL Secretariat has produced options ranging from disclosure to prohibition and is providing stakeholders with an opportunity to weigh in on which path to follow. How the work on this issue unfolds, procedurally and substantively, is a key test for the UNCITRAL process more broadly.

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<sup>14</sup> Section 4 of the CCSI/IISD/IIED submission (2019) sets forth a more comprehensive and robust list of sanctions for consideration (n 8).



## NEWS IN BRIEF

### ECT modernization negotiations continue with two rounds over the summer as opposition mounts

Since we last [reported](#) on the process, there have been two virtual negotiation rounds on ECT modernization, taking place in the midst of increased civil society opposition to the agreement, particularly within the EU.

The fifth round took place in June 2021. Topics covered at the meeting, according to a [public statement](#) released by the modernization group, included the definition of transit; issues related to CSR and sustainable development; dispute settlement, with a focus on prevention and frivolous claims; security for costs; third-party funding (TPF) and valuation of damages; and, finally, the extent to which the UNCITRAL rules on transparency in ISDS should be adopted.

The sixth round of talks took place in July 2021 and covered pre-investment issues, regional economic integration organization, obsolete provisions, the definition of economic activity, and further issues related to investment protection. With regard to the latter, the [public communication](#) released after the talks notes that the definitions of investment, investor, and indirect expropriation, as well as denial of benefits, were discussed.

According to a [statement](#) put out by the EC, the sixth round made “substantial progress” related to investment protection specifically. Nevertheless, pressure within Europe to exit the ECT continues to mount; for example, as Slovenia assumed the presidency of the Council of the European Union in July, Slovenian NGOs have [reportedly](#) called on their government to push forward discussions of exit from the ECT entirely. In the lead up to COP 26, to be held in November 2021, European civil society organizations have [called](#) on European leaders to use the conference as a deadline to exit the treaty.

Meanwhile, on September 2, the CJEU opined in a [preliminary ruling](#) that the ISDS provision in the ECT was incompatible with EU law. According to the Court, the EU did not have the authority to remove from the EU jurisdictional system the settlement of a dispute between an investor from an EU Member state and another

EU Member state. To do so, it stated, would imply questioning “the preservation of the autonomy and the specific character of the law established by the [European] treaties” (para 63). Despite the ECT being a multilateral agreement that also creates relationships with non-EU member states, this precluded “the ECT from being able to impose the same obligations on the Member states among themselves” (para 65). The ECT therefore had to be interpreted as not applicable to such disputes.

In taking this view, the Court confirmed that its reasoning in the landmark decision *Achmea* equally applied to the ECT. In *Achmea*, the CJEU had held that ISDS provisions in intra-EU BITs were incompatible with EU law, prompting EU member states to terminate such BITs. While the new opinion was stated obiter and is not legally binding, it is a strong indicator that the Court will hold ECT-based ISDS to be incompatible with EU law in one of two upcoming decisions in 2022 - a [request](#) for opinion by the Belgian government and a [request](#) for a preliminary ruling by the Svea Court of Appeal. The opinion also [raises the question](#) of how arbitral tribunals and enforcement courts - especially in the US - will react when asked to rule on intra-EU disputes.

### Structured discussions on investment facilitation continue at the WTO

Following the circulation of the “Easter text” last April, which consolidated the two main negotiating documents used in the negotiations (the Informal Consolidated Text and the Revised Text), and will serve as the main basis for drafting any ultimate agreement on investment facilitation, participants in the structured discussions on investment facilitation have continued to meet over the last several months.



In a meeting in May, participants focused on the issues of transfers and payments, focal points, domestic regulatory coherence, domestic supplier databases, cross-border cooperation, and provisions on responsible business conduct.

At a meeting in June, participants discussed texts prepared by the coordinator on three topics: transparency of investment measures, responsible business conduct, and a possible MFN clause. Time was also spent on implementation, technical assistance, and capacity building for developing and LDC signatories.

According to an annotated agenda, at a meeting in mid-July, members received reports from facilitators on scope, movement of business persons, and draft provisions of the “Easter Text”, including the preamble, objectives, measures against corruption, dispute settlement and final provisions. In addition, participants conducted a stock-taking exercise to aid in planning for upcoming meetings.

At the end of July, the coordinator issued a revised “Easter Text” containing updates to several sections including to Sections II (“Transparency of investment measures”); III (“Streamlining and speeding up administrative procedures”); IV (“Focal points, domestic regulatory coherence and cross-border cooperation”); and, VI (“Sustainable investment”). It also includes some new definitions in Section I “Scope and general principles”.

At the beginning of August, the coordinator circulated revised text for the preamble, as well as for Articles 1 on Scope, 24 on Cross-Border Cooperation, and 35 on Dispute Settlement.

Further meetings will take place in September, October, and November in the lead up to the 12th Ministerial Conference, which will be held November 30 to December 3, 2021.

## UNCITRAL WGIII to consider proposals on various elements of ISDS reform while the outcome of the request for additional funding remains to be seen

As we reported, UNCITRAL WGIII on ISDS reform held its 40th session in May 2021, at which time delegates discussed a draft work and resourcing plan. Following this session, during which the document was adopted via silent procedure, the UNCITRAL Commission discussed the request for additional funding from the UN General Assembly in order to implement the draft working and resourcing plan during its 54th Session, held from June 28 to July 16, 2021.

During the UNCITRAL Commission session, the proposal to request additional funding was supported by a majority of states including most developing countries, the EU, Canada, and Australia. However, the proposal failed to reach the required consensus due to the resistance of other states, such as Russia, Belarus, Iran and Bahrain. The decision on the proposal for a request for additional resources was submitted to the silent procedure. Additionally, several states, particularly developing countries, used the Commission meeting to reiterate concerns regarding the content of the revised work plan, including the need to accord sufficient time to cross-cutting issues and damages.

While the final approval of the request for additional funds to the UN General Assembly has not yet been made official, the WGIII Secretariat continues to advance its work.

This has included an informal webinar organized with the Academic Forum on Damages in ISDS on August 26, 2021, and the Intersessional Meeting on Procedural Rules Reform (virtual) hosted by the Republic of Korea from September 2 to 3, 2021.

Additionally, the WGIII is also advancing with the drafting process on a number of areas of reform highlighted in the last version of the working and resources plan, discussed at the 40th Session. To that end, the UNCITRAL Secretariat has released a set of documents to be discussed in the coming months. These include:

- Assessment of damages and compensation
- Mediation and other forms of alternative dispute resolution
- The establishment of an advisory centre
- The selection and appointment of ISDS tribunal members
- Third-party funding of ISDS claims.



Documents related to these issues are open for comments, with deadlines for submissions between September 15 and December 31, 2021, as presented in the table below

Title	Content	Deadlines for submissions/ comments
Initial Draft on the Regulation of Third-Party Funding	Draft provisions reflecting various models of regulation and accompanied by general remarks and specifics comments	September 15, 2021
Initial Draft on the Establishment of an Advisory Centre; and its addendum 1	Preparatory work on the possible structure, scope of services, beneficiaries, costs, and financing	September 15, 2021
Draft Code of Conduct for Adjudicators in International Investment Disputes Version Two (jointly with ICSID)	Full draft text with explanatory of changes in this second version	No date specified
Draft Note on the Implementation and Enforcement of the Code of Conduct (jointly with ICSID)	Outlines of various implementation options of the Code as a binding instrument, as well as possible sanctions for noncompliance that could be further developed	No date specified
Initial draft on standing multilateral mechanism: the selection and appointment of ISDS tribunal members and related matters	Draft provisions reflecting various options, accompanied by general remarks and specifics comments	November 15, 2021
Initial draft on assessment of damages and compensation	Outlines of key issues, existing legal principles and methodologies on the assessment of damages and the determination of compensation	November 30
Initial draft on mediation and other forms of alternative dispute resolution (ADR); and its addendum 1	Draft provisions reflecting various options, accompanied by general remarks and specifics comments; as well as guidelines for effective use of mediation	December 31, 2021

We discuss the draft on TPF at greater length in an Insight article [here](#).

## Ecuador rejoins the ICSID Convention

Twelve years after it denounced the agreement, Ecuador has again ratified the ICSID Convention. The agreement came back into force on September 3, following the deposit of the instrument of ratification with the World Bank on August 21.

In 2009, during the administration of the former president Rafael Correa, Ecuador both withdrew from the convention and terminated BITs to which it was a signatory. Correa argued that the agreement violated [Article 422](#) of the Ecuadorian constitution, which prohibits “international treaties in which the State cedes sovereign jurisdiction to international arbitration bodies.” The former president also claimed that the Convention led Ecuador to face millions of dollars in cases in international arbitration.

The decision to rejoin the ICSID Convention has also been upheld by Ecuador’s Constitutional Court. However, observers note that the Court must still render a judgement on Article 422 before the country can sign new IIAs and fully reintegrate into the investment protection regime.

Rejoining the ICSID Convention was part of the measures to attract foreign investment put in place by president Guillermo Lasso, who took office last May.



## Spain and Colombia sign new BIT

The prime minister of Spain, Pedro Sánchez, and the president of Colombia, Iván Duque Márquez, signed a new BIT on September 16, 2021. Both countries sought to modernize the previous treaty, which had come into force in 2005.

Since the entering into force of the 2009 Lisbon Treaty, which placed FDI at the level of EU-level competence, the EC has been charged with negotiating IIAs with non-EU member states. Thus, the Spanish government reportedly had to obtain authorization from the EC in order to carry out these negotiations and to ensure that the new agreement was aligned with EU objectives and principles.

On the Colombian side, the negotiations followed a decision from the country's Supreme Court that ruled that the government must clarify the scope of the FET and non-discrimination standards in the Colombia–Israel FTA and Colombia–France BIT (see our analysis of that decision here). Some features of the new BIT include:

- Holding companies are not considered investors
- MFN treatment cannot reach into other treaties
- ISDS will be replaced by the multilateral court once this enters into operation

## Pakistan terminates 23 BITs

The government of Pakistan has reportedly resolved to terminate 23 of the country's 48 BITs that have completed their initial duration. Additionally, the country will not ratify 16 BITs that have been signed but have yet to enter into force.

Pakistan is currently facing 10 ISDS cases in several international arbitration forums. Recent losses have proved costly; for example, in 2019, an ICSID tribunal awarded the Australian mining company Tethyan Copper Company USD 5.8 billion in a claim against the state.

Well-known for signing the first BIT with Germany in 1959, Pakistan decided to review the entire BIT situation in 2013, developing a new BIT model. Problematic clauses in the BITs, according to the government, included indirect expropriation, FET, national treatment, and MFN.

For the remaining nine ratified BITs that cannot be unilaterally terminated at present, Pakistan will ask its treaty partners to sign a Joint Interpretation Protocol to mitigate the harmful effects or to amend the provisions for ISDS, FET, and expropriation.

## UNWG on Business and Human Rights releases 2021 report

On July 27, 2021, the UN Working Group on Business and Human Rights published its 2021 Report on Human Rights-Compatible IIAs. The Working Group will formally present the report to the UN General Assembly on October 14, 2021. In brief, the report recommends that future IIAs be compatible with states' human rights obligations.

In response to the call for input for the Working Group on Business and Human Rights' report, the International Institute for Sustainable Investment made a submission in April 2021.



## AWARDS AND DECISIONS

### ECT tribunal finds Italy's modifications to its renewable energy incentive scheme reasonable, foreseeable, and proportionate

Silver Ridge Power BV v. Italian Republic, ICSID Case No. ARB/15/37

The majority in *Silver Ridge Power BV v. Italy* dismissed the claimant's claims on merits, holding that Italy's renewable energy framework did not give rise to legitimate expectations of a fixed level of incentives.

#### Background and claims

Silver Ridge Power BV, a company incorporated in the Netherlands, owned and controlled an Italian subsidiary that operated 25 photovoltaic (PV) plants. The local subsidiary and Italy's regulator (the Gestore dei Servizi Energetici S.p.A., or GSE) entered into agreements (GSE conventions) under which the plants benefitted from feed-in-tariffs (FITs) at a specified rate for 20 years.

However, Italy progressively reduced FIT incentives through successive decrees ("Conto Energia," or Energy Accounts) to better reflect the falling costs of producing renewable energy. The Third Energy Account of 2010 established a tri-annual reduction of FITs. The "Romani Decree" of 2011 decreased the lifespan of the Third Energy Account and added conditions of eligibility for PV plants to receive FITs. The Fifth Energy Account of 2012 directed producers benefitting from incentive tariffs under any of the energy accounts to pay an annual administrative fee. Finally, in 2014, Italy enacted the "Spalma-incentivi" Decree under which it reformulated its incentive payments. Consequently, each of Silver Ridge's plants was subjected to an 8% decrease in FIT.

Silver Ridge challenged the adoption of the Romani Decree, Fifth Energy Account, and the Spalma-incentivi Decree under Articles 10 and 13 of the ECT.

#### Italy's intra-EU jurisdictional objection rejected

Italy, supported by the European Commission, argued that disputes between EU investors and member states were governed by EU law and outside the scope of

the ECT. The tribunal found that, even if a conflict exists between EU law and the ECT in respect of the jurisdiction of intra-EU arbitral tribunals, Italy's jurisdictional objection would fail due to the *lex specialis* conflict rule in Article 16 of the ECT. The tribunal noted Article 16 preserved rights of investors arising under Parts III and V of the ECT against overlapping provisions in other agreements if the former were more favourable to the investor or their investment. It found that the substantive guarantees of freedom of establishment and free movement of capital, as well as the procedural mechanism of judicial protection of EU law, overlap with the standards of investment protection and the dispute settlement mechanism in Parts III and V of the ECT. Moreover, in the tribunal's view, "at least some of the provisions of Part III and Part V of the ECT are more favorable to investors and investments with respect to ECT intra-EU claims than EU law" (para. 212). Accordingly, the tribunal held that the conditions for the rule in Article 16 were met and EU law did not operate to limit its jurisdiction.

The tribunal also rejected three other jurisdictional objections raised by Italy. First, the tribunal found that the forum selection clauses in the GSE conventions did not preclude its jurisdiction since the fork-in-the-road clause in Article 26(2) of the ECT permits the investor to choose its preferred mode of dispute settlement. Second, the tribunal dismissed Italy's objection that Silver Ridge had failed to request amicable settlement in relation to the Romani Decree as required under Article 26 of the ECT. Finally, the tribunal held that the administrative fee imposed by the Fifth Energy Account did not fall under the taxation carveout in Article 21 of the ECT. The tribunal observed that since this fee was paid for a specific purpose—for processing applications and to cover the management, control, and inspection costs under the GSE—there was sufficient degree of reciprocity in the payments to qualify them as fees and not taxes.

#### Spalma-incentivi decree did not breach umbrella clause or FET

The tribunal first addressed Silver Ridge's claims concerning the Spalma-incentivi Decree under Article 10(1) containing the umbrella clause and Article 10(1) on FET.



As regards the former, Silver Ridge argued that Italy had breached the umbrella clause by changing the terms of its obligations under the GSE conventions to the detriment of the investment. Drawing from Italy's legislative framework for renewables, the tribunal found that "the GSE conventions only reflect a legal relationship whose existence and essential features have been determined before" (para. 376). Accordingly, the tribunal held that these declaratory instruments did not constitute obligations "entered into" with Silver Ridge's investments for the purposes of the umbrella clause.

Silver Ridge further claimed that the Spalma-incentivi Decree both violated its legitimate expectations and failed to ensure legitimacy and transparency of the Italian legal framework. The tribunal opined that for legitimate expectations to exist within the meaning of this article, the relevant question was whether acts of the host state objectively gave rise to protected expectations in the factual circumstances of the given case. The tribunal also endorsed existing jurisprudence in relation to Article 10 of the ECT to note that any assessment under this provision should balance the investor's legitimate interest in the stability and transparency of the host state's legal framework and the host state's right to adapt this legal framework to relevant developments over time.

Turning to the facts of this case, the tribunal found that the terms of Italy's energy accounts, in combination with the related legislative decrees, were detailed and specific enough to create legitimate expectations. However, the majority held that Italy had not committed itself to leave this legal framework untouched for 20 years. In the majority's view, the relevant legislative acts created a system of fair remuneration for PV energy producers without guaranteeing them a fixed compensation. The majority found the reference to "constant" incentives under the Romani Decree and the energy accounts to mean stable but not fixed remuneration. Here, the majority also emphasized the absence of a stabilization or freezing clause under Italy's legislative framework for renewables. Accordingly, the majority held that the investor "could legitimately rely on the overall integrity of the incentivization regime for solar energy in Italy" but "had to be prepared for certain, non-radical modifications of the applicable legal framework" (para. 437).

In light of this conclusion, the majority considered whether Italy's measures amounted to fundamental and radical modifications of its regulatory framework. The majority accepted Italy's contention that the Spalma-incentivi Decree was aimed at a public purpose, i.e. to strengthen the stability of the FIT scheme by

redistributing economic advantages. With respect to its foreseeability, the majority acknowledged that the Spalma-incentivi Decree was the first of its kind: previous reforms were prospective reductions that had not affected incentive payments to plants already admitted to the incentivization regime. Finally, the majority accepted that the modifications introduced by Italy and the 8% reduction in incentive payments had a considerable impact on Silver Ridge's plants. Nevertheless, the majority opined that this "did not exceed what was necessary to reach [Italy's] public policy objectives" (para. 465). In support of this conclusion, the majority noted that the Spalma-incentivi Decree distinguished between various categories of PV plants in an effort to adequately distribute the economic burden of FIT reduction. Moreover, while the majority acknowledged that high leverage was common for financing projects in the renewable industry, it noted that such high costs did not "dispense [Silver Ridge] as a reasonable investor would do, from preparing itself for certain strains or stumbles in the flow of incentive payments" (para. 468). Accordingly, the majority rejected Silver's ridges claims based on the Spalma-incentivi Decree, attributing Silver Ridge's losses to its entrepreneurial choices.

The dissenting arbitrator opined that Italy had reneged on its commitment to provide incentive payments for 20 years, irrespective of whether it had given "a separate promise that it would not violate the terms of its specific commitment" (para. 9, dissenting opinion). The dissenting arbitrator also noted that the magnitude of incentive reductions was only relevant for the calculation of damages and should not have affected the majority's decision on the proportionality of Italy's conduct.

#### Romani Decree was not the proximate cause for the failure of Silver Ridge's project

Silver Ridge's claim with respect to the 2011 Romani Decree concerned the decree's impact on Project Vega, a solar PV project in Italy's Puglia region destined to be the largest in Europe at the time. Silver Ridge argued that the 2011 Romani Decree had triggered a phase of regulatory uncertainty and led to a sharp decrease in FIT, forcing the investor to abandon the project.

The tribunal noted that at the time of adoption of the Romani Decree, several aspects of Project Vega remained unrealized. The tribunal also considered Silver Ridge's admission that it was prepared to complete Project Vega in 2011. While it acknowledged that the Romani Decree was "an unfortunate development from the point of view of the Claimant"



(para. 520), the tribunal noted that Project Vega would have been eligible for incentive payments if Silver Ridge had connected the plant to the grid by the 29 March 2012 cutoff date under the Romani Decree. In this light, the tribunal held that Silver Ridge had failed to establish that Italy's actions were the "proximate" cause of its decision to abandon its project.

#### Actions under the Fifth Energy Account did not amount to disproportionate regulatory changes

With respect to the Fifth Energy Account, Silver Ridge claimed a threefold violation of the ECT. First, it argued that the sudden and unpredictable enactment of the Fifth Energy Account compromised the profits Silver Ridge expected from its new PV plants under the Fourth Energy Account, in violation of Italy's FET obligations. Second, Silver Ridge advanced that the reduced benefits under the Fifth Energy Account, combined with their retroactive character, rendered the measure expropriatory. Finally, it argued that the reduction of incentive payments to compensate for a newly invented GSE administrative fee also resulted in a breach of the FET standard.

On Silver Ridge's first claim, the tribunal recalled that Silver Ridge could only expect to be protected against fundamental or radical changes to the Italian regime for incentivization of renewable energy. The tribunal was convinced that the Fifth Energy Account had been adopted for the public purpose of strengthening the sustainability of the Italian incentive regime and that the consequent changes in the remuneration system did not result in a genuine overhaul of existing practices. In addition, the tribunal also noted that the changes introduced under the Fifth Energy Account were foreseeable; the Fourth Energy Account provided for a modified regime for large plants and acknowledged that incentive regimes may be revised when targets under this scheme were reached. On this basis, the tribunal rejected Silver Ridge's claim.

The tribunal did not find any merit in Silver Ridge's expropriation claim, noting that "at the moment of the adoption and entry into force of the Fifth Energy Account, accession to the 2013 tariff was a mere aspiration on the part of the Claimant, but not a 'right' in the meaning of the *Electrabel v. Hungary* decision, of which the Claimant would have been deprived" (para. 610).

The tribunal found no breach of the FET standard with respect to the introduction of administrative fees either. In particular, the tribunal recalled its previous

findings in respect of the reasonableness of the administrative fee and its foreseeability. The tribunal was also satisfied that the measure was proportionate since "the administrative management fee consists in a relatively low amount, exceeding half of a percent of the incentives received by the Claimant" (para. 624).

#### Decision and costs

The tribunal unanimously rejected Italy's jurisdictional objections, as well as Silver Ridge's claims with respect of the Romani Decree and the Fifth Energy Account. A majority of the tribunal also dismissed Silver Ridge's claims in respect of the Spalma-incentivi Decree.

The tribunal ordered the parties to bear half of the arbitration costs and their legal fees. In arriving at this decision, the tribunal noted that while Silver Ridge's case had failed on the merits, Italy's "objections and request [on jurisdictional matters] significantly contributed to the overall costs of the proceedings" (para. 636).

*Notes:* The tribunal was composed of Bruno Simma (president, appointed by the parties, German/Austrian national), O. Thomas Johnson (claimant's nominee, U.S. national), and Bernardo M. Cremades (respondent's nominee, Spanish national). The award is available at <https://www.italaw.com/sites/default/files/case-documents/italaw16138.pdf>

The author of this piece has elected to contribute anonymously.



## Ad hoc tribunal rules in favour of German energy investor

*Frazer Solar GMBH v The Kingdom of Lesotho*

**Anqi Wang**

In its January 2020 award, an ad hoc tribunal ordered the Kingdom of Lesotho to pay EUR 50 million to German investor Frazer Solar GMBH (Frazer) for breach of the investment contract for an energy project.

### Background and claims

In 2013, Lesotho updated its energy policy to harness renewable energy and reduce reliance on fossil fuels and imported electricity. Subsequently, the claimant proposed a renewable energy project in November 2017 (“the project”), after which Frazer and Lesotho entered into a non-binding memorandum of understanding (“the MoU”). According to the MoU, the proposed project involved the installation of 36,000 to 40,000 solar water heating systems (SWHs) and up to 1 million light-emitting diode (LED) lights over a four-year period. The project would be funded by the German export credit agency, KfW IPEX-Bank GmbH (“KfW”) to the amount of EUR 100 million.

In September 2018, the parties concluded a written supply agreement based on the MoU. However, after the supply agreement was signed, the Minister of Finance of Lesotho, Minister Majoro, rejected KfW’s offer to finance the project. It was later reported in the local media that Minister Majoro had committed to another renewable energy project in Mafeteng in Lesotho, to be funded by a Chinese-owned state bank, EXIM Bank (para. 53).

On the assumption that the supply agreement would not be implemented, the claimant sent a letter of demand to the respondent alleging the breaches of the supply agreement by Lesotho. The Government of Lesotho did not respond to the letter or take any remedial action. On July 29, 2019, the claimant sent a letter to the Prime Minister and Minister Tsolo to notify the government of the termination of the supply agreement.

In August 2019, the claimant filed for ad hoc arbitration against Lesotho pursuant to Clause 24 of the supply agreement, alleging that Lesotho breached several obligations under the supply agreement. On August 8, 2019, the Chairperson of the Johannesburg Bar Council appointed a sole arbitrator as required by the claimant. The arbitration was seated in Johannesburg and was governed by South African Law. The claimant’s

allegations included two sets of breaches. First, the claimant alleged that the respondent breached its obligations under Clause 17 of the supply agreement, according to which the respondent warranted that the project complied with all laws and had the necessary government approvals (para. 30.1.1); that the claimant was expressly authorized to commence implementation of the project without delay (para. 30.1.2); that the respondent had signed the financing agreement prior to or concurrently with the signing of the supply agreement, and had agreed to be bound by the terms of the financing agreement; that the respondent agreed to remunerate the claimant for the work performed in accordance with the drawdown schedule set forth in the supply agreement (para. 30.1.4); and that the respondent would ensure the smooth implementation of the project without interruption or delay (para. 30.1.5).

Second, the claimant argued that the respondent breached Clause 18 of the supply agreement, which provided that for a period of 5 years from the date of commencement of the supply agreement, the respondent should give the claimant the first opportunity to undertake any other renewable energy or electricity generation opportunities in Lesotho (para. 30.2). Clause 18 of the supply agreement provides that (para.30):

GOL hereby grants FSG the first opportunity for all other energy, energy efficiency or electricity generation opportunities with GOL for a duration of 5 years calculated from the Commencement Date.

Based on the above allegations, the claimant sought payment of EUR 50 million in liquidated damages and the expected value of the profits that the project would have realized had the respondent complied with the supply agreement.

### Allegations upheld by the tribunal

In support of its argument, the claimant relied on evidence of personal discussions, as well as negotiations for the conclusion of the MoU and the supply agreement between Frazer, the founder and managing director of the claimant, and the Lesotho government. The tribunal accepted the claimant’s evidence and upheld the allegations of a breach of Clause 17, under which the respondent guaranteed the timely and smooth implementation of the project (para. 100).

Several important factors were specified by the tribunal in reaching this conclusion. First, the tribunal considered that the claimant’s argument was adequately supported by the contemporaneous documentary evidence, despite the claimant being the only witness to testify.



Second, the tribunal took into account the existence of the contemporaneous tripartite correspondence between the claimant, Minister Tsolo, and KfW about KfW's commitment to finance the project and the request by Minister Tsolo to KfW for a formal offer on this issue (para. 97).

Third, the tribunal also took note of the evidence showing the claimant's intention to pursue the conclusion of the supply agreement before filing the arbitration. However, none of these documents of the claimant received a reply from the Lesotho government, which was considered "disconcerting" by the tribunal. (para. 99).

Moreover, the tribunal found that the Government of Lesotho did provide the warranties included in Clauses 17.1.1 to 17.1.3, and 17.1.5 to 17.1.7 and that its conduct constituted a breach of these obligations (para. 100). The tribunal also noted that some clauses (including 5.1.4 and 17.2) of the supply agreement explicitly addressed the importance of the timely implementation of the project (para. 101). The project was not implemented because the Minister of Finance refused to execute the finance agreement necessary for the project since he had already committed support to a competing renewable energy project in Mafeteng (para. 104).

Based on the above considerations, the tribunal concluded that the respondent had materially breached several clauses of the supply agreement. According to the tribunal, these clauses were crucial for the implementation of the project, and the breaches of them, therefore, related to the basis of the supply agreement (para. 105).

#### Allegations rejected by the tribunal

The tribunal nevertheless rejected the claimant's contention that the respondent had violated Clause 18 of the supply agreement. According to Clause 18, the claimant was entitled to the contractual right of the first opportunity to execute additional renewable projects with the Government of Lesotho after the completion of the current project under the supply agreement (para. 107). That is, to establish a violation of Clause 18, the Mafeteng project would have to be competing for additional renewable projects in Lesotho after the current project was successfully conducted (para. 107).

However, the tribunal refused, even on the most generous consideration of the claimant's evidence, to consider the Mafeteng project as such other renewable energy opportunity provided for in Clause 18 (para.

108). In this regard, the tribunal noted that the reason for the failure of the supply agreement was that Minister Majoro refused to sign the finance agreement with KfW due to Minister Majoro's commitment to the Mafeteng project, a direct competitor of the project under the supply agreement. Moreover, no evidence existed to prove that the Mafeteng project was an addition to the supply agreement. On the contrary, the tribunal noted that the two projects were in fact competing with each other, the survival of the Mafeteng project indicated the demise of the supply agreement (para. 108.4). Therefore, the Mafeteng project was not part of the "all other renewable energy ... opportunities" after the completion of the supply agreement required by Clause 18. Having found this, the tribunal concluded that the claimant had not successfully established a contractual violation by the respondent under Clause 18 of the supply agreement (para. 109).

#### Compensation

The tribunal stated that the claimant was entitled to recover damages arising from the above breaches, i.e., the damages referred to as liquidated damages in its main claim or loss of profits in its alternative claim (para. 110). The compensation should place the claimant in the same position possible as it would have been had the respondent not breached the terms of the supply agreement without exposing it adversely or beneficially to the fluctuations of the exchange rate between the euro and the local currency Maloti (para. 114.3). As such, the tribunal eventually awarded liquidated damages, as elected by the claimant, at EUR 50 million in accordance with Clause 12 of the supply agreement (para. 112).

The tribunal set the interest for liquidated damages at the rate of 1.7% per annum, or EUR 2,328 per day. For the pre-award interest, the tribunal calculated the period from the claimant's communication with the respondent on March 11, 2019, about the breaches to the date of the delivery of the award. This added up to an amount of EUR 754,273 for the pre-award interest.

*Note:* The tribunal was composed of a sole arbitrator, Vincent Maleka SC, appointed by the Chairperson of the Johannesburg Bar Council. The award, dated January 28, 2020, is available at <https://jsumundi.com/en/document/decision/en-frazer-solar-gmbh-v-the-kingdom-of-lesotho-arbitration-award-tuesday-28th-january-2020>

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## The ICSID tribunal in *Infinito Gold v Costa Rica* upholds several claims but declines to award damages. The majority of the tribunal found breaches of the FET standard but damages too speculative

*Infinito Gold Ltd. v. Costa Rica, ICSID Case No. ARB/14/5*

**Maria Bisila Torao**

In an award dated June 3, 2021, an ICSID tribunal upheld some of the claims brought by *Infinito Gold Ltd.* ("*Infinito*"), a company incorporated under the laws of Canada, against Costa Rica's revocation through court and executive measures of *Infinito's* concession for a gold mining project in northern Costa Rica. The majority of the tribunal found that the government's legislative mining ban and the subsequent revocation of *Infinito's* gold mining exploitation concession amounted to breaches of the FET standard under the treaty. However, the tribunal declined to award damages as it deemed the monetary consequences of *Infinito's* loss too speculative to give rise to an award in damages.

### Background and claims

In May 2000, the claimant, *Vannessa Ventures Ltd.* at the time, acquired *Infinito*, which held an exploration permit granted in 1993 for the *Crucitas* area in the *Crutis* district. The permit was extended to September 1999. Between 1993 and 2000, *Industrias Infinito* performed drilling and studies to confirm the existence and extent of the gold deposit. On December 17, 2001, *Infinito* obtained its exploitation concession. The concession, which became effective in 2002 (the "2002 Concession"), gave a 10-year term subject to extensions and one renewal, allowing *Infinito* to extract, process, and sell the metals from the *Crucitas* gold deposit.

On February 13, 2002, *Abel Pacheco*, at the time a presidential candidate, filed a request before the Ministry of Environment and Energy ("*MINAE*"), demanding the revocation of the 2002 Concession. He alleged that it was against the national interest and threatened the constitutional right to a healthy environment. Soon after, in April 2002, environmental activists *Carlos* and *Diana Murillo* filed a constitutional challenge, a writ of *amparo*, against the resolution that granted the 2002 Concession on environmental grounds (the "*Murillo writ of amparo*"). Later that same year, *Pacheco* became the president elect of Costa

Rica and declared, on June 5, 2002, an indefinite halt on open-pit mining (the "2002 Moratorium").

On November 26, 2004, the Constitutional Chamber of the Supreme Court ruled on the *Murillo Amparo* (the "2004 Constitutional Decision"). It determined that the 2002 Concession violated Article 50 of the Constitution—which guarantees the right to a healthy balanced environment—because that concession was granted before the environmental impact assessment ("EIA") was approved. The Constitutional Chamber held that granting the 2002 Concession had violated the constitutional right to a healthy environment and annulled the 2002 Concession "without prejudice to what the environmental impact assessment may [had determined]" (para. 83).

Two years later, after President *Óscar Arias* took office in May 2006, *Arias* and *MINAE* repealed the 2002 moratorium and granted *Infinito* an exploitation concession (the "2008 Concession"). This concession was granted under a domestic administrative term known as "conversion." The conversion allowed for the previously annulled concession to be converted into a valid one by creating a new one instead of reinstating the previous one. A number of challenges against the 2008 Concession were filed, but in 2010, the Constitutional Chamber ruled that the project did not violate the applicants' right to a healthy environment.

Later, on April 16 2010, the Contentious Administrative Tribunal issued a temporary injunction preventing the *Crucitas* Project from moving forward. Subsequent executive moratoriums followed that year by *Arias* (the "*Arias Moratorium*") and by the next president, *President Chinchilla* (the "*Chinchilla Moratorium*"), who took office on May 8, 2010 (together, the "2010 Moratoria"). Both decrees essentially declared an indefinite moratorium on open-pit gold mining, understood as mining activities using cyanide and mercury in ore processing.

In December 2010, The Contentious Administrative Tribunal issued a decision (the "2010 CA Decision") and annulled *Infinito's* 2008 Concession together with related administrative decisions. It argued that when the 2004 Constitutional Decision revoked the 2002 Concession, that annulment qualified as an absolute nullity that did not allow for "conversion" into the 2008 Concession. As a result, the 2008 Concession did not qualify as a pre-existing right and was void. That same month, the Costa Rican government enacted an amendment to the Mining Code prohibiting open-pit mining, which came into



force in February 2011 (the “2011 Legislative Mining Ban”). Under this ban, all pending applications for mining concessions were removed, which prevented Infinito from applying for a new concession. As a result, on November 11, 2011, Infinito requested the Constitutional Chamber to declare that the 2010 CA Decision was unconstitutional as it conflicted with the 2010 Constitutional Decision. The Administrative Chamber of the Supreme Court denied Infinito’s cassation request (the “2011 Administrative Chamber Decision”), and it upheld the main conclusions of the 2010 CA Decision, mainly the applicability of the 2002 Moratorium.

On January 9, 2012, the Ministry of the Environment, Energy and Telecommunications (“MINAET”) ultimately cancelled Infinito’s 2008 Concession (the “2012 MINAET Resolution”). Infinito challenged this decision, but on June 19, 2013, the Constitutional Chamber dismissed Infinito’s unconstitutionality challenge and held that the challenge was inadmissible because the Administrative Chamber had already issued a ruling (the “2013 Constitutional Decision”).

By September 2015, Infinito had left the Crucitas site. Soon after, the Contentious Administrative Tribunal ordered Infinito, the National System of Areas Conservation, and the state to pay USD 6.4 million for environmental damages within six months (the “2015 CA Damages Decision”). Upon appeals, however, in December 2017, the Administrative Chamber of the Supreme Court overturned the decision for lack of motivation.

Meanwhile, on February 6, 2014, Infinito filed for arbitration against Costa Rica, claiming that Costa Rica’s conduct had breached Articles II (1), II (2), IV and VIII of the Canadian–Costa Rica BIT. In particular, the claimant argued that the government’s decision to cancel the exploitation concession and other project approvals, as well as other measures, destroyed Infinito’s investments and its rights to develop and commercialize the gold mine.

### The Claimant’s shares in Infinito qualify as protected investment under the treaty

Costa Rica argued in its jurisdictional objections that the tribunal lacked jurisdiction *ratione materiae et ratione voluntatis* because the concession was not owned and controlled following Costa Rican law as required by the BIT, and the investment was obtained through deceitful conduct.

The claimant had listed a number of assets as the investments (shares in Infinito, money invested through

intercompany loans, the concession, the pre-existing mining rights, other approvals for the project; the project’s physical assets including the mining infrastructure built so far, and, the project’s intangible assets). The tribunal reasoned, however, only the shares in Infinito qualified as an investment = to establish jurisdiction. Infinito owned these shares indirectly through a company incorporated under the laws of Barbados, the Crucitas (Barbados) Limited (para. 176).

### Corruption concerned matters that happened after the initial investment was made

The respondent initially claimed that the tribunal lacked jurisdiction because the investment was obtained through corruption, as there were ongoing criminal investigations regarding Infinito’s investment. However, after local criminal courts ruled certain corruption charges were time-barred, Costa Rica withdrew this objection to contend the 2008 Concession was not granted following domestic law.

The tribunal rejected the illegality objection but considered that the corruption allegations raised an international public policy issue, which the tribunal should address *ex officio*. After analyzing this, it concluded that nothing confirmed that the 2008 Concession had been acquired through corruption, even if corruption allegations were found. The majority concluded that under the circumstantial evidence standard of proof, which is a “less demanding standard of proof,” it could not be concluded that the concession was unlawful (para. 181).

### Claimant claims are not time-barred under Article XII(3)(c) of the BIT

Under Article XII(3)(c), investors must submit a dispute to arbitration within three years from the date the investor first received or should have acquired knowledge of the alleged breach, loss, or damage.

Costa Rica argued that the alleged breaches crystallized before the cut-off date established by the tribunal, February 6, 2011. Thus Infinito’s claim fell outside the temporal scope of the BIT because the relevant moment for Article XII(3)(c) was when the investor understood its investment to be worthless. Consequently, the claimant could not invoke any breach because the legal and factual situation holding Infinito’s claims had already been shaped by events before February 6, 2011, the cut-off date.

However, in the majority’s view, the limitation period began only once the breach as a legal notion has occurred. In other words, the moment at which a breach



occurs, according to the majority of the tribunal, "will depend on when a fact or group of facts is capable of triggering a violation of international law" (para. 220).

Additionally, the majority explained that breach and loss could coincide depending on the standard breached. It further addressed knowledge of the breaches and loss for each breach raised by Infinito (FET, expropriation, denial of justice, full protection and security). The tribunal's majority concluded that the claims were not time-barred because the claimant did not have knowledge of breach and loss after the cut-off date.

#### Claimant has failed to establish a composite breach

Infinito claimed that the breach had occurred through several measures (namely the 2011 Administrative Chamber Decision, The 2011 Legislative Mining Ban on open-pit mining, The 2012 MINAET Resolution, and the reinitiation of the CA proceedings for environmental damage in January 2019). The majority explained that Infinito's claims suggested "a series of actions or omissions defined as wrongful," a composite breach resulting from the combined effect of the various measures. However, the tribunal's majority also explained that even if Infinito could rely on a composite breach, it had not properly proved such a breach (para. 230).

#### Autonomous FET standard: Article II(2)(a) of the BIT is not limited to customary international law

While Costa Rica argued that the FET was limited, Infinito maintained that under the BIT, Costa Rica must have granted fair and equitable treatment under the principles of international law. Infinito claimed that the language of Article II in its ordinary meaning did not limit the FET standard to the minimum standard of treatment under customary international law because it does not refer to it.

Applying the general rule of interpretation, Article 31 of the VCLT, the majority of the tribunal upheld the claimant's argument. It concluded that Article II(2)(a) of the BIT is not limited to the minimum standard of treatment under customary international law. The majority explained that the expression "principles of international law" does not refer to customary international law, which is only "but one source of international law and is distinct from general principles" (Para. 331-337).

#### FET breach: Domestic court judicial measures may breach the FET standard outside of a denial of justice

Three of the measures Infinito claimed had affected its investment were judicial decisions (the 2011

Administrative Chamber Decision, the 2013 Constitutional Decision, and the CA Damages Decision). Costa Rica argued that judicial measures could only engage the state's international responsibility if they amount to a denial of justice because they cannot breach international law. However, Infinito challenged this and contended that neither the BIT nor the ILC Articles on State Responsibility exclude liability for acts of judicial organs that do not qualify as a denial of justice.

By agreeing with the approach taken in *Sistem v Kyrgyz Republic*, the majority concluded that domestic courts' decisions are not immune from scrutiny by international tribunals because court decisions may deprive investors of their property rights in the same way as if the investor had been expropriated by decree. Thus, "judicial decisions that are arbitrary, unfair or contradict an investor's legitimate expectations may also breach the FET standard even if they do not rise to the level of a denial of justice" (para. 359).

The tribunal majority further explained that judicial measures derived from the state and the BIT does not differentiate between acts from different branches of the government. Before analyzing whether a denial of justice had occurred, it reasoned that a denial of justice "may be procedural or substantive and that in both situations the denial of justice is the product of a systemic failure of the host State's judiciary taken as a whole" (para. 445).

#### No procedural or substantial denial of justice

Infinito asserted that a procedural denial of justice had occurred because Costa Rica lacked a system that deals with inconsistent judicial decisions. According to the claimant, the *res judicata* principle was not respected because the Administrative Chamber did not comply with a prior judicial decision issued by the Constitutional Chamber of the Supreme Court. Notably, the claimant argued that the 2011 Administrative Chamber Decision, which upheld the 2010 CA Decision failed to reverse certain findings of the CA decision that were inconsistent with the 2010 Constitutional Decision, which had found the 2008 Concession to be constitutional.

Costa Rica objected to this. It claimed the 2011 Administrative Chamber Decision was consistent with the Constitutional Chamber's, since both chambers have a significantly different scope and jurisdiction in terms of appeal and review of lower courts decisions.



The tribunal rejected Infinito's argument and noted that a lack of a domestic body or mechanism to deal with inconsistencies that arise from the decisions of different courts could not constitute a breach in itself. It also indicated that Infinito had previously raised the *res judicata* objection before domestic courts (both the CA and the Administrative Chamber, which had heard and dismissed them on the basis of the different scope of jurisdiction). Under Costa Rican law, "the competence to review the legality of administrative acts lies exclusively with the contentious-administrative courts" (paras. 447-452), while the Constitutional Chamber assessed only compliance with constitutional standards, leaving outside its scope the concession's legality.

The tribunal concluded that no inconsistency existed as the domestic tribunal had properly assessed Infinito's *res judicata* objection. Moreover, the tribunal found that the lack of a mechanism to deal with inconsistency did not amount to a denial of justice because only a lack of remedy that deprives an investor of a fair opportunity to plead its case or inexistent access to justice would amount to a denial of justice (para. 483).

Similarly, Infinito also asserted that a substantial denial of justice had occurred because the 2011 Administrative Chamber amounted to such denial as the court applied the 2002 Moratorium to the Crucitas Project, breaking Costa Rican law. Relying on the expert report, the claimant argued that the cancellation of the 2008 Concession was inappropriate because Infinito had vested rights within the meaning of the Mining Code.

The tribunal rejected this claim because the conversion of the concession was, in the tribunal's view, illegal because the Constitutional Chamber had annulled the 2002 Concession in 2004, and this nullity was absolute. Thus, after the Constitutional Chamber's declaration of nullity, Infinito's right to the exploitation concession had disappeared.

### Regulatory measures that prevent applying for a new concession are disproportionate but do not amount to damages, as they are too speculative

The majority next analyzed whether Costa Rica's measures violated the FET standard of the BIT.

Infinito had argued that Costa Rica had breached the FET standard through a number of measures that hindered/thwarted Infinito from reapplying for a concession. These measures were the 2011 Legislative Mining Ban and the 2012 MINAET Resolution.

In the view of the tribunal's majority, Costa Rica had breached its FET obligation under the treaty because it deprived the claimant of the opportunity to apply for a new concession through the 2011 Legislative Mining Ban and the 2012 MINAET Resolution that extended the implementation of the Ban. The tribunal also explained that the 2011 Legislative Mining Ban was not unfair and inequitable in the abstract. However, the ban's application to the claimant was unfair because that application of the ban to the Crucitas Project was disproportionate to the public policy pursued. It further concluded that no damages were identified even if a breach had been established because Infinito did not put forward any quantifiable harm for the loss of opportunity and did not give the tribunal elements to calculate it (para. 582).

### The BIT does not provide for an exception to liability regarding environmental protection

Costa Rica argued that even if it had breached its FET obligation through the 2011 Legislative Mining Ban and the 2012 MINAET Resolution that implemented the ban, the environmental exception in Section III(1) of Annex I of the BIT exempted Costa Rica from liability. The tribunal thus analyzed whether Section III(1) of the BIT provided for an exception to liability. Using the general rule of interpretation (Article 31 of the VCLT), the tribunal interpreted the treaty's provision concluding that Section III(1) of the Costa Rica-Canada BIT was not an exception to liability. And it further explained that because Section III contains the wording "any measure otherwise consistent with this Agreement," this means all measures meant to ensure that investment activity respects the environment must also be consistent with the BIT's investment protection framework (para. 773). Consequently, and according to commentators, this provision could not override mandatory treaty obligations.

Costa Rica also argued that the words "otherwise consistent with this Agreement" in Section III(1) did not apply to the measures Infinito wanted to challenge because those measures only maintained pre-existing measures that Infinito could not challenge because of the three-year limitation period. The tribunal rejected this argument and interpreted that the relevant wording also applied to measures aiming to maintain or enforce previous ones.

### Costs

Both parties sought an award of the entirety of the costs related to this arbitration. The claimant had



requested that the respondent bear all expenses by Infinito. Infinito's total expenses amounted to USD 2,099,918.27 for costs and fees for the jurisdictional phase and USD 3,513,732.09 for the merits phase. In contrast, the respondent costs amounted to approximately USD 3 million (USD 997,403.63 for costs and expenses for the jurisdictional phase and USD 2,016,863.95 for costs and expenses in the merits phase).

The tribunal stated that under the ICSID Convention it had broad discretion to allocate all costs of the arbitration and noted that while Infinito had prevailed in the jurisdiction phase, Costa Rica had largely succeeded on the merits. It also noted that parties and their counsel had conducted the proceedings cooperatively and efficiently. Thus, the tribunal weighing these elements concluded that it was fair to split the costs of the proceeding equally while each party should bear its legal costs.

#### Prof. Brigitte Stern's dissenting opinion

In a partial dissent, arbitrator Stern reasoned that she would have reached the same conclusion but through different reasoning for the time-barred objections. Thus, she felt it necessary to explain her rationale as she agreed with the case's final outcome.

Stern focused her analysis on the 2011 Administrative Chamber Decision and argued that, even if Infinito had identified a number of measures that it considered breached the BIT, ultimately, the claimant's argumentation focused on the 2001 Administrative Chamber Decision as to the main breach that has to be considered for the application of the statute of limitations (the cut-off date). She noted that first knowledge of the breach or loss has wrongly been "metamorphosed into first knowledge of a completed breach, which disguises, in fact, final knowledge" (Dissent, para. 14). Stern further argued that, in her view, this was contrary to the rules of interpretation of the VCLT when interpreting Article XII(3)(c). She concluded that this Article refers to the date when an investor first acquires knowledge of a breach and loss and not when the existence of the breach and loss is finally known (Dissent, para. 14).

Stern also disagreed with the majority's analysis of the FET standard and explained that Article II(2)(a) of the BIT was in her view limited to the minimum standard of treatment under customary international law because a reference to both "rules of international law" and "the principles of international law" is made. For

Stern, such a double deference to both terms without elaborating more on that "is sufficient to conclude that the FET must be interpreted according to international law as applied among all nations, which is customary international law" (Dissent, para. 81).

Stern further noted that because the majority's analysis does not give meaning to the BIT's reference to the principles of international law, reference to international law is, as a result, erased even though the BIT specifically mentions it (Dissent, para. 84).

*Notes:* The tribunal was composed of Gabrielle Kaufmann-Kohler (president, nominated by the parties, Swiss national), Bernard Hanotiau (claimant's appointee, Belgian national) and Brigitte Stern (respondent's appointee, French national). The award of June 3, 2021 is available at [xx].

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Edited by Jean Ho and Mavluda Sattorova, Hart Publishing (2021)

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Yoram Z. Haftel, Soo Yeon Kim, and Lotem Bassan-Nygate, *World Trade Review* (August 2021)

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Andie Althchiler, *Pace Law Review* (August 2021)

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#### **UNCITRAL Working Group III: Investor-State Dispute Settlement Reform, 41st Session**

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#### **10th Annual UN Forum on Business and Human Rights**

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