

An ISDS Carve-out to Support Action on Climate Change

By Gus Van Harten



**Protecting a Multilateral Agreement
on Climate Change from the Threat of
Corporate Trade Challenges**

A foreword by Maude Barlow

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A foreword to An ISDS Carve-out to Support Action on Climate Change, by Gus Van Harten

In December 2015, the world gathered in Paris, France for COP 21, the United Nations Conference on Climate Change. This historic gathering was an important moment for the nations of the world to truly and meaningfully come to an agreement to seriously reduce greenhouse gas emissions. Expectations were high.

In the lead-up up to COP 21 there were some signs of hope that governments were serious about tackling climate change. In June 2015, the leaders of the G7 countries agreed to cut greenhouse gases by phasing out the use of fossil fuels by the end of the century. Germany's Chancellor Angela Merkel – who is pushing for a 2050 deadline and committed to immediate binding emission targets – spoke of the need to “decarbonize the global economy in the course of this century.”

That same month, China – the world's top greenhouse gas emitter – pledged to cap rising emissions by 2030, a first for a nation whose policies have favoured unlimited industrial growth. In August 2015, U.S. President Barack Obama, perhaps mindful of his legacy, unveiled the first nationwide standards to end the limitless dumping of carbon pollution from U.S. power plants.

World leaders did make some progress in Paris. The 190 governments came to an agreement, albeit non-binding, to cut emissions to keep the global temperature increase to two degrees or less. World leaders also set in motion a process for more discussions on climate change, which will carry on until COP22 in Marrakech, Morocco in November 2016.

World opinion is shifting dramatically as fewer and fewer people question the overwhelming scientific evidence of human-induced climate change. A July 2015 Pew Research Center survey found that climate change is seen as a top global threat. The hope for a real and meaningful multilateral agreement on climate change keeps growing. Marrakech provides another opportunity for a binding agreement.

But there is a problem that needs to be addressed if any agreement or treaty reached is to be realized in the home countries of the parties. The central problem is that many of the same countries pledging to take serious action on climate change are also party to, or are aggressively negotiating, trade and investment deals that contain a mechanism that gives large corporations the right to challenge any changes to the current rules under which they operate.

The mechanism in these trade deals is called investor-state dispute settlement (ISDS). It gives foreign corporations the right to directly sue governments for financial compensation if those governments introduce new laws or practices – be they environmental, health or human rights – that negatively affect corporations' bottom line. ISDS essentially grants corporations equal status to governments in these negotiations and privatizes the dispute settlement system between nations.

According to the United Nations Conference on Trade and Development, there are now over 3,200 ISDS agreements (mostly bilateral) in the world, with one concluded every other week. These corporate rights are deeply entrenched in the North American Free Trade Agreement (NAFTA), as well as in all new regional deals, including the Canada-European Union Comprehensive Economic and Trade Agreement

(CETA), the Transatlantic Trade and Investment Partnership (TTIP) agreement between Europe and the U.S., and the Trans-Pacific Partnership (TPP), a massive deal between 12 Pacific-aligned countries.

Corporations have used ISDS to challenge governments over 600 times, and in numerous cases these challenges are clearly related to health or environmental decisions by governments.

Canada, for instance is facing \$2.6 billion in challenges from American corporations under NAFTA. Current and past challenges include bans against environmental harmful additives to gasoline, exports of hazardous PCBs and lawn pesticides, as well as moratoriums on fracking.

ISDS also threatens the fight against environmental racism, and this in turn makes it harder to combat the inequitable impacts of climate change on Indigenous peoples and the poor. In June 2015, 10 UN rapporteurs on human rights issued a statement drawing attention to “the potential detrimental impact” that treaties such as TTIP and TPP “may have on the enjoyment of human rights as enshrined in legally binding UN instruments,” including “a clean environment.”

The experts noted that investor-state rules provide protection for investors, but not for states or their populations. In looking at the history of ISDS settlements, the UN human rights experts concluded that “the regulatory function of many states, and their ability to legislate in the public interest, have been put at risk.”

So the stage is set for a conflict. For any meaningful agreement on climate change to be successful, each country will have to take the promises home to their own legislatures and change laws and practices accordingly. Yet the ISDS “rights” of foreign corporations to challenge any changes that might negatively impact their profits are strongly entrenched in international trade law. In other words, the power of corporations to use ISDS could strongly undermine any agreement if corporations decide to fight the necessary resulting regulatory changes.

The report, *An ISDS Carve-Out to Support Action on Climate Change*, is offered to governments and negotiators as a way to resolve this conflict. In it, Gus Van Harten, Osgoode Hall professor, legal scholar and internationally recognized authority on investment law, outlines how a multilateral agreement on climate change could include a safeguard against the risk of ISDS lawsuits that target climate change action by governments.

Without such a carve-out, Van Harten argues, governments face an incentive to avoid climate change action in order to limit potential liability due to actual or anticipated ISDS claims. Drawing on the language of the *UN Framework Convention on Climate Change*, Van Harten proposes wording for a safeguard that allows governments to introduce the measures needed to stabilize greenhouse gas emissions and truly deal with the growing threat of climate change.

This report, which was originally published in the lead-up to the Paris negotiations, contains an idea that is gaining momentum. The European Parliament made an ISDS carve-out its position going into the Paris climate talks. COP 21 was one step on our path to address climate change. COP 22 in Marrakech is yet another opportunity for the climate and trade justice communities to adopt the demand that the threat of ISDS must be part of any meaningful climate change negotiations.

About Maude Barlow

Maude Barlow is a social justice and environmental activist and author. She is the National Chairperson of the Council of Canadians, Canada’s leading social action organization.

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How should a multilateral agreement on climate change include a safeguard against risks of investor-state dispute resolution (ISDS) lawsuits targeting climate change action by governments? The aim of this short report is to identify language for an ISDS carve-out that is reliable and clear considering the importance of climate change action and the financial uncertainties and potential deterrent presented by ISDS for states considering such action.

Keywords: Climate change, multilateral negotiations, investor-state arbitration

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An ISDS Carve-out to Support Action on Climate Change

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20 September 2015

I. Overview

In this short report, I discuss how a multilateral agreement on climate change could be safeguarded against the risk of investor-state dispute resolution (ISDS) claims that target climate change action.

In particular, I propose detailed language for an ISDS carve-out that is informed by past interpretive approaches of ISDS tribunals, the importance of climate change action, and the potential deterrent that ISDS creates for governments considering such action.

The suggested carve-out is as follows:

“This Article applies to any measure adopted by a Party to this Agreement and relating to the objective of stabilizing greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system or relating to any of the principles or commitments contained in Articles 3 and 4 of the *United Nations Framework Convention on Climate Change* of 1992.

Such a measure shall not be subject to any existing or future treaty of a Party to the extent that it allows for investor-state dispute settlement unless the treaty states specifically and precisely, with express reference to this Article and this Agreement, that this Article is overridden. For greater certainty, in the absence of such a reference in a future treaty between two or more Parties, the future treaty is presumed to include in full and without qualification the first three paragraphs of this Article.

Any dispute over the scope or application of this Article shall be referred to, and fall within, the sole and exclusive jurisdiction of [specific body and process pursuant to the multilateral climate change agreement]. For greater certainty, no investor-state dispute settlement tribunal, arbitrator, body, or process has jurisdiction over any dispute related to the scope or application of this Article.

The Parties shall not agree to any future treaty that allows for investor-state dispute settlement unless the future treaty incorporates in full and without qualification the language of the first three paragraphs of this Article. The Parties shall make best efforts to renegotiate any existing treaty with a non-Party that allows for investor-state dispute settlement in order to ensure that the existing treaty incorporates in full and without qualification the language of the first three paragraphs of this Article.”

This proposed language is aimed at ensuring a reliable carve-out to protect against risks of ISDS arbitration claims targeting climate change action. Some terms used in the carve-out, including “measure” and “investor-state dispute settlement” would require definition in a multilateral climate change agreement, as discussed below. If the carve-out were included in a multilateral climate change agreement, it would apply to all treaties allowing for ISDS among the states parties to that multilateral agreement.

To support its reliability, any disputes about the scope or application of the carve-out should be referred to a decision-making body that is established and acts under the auspices of the multilateral climate

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change agreement, not an ISDS treaty. This would avoid the risk of evasive interpretation by ISDS tribunals and allow a forum that has direct expertise and institutional commitment concerning climate change action to resolve disputes about the meaning of the carve-out.

II. Comments

These comments are supported by references to other documents and publications on ISDS. The citations below are to the author's publications which in turn include more detailed discussion and extensive references to relevant data, past ISDS decisions, and secondary literature.

A. Risks posed by ISDS to climate change action

Faced with risks of uncapped financial liability due to ISDS claims, states may be deterred from implementing measures to fulfill their climate change responsibilities. In particular, ISDS poses a risk to climate change measures because:

- i. Multinational companies and wealthy foreign nationals have a unique legal right and the financial capacity to bring costly ISDS claims against states without first resorting to domestic courts or tribunals (where they offer justice and are reasonably available) for violations of foreign investor rights.² Two common themes in the hundreds of ISDS cases thus far are disputes in the resource sector and disputes relating to public health or environmental protection measures.³
- ii. Foreign investor rights are often stated ambiguously in the treaties that allow for ISDS. In turn, such rights are subject to broad discretion of ISDS tribunals to decide issues of state liability.⁴ In various cases, ISDS tribunals have interpreted foreign investor rights in ways that require public compensation for general and public purpose changes to the state's regulatory framework as applied indiscriminately to all asset owners.⁵
- iii. ISDS arbitrators have broad power over public budgets due to their authority to award uncapped amounts of compensation to foreign investors.⁶ States have no opportunity to avoid liability after the arbitrators issue their decision. Thus, states may face an incentive to avoid climate change action in order to limit their potential liability due to ISDS claims.

To safeguard against the risk of ISDS claims that frustrate or deter climate change action, it is suggested that a multilateral climate change agreement should include a broad carve-out from all treaties that allow for ISDS arbitration.⁷

2 G Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007), 110-113.

3 G Van Harten, *Sovereign Choices and Sovereign Constraints: Judicial Restraint in Investment Treaty Arbitration* (Oxford University Press, 2013), 82-89.

4 Van Harten, note 1 above, chapter 4 and 122-124; Van Harten, note 2 above, 45-46.

5 Van Harten, note 2 above, 52-54, 57-61, and 82-89.

6 Van Harten, note 1 above, 101-109 and 145-149; Van Harten, Note 2 above, 113-114.

7 The term "measure" should be defined broadly, as it is in many investment treaties, to include "any law, regulation, procedure, requirement or practice". e.g. *North American Free Trade Agreement* (NAFTA), Article 201; proposed *Canada-European Union Comprehensive Economic and Trade Agreement* (CETA), Article X.01.

B. Characteristics of a reliable carve-out

1. Application to existing and future treaties that allow for ISDS

For existing ISDS treaties, a carve-out in a multilateral climate change agreement should be designed as a subsequent legal agreement that would take precedence over the existing ISDS treaty. That is, the multilateral climate change agreement would be a subsequent agreement between its Parties to override all of their past treaties allowing for ISDS in matters subject to the carve-out. The states would be agreeing or clarifying in the multilateral climate change agreement that their existing consents, if any, to allow ISDS claims against them simply do not apply to climate change measures.

For future ISDS treaties, the situation is more complicated. The carve-out from ISDS in a multilateral climate change agreement would need to be sufficiently specific in its prioritization of the carve-out over the Parties' consents to ISDS in any future treaty allowing for ISDS. The carve-out proposed here aims to achieve this objective by referring to existing or future treaties and by including a requirement that any other treaty, in order for it to override the carve-out, must be specific and precise on the issue and, in particular, must expressly mention the carve-out in the multilateral climate change agreement. The aim is not to encourage future overrides of the carve-out but rather to preclude evasive interpretations by ISDS tribunals – which have, for example, regularly avoided exclusive jurisdiction clauses in contracts that appear to preclude the treaty claim⁸ – that would defeat the carve-out.

For greater certainty, the carve-out also includes an obligation of each Party to reproduce the carve-out in any future ISDS treaty and a clarification that any future ISDS treaty among the Parties is presumed to include the carve-out.

2. Application as between states that are party to the climate change agreement

A carve-out from ISDS would only apply to ISDS treaties between or among states that are Parties to the multilateral climate change agreement. For example, a bilateral investment treaty (BIT) allowing for ISDS would be covered by the carve-out if both of the states parties to the BIT were also Parties to the multilateral climate change agreement. Similarly, a trade or investment treaty that was between more than two states and that allowed for ISDS (e.g. NAFTA, the Energy Charter Treaty) would be covered by the carve-out albeit only for those states parties to the trade or investment treaty that were also Parties to the multilateral climate change agreement.

Yet the carve-out would not apply in the case of an ISDS treaty between, on the one hand, a state that is a Party to the multilateral climate change agreement and, on the other hand, a state that is not a Party. It would not apply because the ISDS treaty would not have been overridden by a subsequent agreement between the states parties to the ISDS treaty. In light of this weakness, in its fourth paragraph the carve out establishes binding obligations of the states parties to include the carve out in future ISDS treaties and to make best efforts to renegotiate any existing ISDS treaty – with a state that is not a Party to the multilateral climate change agreement – in order to incorporate the carve-out into the existing treaty. The issue of how to enforce these negotiating obligations is left open with the expectation that they would become part of a general enforcement process in the multilateral climate change agreement.

⁸ Van Harten, note 2 above, 135-147.

3. Application to the subject matter of climate change

What is meant by “action” or “measures” on climate change? The approach adopted here is to include any measure linked to the objective, principles, or commitments of the *UN Framework Convention on Climate Change*, which states for example:⁹

“The ultimate objective of this Convention and any related legal instruments that the Conference of the Parties may adopt is to achieve, in accordance with the relevant provisions of the Convention, stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system....”

By drawing on the language of the *Framework Convention*, including the principles and commitments in Articles 3 and 4, the proposed carve-out is intended to apply to a wide range of state measures relating to climate change mitigation and adaptation as characterized ultimately in the *Framework Convention*, its other provisions and processes, and related climate change agreements.

4. Connection between the carve-out and climate change action

Government action on climate change can take many forms. The proposed carve-out has been framed broadly to encompass anticipated and unanticipated measures that states may adopt and thus to avoid deterring regulatory innovation.

Many existing exceptions in ISDS treaties are unreliable because they use qualified language. For example, many existing ISDS exceptions apply only to state conduct that is shown to be “necessary” to achieve a regulatory aim or only where an ISDS award is shown to “prevent” the state conduct.¹⁰ This language creates significant uncertainty by leaving open the risk of unavoidable liability for the state, at the time of an ISDS award, if ISDS arbitrators decide that the state could have adopted some other measure instead of the impugned one or that the state is not prevented from adopting a measure merely because it must pay compensation for the measure.

To avoid these uncertainties, the broader term “relating to” – used in some exceptions in ISDS treaties – has been adopted in the carve-out. This language allows for wider coverage and flexibility, while still putting a limit on wholly unrelated and thus arbitrary action by states by requiring some connection between the climate change objective and the measure said to be covered by the carve-out.

5. Application to ISDS

The carve-out applies to any existing or future treaty “to the extent that it allows for investor-state dispute settlement.” What is meant by “investor-state dispute settlement?” A multilateral climate change agreement should define this term based on the language used in existing treaties to establish states’ consents to ISDS. In particular, the definition could be linked to the types of treaties that typically allow for ISDS and to the specific rules under which ISDS claims are made.

With this in mind, the following definition is proposed:

“ISDS means any proceeding arising from a claim against a state where the claim is brought pursuant to (a) a treaty concerning international trade or foreign investment and (b) any of the following arbitration rules: the *ICSID Convention* (also known as the ICSID rules), the ICSID additional facility rules, the UNCITRAL arbitration rules, or any other arbitration rules including any *ad hoc* arbitration rules and any arbitration rules agreed by the disputing parties.”

⁹ *United Nations Framework Convention on Climate Change*, Article 2.

¹⁰ e.g. *Agreement Between the Government of Canada and the Government of the People’s Republic of China for the Promotion and Reciprocal Protection of Investments*, Article 33(2).

This definition aims to capture all forms of investor-state arbitration proceedings under trade and investment treaties, but not state-state or non-arbitration proceedings. Therefore, the carve-out would apply to trade and investment treaties only to the extent that they give foreign investors the unique right to bring ISDS claims. Direct state-to-state proceedings and soft forms of ISDS – i.e. mediation or conciliation – would still be permitted in order to enforce foreign investor rights. It would be possible but complex, especially for state-to-state proceedings, to broaden the carve-out so that it applied to such proceedings. The present focus is informed by the fact that the vast majority of treaty-based ISDS claims have been investor-state arbitrations.

Also, the definition would capture treaty-based investor-state arbitration but not investor-state arbitration pursuant to a state’s own legislation or a contract. To capture these other forms of ISDS, clause (a) would need to be removed.

6. Avoidance of circular language

Some ISDS treaties contain exceptions with circular language that limits or defeats the exception. For example, an exception may be limited to measures said to be “otherwise consistent with” the ISDS treaty.¹¹ This language clearly undermines the exception and should be avoided in a carve-out for climate change action.

7. Disputes over scope of the carve-out

An important aspect of the uncertainty of state liabilities due to ISDS is the authority of ISDS tribunals to interpret ISDS exceptions narrowly. Various cases indicate this tendency of ISDS arbitrators.¹²

With this in mind, it is suggested that disputes over the applicability of a climate change carve-out should be referred to a decision-making body that is established under the auspices of a multilateral climate change agreement rather than an ISDS treaty. Such a body would have greater expertise and institutional commitment to ensure that the carve-out was interpreted to cover all forms of action reasonably aimed at climate change mitigation or adaptation. By locating this interpretive authority in a single body, uncertainties about varying or conflicting interpretations among diverse ISDS tribunals would also be avoided.¹³

The language in the third paragraph of the carve-out aims to protect the exclusive jurisdiction of this body under the multilateral climate change agreement. The language is detailed and legalistic due to ISDS tribunals’ past record of taking jurisdiction over ISDS disputes even in the face of, for example, an exclusive jurisdiction clause in a related contract or a waiting period or fork-in-the-road clause in an ISDS treaty.¹⁴ Beyond these points, questions about the body and process that should be used to resolve disputes about the ISDS carve-out are more a matter for experts in the *Framework Convention on Climate Change* than for ISDS experts.

11 e.g. NAFTA, note 6 above, Article 1114.

12 Van Harten, note 2 above, 66-68.

13 G. Van Harten, “Arbitrator Behaviour in Asymmetrical Adjudication: An Empirical Study of Investment Treaty Arbitration” (2012) 50 *Osgoode Hall Law Journal* 211, 237 and 245 (documenting conflicting approaches by tribunals to, e.g., the ambiguous foreign investor right to ‘most-favoured-nation treatment’).

14 Van Harten, note 2 above, 135-150.

