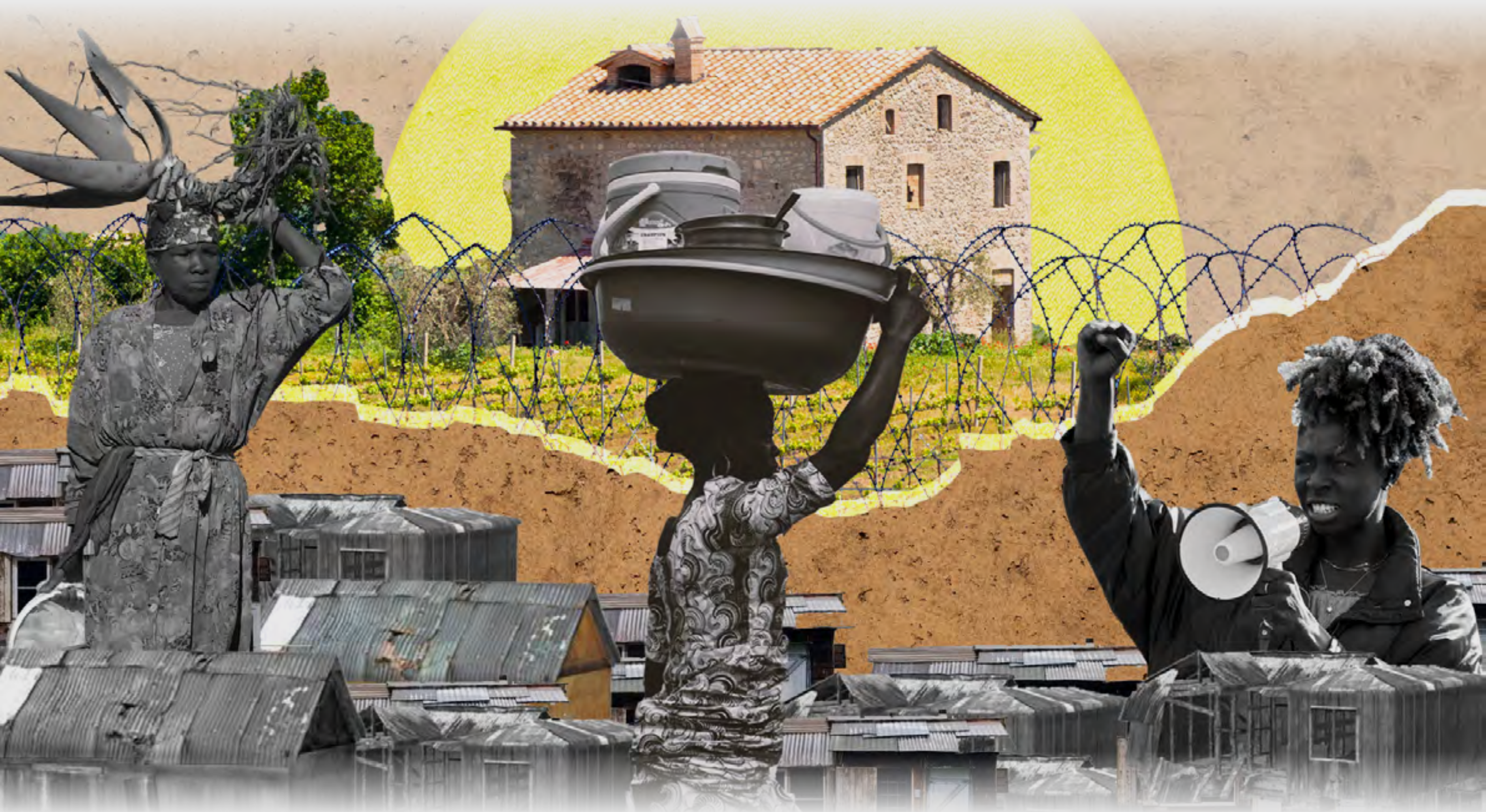
ENERGY TRANSITION MYTHBUSTERS

MYTH #6 — Investment protection is necessary to encourage energy transition investment



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THE MYTH

Investments in the energy sector are often protected by International Investment Agreements. These agreements contain specific measures geared towards 'investment protection', in particular investor-state dispute settlement (ISDS) clauses, which enable foreign investors to sue governments at international tribunals to challenge policies that have reduced their profits, or that could do so in the future.

Within the energy sector, the most frequently invoked International Investment Agreement is the 1994 Energy Charter Treaty (ECT). The Treaty is signed by 53 member states in Europe and Asia, including the EU and Euratom.[176] The ECT secretariat has been pushing hard to expand the Treaty into Africa, the Middle East, Latin America and more countries in Asia.[177] Investors and investment lawyers present the ECT and other ISDS schemes as necessary to protect and attract renewable energy investments. They argue that investors need protection through ISDS to provide legal certainty and stability. In the words of the ECT website:

'...the Treaty is designed to provide a stable interface between the foreign investor and the host government. This stability is particularly important in the global energy sector, where projects are highly strategic and capital-intensive, and where risks have to be assessed over the long-term. It is a major task to reduce these risks, as much as possible, by creating a stable and transparent investment climate.' [178]

Because renewable energy projects often require significant upfront investment, it is often argued that renewables investments, in particular, depend upon stable legal and regulatory frameworks. Proponents argue that without ISDS, renewable projects are too risky for investors to back with the scale and urgency required to meet international climate targets.

THE REALITY

International investment treaties, in particular the Energy Charter Treaty (ECT), have become powerful weapons for fossil fuel corporations and investment funds. ISDS enables corporations to sue governments to challenge policies that could reduce their profits — even those enacted to deal with the social, energy and climate crises.

Only investors can initiate ISDS claims — there is no parallel mechanism for governments to sue investors. Arbitration proceedings bypass national jurisdictions and lack transparency, while rulings are unpredictable and depend solely on the arbitrators' decisions, with no right of appeal. Arbitrators often lack independence and impartiality. Arbitration awards can be enforced anywhere in the world: if states lose cases and fail to pay compensation, investors can seize their assets in other countries.[179]

ISDS cases that relate to the environment have significantly increased over recent years. As of December 2022, the total number of known ISDS cases stood at 1,257.[180] **175 of these cases were brought against government measures related to the environment, 192 were initiated by a fossil fuel investor,** and at least 80 challenged measures relating to regulatory changes for re-newable energy production.[181] Around half of all environment-related ISDS cases were brought through the ECT. As of June 2021, the average amount claimed by investors from governments under the ECT reached $1.6 billion.[182]

The reality is that ISDS is standing in the way of climate action, while alleged benefits pertaining to renewables investment do not seem to be materialising. What's more, ISDS undermines governments' capacity to implement democratically agreed climate policies. **ISDS claims can easily run into billions because corporations not only sue to recover money they have already spent, they can also claim compensation for hypothetical future profits lost due to government actions.**[183]

ISDS BLOCKS CLIMATE ACTION

In its latest report, the Intergovernmental Panel on Climate Change highlighted the danger that treaties like the ECT can 'be used by fossil-fuel companies to block national legislation aimed at phasing out the use of their assets'.[184] Indeed, The ECT does not support an immediate halt to new fossil fuel projects. Even plans for a 'modernised' Energy Charter would continue to protect all fossil fuel investment for at least another 10 years.

As demonstrated by the following examples, **ISDS presents a risk for governments that take measures to advance low-carbon energy transition and offer support for the fossil fuel and nuclear industries:**

Sued for phasing out nuclear energy: Swedish state-owned multinational energy company Vattenfall filed a lawsuit against Germany in 2012, claiming €4.3 billion plus interest for lost profits related to two of its nuclear reactors. The legal action was a response to a decision by the German Parliament to accelerate the phasing out of nuclear energy, following the Fukushima disaster in 2011 and strong anti-nuclear protests throughout the country.[185]

Sued for prohibiting coal power production: The Netherlands was sued twice for its plans to stop coal power production by 2030. The German energy giant RWE claimed €1.4 billion in compensation. Meanwhile, Uniper, another German multinational, filed a similar lawsuit, claiming around €1 billion.[186]

Sued for banning offshore oil extraction: Italy was sued by the British oil and gas company Rockhopper after cancelling its concession to drill for oil in the Adriatic Sea. This came after a decade-long struggle by coastal Italian communities who denounced the danger of drilling, which had already caused earthquakes and threatened new ecological disasters. The oil company is demanding €300 million compensation, seven times more than the figure initially invested by the company. The claim came after Italy withdrew from the ECT in 2015; **investors can continue to use ISDS procedures provided for in the ECT up to 20 years after withdrawal.**[187]

There is a strong precedent, then, of countries being bullied out of important energy transition policies by ISDS. In addition, even the threat of new lawsuits could be enough for a government to reconsider passing new regulations that could 'damage' investors' 'economic expectations'.

It is no wonder, then, that multiple countries including Denmark, France, Spain, Germany and the Netherlands, have announced plans to leave the ECT, citing the tension between the ECT and climate action as central to their decision. What's more, the European Commission recently noted that a joint EU exit from the Treaty appears inevitable, because the Treaty 'clearly undermines' EU climate targets.[188]

ISDS DOES NOT SUPPORT RENEWABLES INVESTMENT

There is no evidence to support the claim that ISDS and the ECT help to attract and protect investment in clean energy technologies. Investment Agreements and investment protection measures do not figure in the 167 criteria used by Bloomberg New Energy Finance to assess countries' attractiveness for renewable energy investment.[189] Indeed, **countries that have not signed or have recently terminated Investment Agreements are ranked by Bloomberg New Energy Finance as providing the best opportunities for renewable energy investors.**[190]

These findings are congruent with a broader evidence base that suggests that Investment Agreements like the ECT do not contribute to investors' decision-making. Multiple recent studies have demonstrated that investment protection measures have little to no effect on Foreign Direct Investment to a country.[191]

The case of Spain further debunks the myth that investment protection supports the clean energy transition. Spain is the most sued country under the ECT, largely because of changes to its renewable subsidy schemes. The Spanish government's Feed-in-Tariff scheme created a highly lucrative environment for investment in solar energy, attracting capital from international investors and financial institutions.

However, the government cut the Feed-in-Tariff in 2008 due to the financial crisis. A torrent of ISDS cases have ensued under the ECT: **Spain received 51 claims, of which 27 have already been resolved, 21 of them in favour of the investor.**[192]

An estimated €8 billion is being claimed by foreign investors, with €1.2 billion paid out so far by the government in cases it has already lost — a figure that equals Spain's commitment for spending on climate change, and five times its 2021 spending on measures to alleviate energy poverty.[193] The beneficiaries of these claims are not renewable energy companies. On the contrary, **89 per cent of the claimants are financial institutions and investment funds, for whom the energy transition is little more than a source of profit.**[194] Indeed, in half of the cases, the companies suing Spain also had investments in the coal, oil, gas, and nuclear energy sectors.[195]

As such, while at face value the case of Spain looks like an example of ISDS being used to defend renewables investment, this turns out to be far from the truth. In fact, what we see here is ISDS being used to line the pockets of investors that have no particular interest in renewable energy. Meanwhile, government funds that could have been used to spearhead ambitious climate policy and clean energy investment are depleted. Some domestic investors even registered a shell company in an ECT member country to sue the Spanish government.[196]

ISDS UNDERMINES POPULAR SOVEREIGNTY

The implications of this are compounded, particularly for governments of resource-rich countries in the global South, due to the possibility of ISDS being deployed in cases relating to the metals and minerals required for renewable energy technologies such as lithium, cobalt and nickel. **The risk here is that governments introducing new policies or regulations pertaining to markets in these commodities could be sued through an ISDS tribunal by investors with a stake in the renewable technologies whose supply chains depend upon access to these minerals and metals.**

As the market value of some transition metals alone is expected to reach tens of billions of dollars,[197] ISDS claims in this sector promise to be highly lucrative. For example, following remarks by the government of Chile alluding to plans around the nationalisation of its lithium resources, Simco SpA, a joint venture between the *Chilean* company Grupo Errázuriz and Taiwanese company Simbalik Group, has threatened to invoke ISDS. Any potential claim could be worth more than $2.5 billion, as Simco estimates that the potential 'damages' (including lost future profits) may total this figure.[198]

Time and again, ISDS lawsuits — or even the mere threat of them — have been sufficient to deter governments from taking necessary measures. This dangerous dynamic known as 'regulatory chill' has also been observed in relation to energy transition resources.[199] Take Newmont, a US mining company registered in the Netherlands that evoked the Indonesian-Dutch Bilateral Investment Treaty in 2014.[200] This happened five years after the Indonesian government introduced export restrictions on copper, a move aimed at boosting domestic employment and the local economy — and to support Indonesia in becoming less dependent on the export of raw materials. Newmont ultimately withdrew its claim after obtaining special exemptions from the mining law.[201]

Wealthy Northern governments are using ISDS to protect their industries, at the expense of resource-rich countries' sovereignty. In a communication to other EU bodies, the European Commission said that in order for the EU's green tech industry to thrive, '[e]xternal energy policy must work hand in hand with the EU industrial and trade policy, ensuring market access for our industry and addressing challenges via the Free Trade Agreements and enforcement action.' ISDS is the main enforcement mechanism of the many trade deals the EU has signed, so the Commission presents ISDS as necessary for its industries to ensure market access to raw materials critical to energy transition technologies.[202] In turn, this usage of ISDS undermines the capacity of resource-rich countries to introduce just transition policies.

ISDS UNDERMINES DEMOCRACY

The anti-democratic implications of the ISDS mechanism present in the ECT and countless other investment protection treaties (there are some 2,500 in total) have generated widespread criticism from academics, lawyers, and civil society.

The heart of the problem is that only foreign investors can sue, making it a one-sided and un-democratic system in which the state is always a defendant and cannot bring counter-claims against investors. It provides special privileges and rights to foreign investors, enhancing their power relative to citizens and governments. As such, **ISDS is a shadow legal system operating outside domestic legislation, capable of overriding national law and government sovereignty.**

Worldwide, ISDS has bolstered corporate impunity, while undermining governments' power to regulate the practices of corporations. It has often left the state as a hostage to investors' interests by enabling corporations to sue for billions of dollars of compensation when they can claim that national policies in some way harm their investments, if not mere hypothetical profits. In the end, the government pays compensation using public money, raising important questions about the balance between private gain and public loss. Moreover, the mechanism can have a chilling effect on public measures. When this happens, a claim or even the mere threat of a claim prevents the state from legislating to protect people's rights. It should be noted, ISDS is also open to domestic companies as long as they have registered a mailbox company abroad in a country where an investment treaty guarantees access to investment protection.

WE NEED A BINDING TREATY TO HOLD ENERGY MULTINATIONALS ACCOUNTABLE

ISDS undermines governments' capacity to design and implement ambitious energy transition policies. The threat of international arbitration hamstrings governments, making it even more difficult to keep fossil fuels in the ground. Luckily, however, by the end of 2022, Spain, France, Italy, Germany, Poland, the Netherlands, Luxembourg and Slovenia decided to pull out of the ECT, after which the European Parliament called for an immediate withdrawal from the Treaty. At the same time, **efforts by the ECT secretariat to lobby countries in Africa, the Middle East, Asia and Latin America to sign on to the Treaty continue unabated.**[203]

As discussed in Myth #1, we need to rethink dominant paradigms on energy transition investment: the public sector must lead the way on delivering a just and democratic transition. For this to happen, the ECT — and ISDS schemes more broadly — must become a thing of the past.

Instead of international arbitration tribunals that favour energy multinationals and foreign investors, we need to employ international law in defence of human rights — especially considering the fact that energy companies, green and polluting alike, are often associated with human rights violations.[204] While the privileges extending to the corporate sector through ISDS are legally binding, so far all existing international instruments on business and human rights are voluntary schemes. That's why social movements, affected communities and trade unions around the world, together with some low- and middle-income countries, have sustained the struggle for an international legally binding instrument that holds multinationals accountable for their human rights violations.[205, 206]

This 'binding treaty', under negotiations at the United Nations Human Rights Council since 2014, should be part and parcel of our growing struggle to reclaim energy from the market and expand governments' capacities to develop democratic energy transition policies.

SUMMARY

- **Investment protection measures are NOT necessary to encourage energy transition investment.**

- **ISDS enables corporations to sue governments for policies in the public interest that reduce their profits, including hypothetical future profits.**

- **ISDS is being used to block climate action and support the fossil fuel industry, who repeatedly sue governments for measures that seek to reduce fossil fuel production and consumption. Multiple countries including Denmark, France, Spain, Germany and the Netherlands are leaving the ECT because of the threat it poses to climate targets and energy transition.**

- **ISDS does not protect or encourage renewables investment: multiple studies show that investors do not take into account the presence of Investment Agreements in their decision-making. Investment Agreements and investment protection measures do not figure in the 167 criteria used by Bloomberg New Energy Finance to assess countries' attractiveness for renewable energy investment.**

- **ISDS undermines domestic legal systems and government sovereignty. It creates a shadow legal system that is highly untransparent and unaccountable, further concentrating power in the hands of international investors and corporations.**

- **Promoting governments' capacity to introduce ambitious energy transition policies means dismantling the ECT and ISDS schemes more broadly.**

- **Instead of international arbitration that favours energy multinationals and foreign investors, we need an international legally binding instrument to hold energy multinationals accountable for their human rights violations.**

This factsheet is part of the Energy Transition Mythbusters publication. Read the full report and find out about the other myths that threaten decarbonisation here: *tni.org/energytransitionmythbusters*

ENDNOTES

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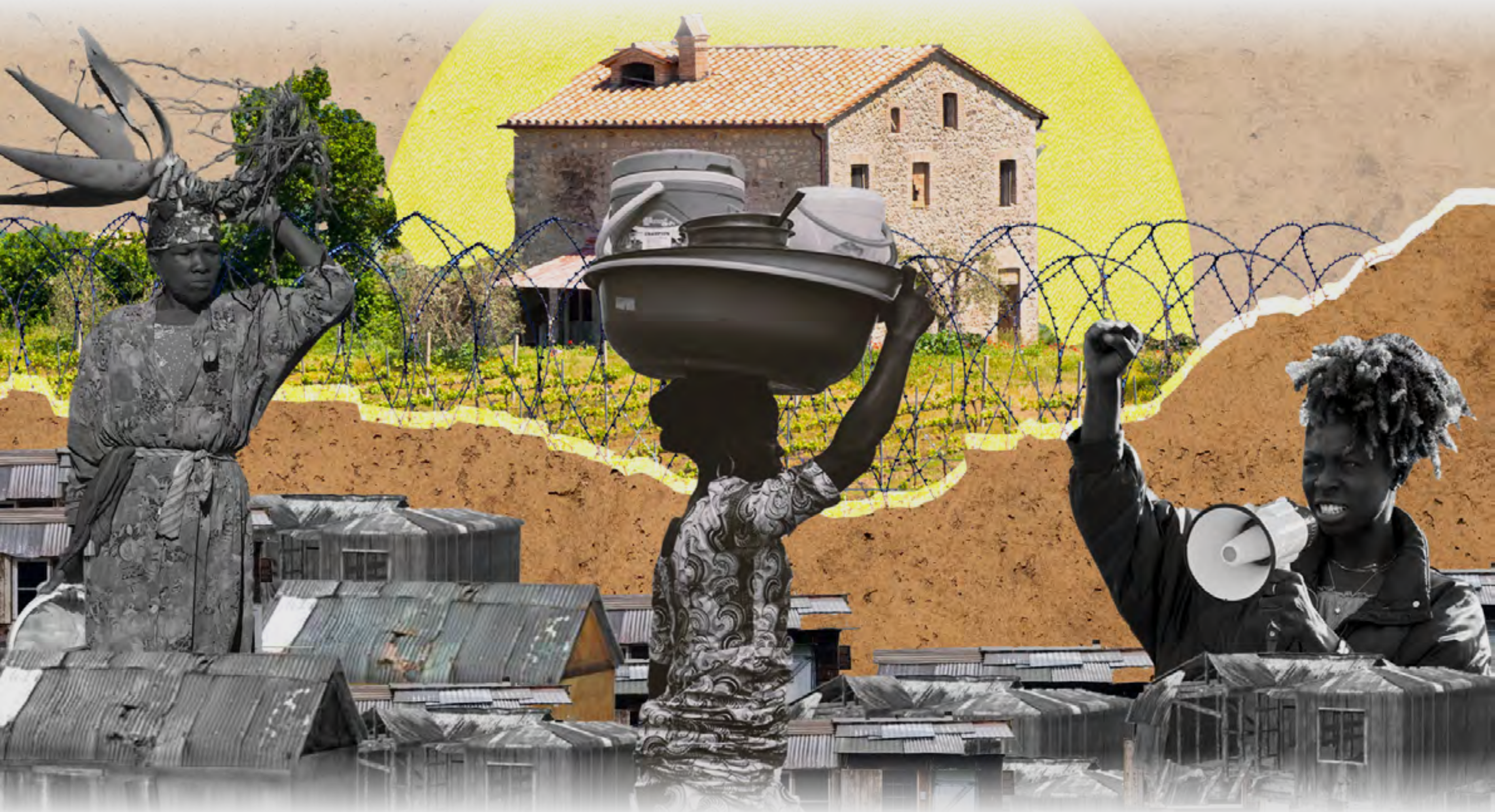

The Transnational Institute (TNI) is an international research and advocacy institute committed to building a just, democratic and sustainable planet. For more than 40 years, TNI has served as a unique nexus between social movements, engaged scholars and policy-makers. TNI has gained an international reputation for carrying out well researched and radical critiques. As a non-sectarian institute, TNI has also consistently advocated alternatives that are both just and pragmatic, for example providing support for the practical work of public services reform. **https://www.tni.org/en**

TRADE UNIONS FOR ENERGY DEMOCRACY (TUED) is a growing global network of unions and close allies working to advance democratic control and social ownership of energy, in ways that promote solutions to the climate crisis, address energy poverty, resist the degradation of both land and people, and respond to the attacks on workers' rights and protections. Established in late 2012, TUED has grown to span dozens of trade unions, labour federations and social movement and policy allies from countries around the world, both North and South. **https://www.tuedglobal.org/**

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