E3G

SUGGESTED TOPIC FOR THE WORKSHOPS UNDER THE SHARM EL-SHEIKH DIALOGUE

E3G SUBMISSION TO UNFCCC

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This response addresses one of the guiding questions on which topics need to be discussed in the workshops and focuses on the specific policy area of investment treaties, which has so far been overlooked in climate discussions but has a huge impact on redirecting capital to climate action.

Investment treaties are international agreements that govern cross-border investment flows. They often include investor-state dispute settlement (ISDS) provisions, which allow foreign investors to sue governments if their business interests are undermined by states' policy measures, including legitimate policy objectives such as climate mitigation and adaptation. There are more than 2,500 stand-alone investment treaties and free trade agreements with investment provisions ("investment treaties") in effect globally, most of which have ISDS provisions.

Investment treaties and Article 2, paragraph 1(c)

As noted in the OECD submission to the UNFCCC Standing Committee on Finance, "investment treaties are associated with extensive finance flows including through provision of a financial service akin to political risk insurance; grants of unique benefits to treaty-covered financial investors such as shareholders; and the availability of uncapped financial remedies against governments, enforceable worldwide."[1] In a recent survey conducted by the OECD, 78% of the respondents considered it very important to make the finance flows associated with investment treaties consistent with a low-carbon pathway as set out in Article 2, paragraph 1(c) of the Paris Agreement.[2]

[1] OECD, 2023, **OECD submission to the UNFCCC Standing Committee on Finance**.

[2] Twenty-three economies responded to this survey and twenty respondents were OECD members. OECD, 2024, **Survey of climate policies for investment treaties (DAF/INV/TR1/WD(2023)2/REV1)**.

Although investment treaties were not addressed in the previous workshops, the following aspects were noted in the deliberations under the Sharm el-Sheikh dialogue that make investment treaties highly relevant to the scope of Article 2, paragraph 1(c):

> The importance of mobilising climate investment from the private sector, given the limitations of available international public finance compared with the scale of climate investment needs.

> Achieving Article 2, paragraph 1(c) could involve system-wide transformations of the financial sector and national economies, including shifting public and private finance flows away from emission-intensive activities.

> Policy and regulatory measures that entail shifting, redirecting and scaling down fossil fuel finance. [3]

Investment treaties interrupt the necessary scaling up of international private investments in clean energy by protecting overseas fossil fuel investments. In the IEA's climate-driven scenarios, over 70% of clean energy investment should come from the private sector by 2030.[4] Currently, less than half of clean energy investment in emerging markets and developing economies (EMDEs) is financed by the private sector.[5] For most EMDEs, the role of international private finance is particularly important in scaling up private clean energy investment, given limited domestic capacity.

However, ISDS insulates fossil fuel investors from transition risks, which can create the wrong expectations and lead to over-investment in fossil fuels. This delays the urgent shift of investments from fossil fuels to clean energy. As the outcome of the first global stocktake noted, the Intergovernmental Panel on Climate Change (IPCC) found that there were barriers to redirecting capital to climate action and clear signals to investors were key in reducing these barriers.[6] Investment treaties are one of these barriers and give confusing signals to investors that governments will protect fossil fuel interests from transition risks. Discussions on scaling down fossil fuel investments are necessary to close the climate finance gap and investment treaties need to be considered along with fossil fuel subsidies or export finance in that context.

[3] UNFCCC, 2023, **Sharm el-Sheikh dialogue on the scope of Article 2, paragraph 1(c), of the Paris Agreement and its complementarity with Article 9 of the Paris Agreement (FCCC/PA/CMA/2023/7/Rev.1)**.

[4] IEA, 2022, **Securing Clean Energy Technology Supply Chains**.

[5] IEA and IFC, 2023, **Scaling up Private Finance for Clean Energy in Emerging and Developing Economies**.

[6] UNFCCC, 2023, **Outcome of the first global stocktake (FCCC/PA/CMA/2023/L.17)**.

Broader impact on climate action

In addition, ISDS poses a risk to climate action more broadly. First, the fear of high-value ISDS claims can create a “regulatory chill effect” and delay climate action. For instance, ahead of COP26, Denmark and New Zealand admitted that the possibility of arbitration claims by foreign investors had prevented them from adopting a more ambitious plan to phase out fossil fuel exploration.[7] Second, any ISDS case that does not involve fossil fuels still has an impact on climate action, by reducing the overall amount of public money available to address the climate crisis.

The recent developments around the Energy Charter Treaty (ECT), the most invoked investment treaty globally, have brought the impact of investment treaties on climate action into stark relief.[8] In 2022, the IPCC highlighted the ECT and other investment treaties as international legal norms that were still “concerned with promoting further development of fossil fuels.”[9] In 2023, the UN Special Rapporteur on human rights and environment recognised ISDS as a “major obstacle to the urgent actions needed to address the planetary environmental and human rights crises” and recommended that all states should immediately eliminate their exposure to future ISDS claims.[10] However, investment treaties remain relatively unknown to the climate community and have not been embedded in climate discussions.

Impact of investment treaties on developing countries

Investment treaties with ISDS disproportionately affect developing countries. First, developing countries are mostly on the receiving end of foreign direct investments and therefore a majority of ISDS cases have been brought against them by investors from developed countries. One study analysed that out of 936 cases publicly available, 86% of the claimants were from high-income countries but 72% of the cases were brought against countries from other income groups. states are high-income countries whereas 92% of claimants are from high-income countries.[11]

[7] Elizabeth Meager, updated 02 August 2022, **COP26 targets pushed back under threat of being sued (Capital Monitor)**.

[8] Despite the negotiations to upgrade the treaty to make it more compatible with addressing the climate crisis, ten European countries since 2022 have announced their intention to leave the ECT, deciding that remaining in the treaty would be inconsistent with their climate commitments.

[9] IPCC, 2022, **Climate Change 2022: Mitigation of Climate Change**.

[10] United Nations General Assembly, 2023, **Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights (A/78/168)**.

[11] Tim R Samples, 2019, **Winning and Losing in Investor-State Dispute Settlement**.

Second, extortionate compensation awards can have a bigger impact on developing economies, exacerbate their debt burden and reduce public money available for climate action. For instance, in 2019, Pakistan lost an ISDS case and was ordered to pay more than USD 5.8 billion in compensation to an Australian investor for not approving the development of a gold and copper mine, which was tantamount to the bailout Pakistan secured from the IMF in the same year.[12] A recent analysis also demonstrates that the financial risks from potential ISDS claims associated with the energy transition could exceed the GDP size of some countries. For example, the financial risk that Mozambique might face due to oil and gas fields protected by investment treaties could be nearly twice the size of its GDP in 2019.[13] Given that one ISDS claim can absorb a large amount of public funds of developing countries that could be otherwise used to tackle climate mitigation and adaptation, discussing the impact of investment treaties under the Sharm el-Sheikh dialogue would be complementary to achieving Article 9.

The world has committed to reaching a net-zero emissions economy by mid-century, and systemic changes have already begun to that end, although with different speeds and scopes, largely due to different national circumstances. Some countries might end up keeping fossil fuel assets slightly longer than others as they build a clean energy asset base. However, continuing to give fossil fuel assets treaty-based investment protection would reduce states' ability to adapt their energy policies to changing economic circumstances at a later stage due to the fear of high financial risks from potential ISDS claims. Therefore, this would lock countries into high-carbon pathways for the coming decades while limiting their ability to deploy renewable energy which continues to become cheaper.

Recommendation

A holistic and comprehensive approach is needed in identifying the scope of and ways to implement Article 2, paragraph 1(c), of the Paris Agreement, including private and public, domestic and international investments and a wide range of policy tools that are related to and could have an impact on finance flows. In this regard, we believe it is important for the Sharm el-Sheikh dialogue to discuss policy areas that have been so far unaddressed and understand their relevance and impact in achieving Article 2, paragraph 1(c). Investment treaty reform is one such area and one which could have a big impact, particularly on developing countries.

[12] International Institute for Sustainable Development (IISD), 2020, **Compensation Under Investment Treaties: What are the problems and what can be done?**

[13] Kyla Tienhaara, Rachel Thrasher, B. Alexander Simmons & Kevin P. Gallagher, 2022**, Investor-state dispute settlement: obstructing a just energy transition**.

Investment treaties, as they currently are, stand in the way of making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. Therefore, government actions to address them can be a part of the implementation of Article 2, paragraph 1(c). This can create momentum to accelerate necessary reform discussions to align investment treaties with the Paris Agreement in other forums at a more technical level, which might otherwise remain unaddressed and hinder the overarching goal of mobilising climate finance.

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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