THE CONTINUING BACKLASH AGAINST INVESTOR-STATE ARBITRATION MAY CALL FOR THE INCREASING USE OF CONTACT TERMS TO PROTECT ENERGY INVESTMENTS

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Just like concessions for natural resources, international energy contracts and large energy projects are particularly susceptible to the "political risk" of uncompensated expropriation or other internationally unlawful government interference. This is because an international energy contract or large energy project normally involves high up-front capital expenditures that might only be recovered from long-term profits many years after the expenditures are incurred.[1] As a result, some governments, regulators and regulated utilities may believe they have strong leverage to demand revisions to contract terms and other long-term expectations, on the basis that an investor can be induced to accept these changes once significant sums have been spent on constructing infrastructure but before the profits are extracted.[2]

As Peter Cameron has noted:

> "Negotiating leverage shifts during the project life cycle: the investors require a long period to achieve their expected return while, once the investment is made, the host state has what it requires. For a variety of reasons, the host state may then conclude that the original bargain is obsolete."

Pertinent examples of this phenomenon abound. Investors in foreign energy projects routinely find, for instance, that the favourable feed-in-tariffs for solar energy projects are revised once the project nears completion.[3] Regulators may increase interference in energy tariffs and rates only

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1 PETER D. CAMERON, INTERNATIONAL ENERGY INVESTMENT LAW: THE PURSUIT OF STABILITY (Oxford University Press, 2ed., 2021), at p. 5; HENRY G. BURNETT & LOUIS-ALEXIS BRET, ARBITRATION OF INTERNATIONAL MINING DISPUTES: LAW AND PRACTICE (Oxford University Press, 2017), at p. 30 § 5.04.

2 *See* Cameron, *supra* note 2, at p. 5; *see also* Burnett & Bret, *supra* note 2, at p. 30 § 5.04 ("Similar to their energy or infrastructure counterparts, international mining investments are particularly vulnerable to political risk because of a variety of factors" including because "they generally require large upfront investments that will take years to recoup.").

3 *See* Maximilian Schmidl, '*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 (Feb. 1, 2021), available

after a transmission line or power generation facility is constructed. The promise of market liberalisation in the power or oil and gas sectors may be quickly overturned, sometimes on the change of Government. Or, finally, successful energy projects may be assailed for obtaining so-called "windfall profits" that are compulsorily escheated to the State by legislation.

To mitigate this risk, many companies investing in large energy projects rely on the terms of over two thousand bilateral investments treaties ["**BITs**"] and other treaties that protect foreign investments[4] – called "international investment agreements," or IIAs.[5] IIAs provide a panoply of substantive rights to foreign investors and their investments in a host state's territory,[6] including, among others, a guarantee of fair market value compensation in the event of an expropriation;[7] treatment equivalent to that provided to nationals[8] and investors of any third state;[9] the free

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athttp://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/). See also Sebastian Perry, *Spain marks 50th renewables claim as new reforms roil investors* (Sep. 21, 2021), https://globalarbitrationreview.com/spain-marks-50th-renewables-claim-new-reforms-roil-investors.

4 Investment Policy Hub, United Nations Conference on Trade and Development: International Investment Agreements Navigator, http://investmentpolicyhub.unctad.org/IIA (May 17, 2022) (listing 2,794 BITs and 425 other investment protection treaties).

5 JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES, (Oxford University Press, 3ed., 2021), at p. 1 ("Investment treaties . . . are essentially instruments of international law by which states (1) make commitments to other states with respect to the treatment they will accord to investors and investments from those other states, and (2) agree to some mechanism for enforcement of those commitments.").

6 KENNETH J. VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION (Oxfod University Press, 2010) at p. 121 ("The substantive provisions of a BIT typically apply to assets that fall within the definition of investment and that are located within the territory of one of the BIT parties."); *accord* Salacuse, *supra* note 5, at p. 188 ("Investment treaties often specifically limit their application to investments made within the territory of the respective contracting parties.").

7 *See* Vandevelde, *supra* note 6, at pp. 271-72 ("BIT expropriation provisions always acknowledge the power of the host state to expropriate covered investment, but they impose conditions on the exercise of that power. . . . The requirement of compensation always appears."); *see also id.* at p. 274 ("The reference to adequate compensation generally means the full value of the investment, that is, the fair market value of the investment.").

8 August Reinisch, '*National Treatment in Building International Investment Law: The First 50 Years of ICSID'*, ed. Meg Kinnear et. al., Kluwer Law International, 389 (2016) ("National treatment is one of the basic non-discrimination disciplines in international investment law. Almost all bilateral investment treaties ('BITs') and multilateral investment agreements contain national treatment provisions requiring contracting states to provide investors and investments from other contracting parties treatment no less favorable than that accorded to their own investors and investments.").

9 David D. Caron and Esmé Shirlow, '*Most-Favored-Nation Treatment: Substantive Protection* in Building International Investment Law: The First 50 Years of ICSID', ed. Meg Kinnear et. al. Kluwer Law International, 399 (2016) ("Most investment treaties contain most favored nation ('MFN') clauses. These clauses vary in their precise wording but in general state that the treatment or rights enjoyed by investors covered by a particular investment treaty shall not be less than that 'accorded to investments made by investors of any third State.') (citations omitted).

transfer of funds into and out of the host state;[10] and so-called "fair and equitable" treatment (or the protection of an investors' reasonable and legitimate expectations).[11]

Just as significantly, IIAs also often permit investors to raise claims against the host state for a breach of the treaty's substantive protections to a neutral, international tribunal – called "investor-state arbitration".[12] Investors have taken advantage of these provisions by filing almost 1,200 claims for breaches of BITs and FTAs[13] against numerous countries such as the United States, Canada, Mexico, Venezuela, Argentina, India, Germany, Australia, China and others.[14] Since its emergence as a nascent form of dispute resolution in the 1980s and 1990s, investor-State arbitrations have become one of the most common way in which large investment disputes between investors and States are resolved.

It is therefore fair to say that the "direct invocation of arbitration claims by investors themselves against the host State" is a "development . . . that has transformed the landscape of modern investment protection."[15] This is particularly true in the energy sector. As such, companies considering foreign energy investments should be aware of recent developments that suggest a possible backlash against IIAs and investor-State arbitration:

i. The final version of the US-Mexico-Canada Agreement ["**USMCA**"], the successor to NAFTA, eliminated virtually any investor-State arbitration for Canadian investors in the US, and vice versa, and essentially gutted the same protection for US investors in Mexico except in the case of a limited set of industries that had lobbied in the US for protection to continue.[16] Based on the author's considerable experience advising Governments who are drafting new model IIAs, the terms of the USMCA are gaining prominence outside of that one treaty. This is despite the fact that, in conversations

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[10] Vandevelde, *supra* note 6, at p. 419 ("The vast majority of BITs include a provision guaranteeing the free transferability of payments related to an investment. In many cases, this provision applies to transfers into the state as well as out of the state.").

[11] ANDREW NEWCOMBE AND LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT, pp. 234, 278 (2009).

[12] *See* CAMPBELL MCLACHLAN. ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (Oxford University Press, 2 ed., 2017), at p. 4 § 1.05.

[13] *See* Investment Policy Hub, United Nations Conference on Trade and Development: Investment Dispute Settlement Navigator, https://investmentpolicy.unctad.org/investment-dispute-settlement (May 17, 2022).

[14] *See* "Respondent State", italaw, https://www.italaw.com/browse/respondent-state .

[15] McLachlan et al., *supra* note 13, at p. 4 § 1.05.

[16] Graham Coop and Gunjan Sharma, '*Procedural Innovations to ISDS in Recent Trade and Investment Treaties: A Comparison of the USMCA and CETA'*, AYIA 2019 (Christian Klausegger et. al, eds., 2019), at p. 474.

with the author, an Ambassador at the US Trade Representative refused to confirm whether the USMCA's terms represented a change in US Government policy on IIAs or a *sui generis* and bespoke result of a particular set of negotiating positions in a particular political environment.

ii. The European Commission has endorsed a policy of replacing IIAs that individual European Union ["**EU**"] member states have signed with non-EU countries, with investment protection chapters in the EU's trade agreements.[17] In 2018, this trend was officially endorsed by the Court of Justice of the European Union ["**CJEU**']'s *Achmea* decision, which ruled that intra-EU BITs are not compatible with certain principles EU law.[18] Following this decision, the EU Member States issued a declaration requesting that EU courts set aside intra-EU investment arbitration awards and suspending any new intra-EU investment proceedings.[19] On 5 May 2020, many EU Member States signed an Agreement for the Termination of all Intra-EU Bilateral Investment Treaties, which then entered into force on 29 August 2020.[20] In a similar ruling, the CJEU clarified, in its *Komstroy* decision, that Energy Charter Treaty ["**ECT**"] intra-EU investment arbitration is not compatible with EU law and thus cannot apply in conflicts between an EU investor and an EU Member State.[21]

iii. In the same vein, the EU's latest IIAs provide for a "multilateral investment court" whose judges will be selected exclusively by the Respondent States.[22] Investors may

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17 *See* European Commission, *EU takes key step to provide legal certainty for investors outside Europe* (Dec. 12, 2012), http://trade.ec.europa.eu/doclib/press/index.cfm?id=854.

18 Slovak Republic v. Achmea B.V., Case C-284/16, Judgment, Grand Chamber, 6 March 2018.

19 European Commission, *Declaration of the Representatives of the Governments of the Member States, of 15 January 2019 on the legal consequences of the Judgment of the Court of Justice in Achmea and on investment protection in the European Union* (Jan 17, 2019) https://ec.europa.eu/info/publications/190117-bilateral-investment-treaties_en.

20 European Commission, '*EU Member States sign an agreement for the termination of intra-EU bilateral investment treaties'* (May 5, 2020).

21 République de Moldavie v Komstroy LLC, Case C-741/19, Judgment, Grand Chamber, 2 September 2021.

22 Issam Hallak, '*Multilateral Investment Court: Overview of the reform proposals and prospects'*, EUROPEAN PARLIAMENTARY RESEARCH SERVICE, PE 646.147 (January 2020), at p. 3; European Commission, '*Commission Staff Working Document Impact Assessment: Multilateral reform of investment dispute resolution, Accompanying the document Recommendation for a Council Decision authorising the opening of negotiations for a Convention establishing a multilateral court for the settlement of investment disputes'*, SWD (2017) 302, 13 Sept 2017, at 44; European Commission, *Commission welcomes adoption of negotiating directives for a multilateral investment court* (March 20, 2018) https://policy.trade.ec.europa.eu/news/commission-welcomes-adoption-negotiating-directives-multilateral-investment-court-2018-03-20_en).

be concerned that the final panel on this multilateral investment court does not contain the same level of business and commercial experience, and knowledge of the public international law of investment, as might be found in investor-State arbitrations today. Some commentators have also indicated a concern regarding the way the judges on such a court are appointed only by the respondent-States, who have an interest in the outcome of the cases.[23]

iv. Moreover, some countries have terminated IIAs, for a variety of reasons. For example, Venezuela terminated the Netherlands-Venezuela BIT,[24] India terminated the vast majority of its BITs,[25] and Pakistan terminated its BITs as well.[26]

v. Other States, such as the Netherlands, have adopted a new model for their IIAs that might diminish the protection afforded to investors.[27] Sometimes, these new treaties contain both substantive and procedural deviations from older generation treaties that diminish protection for investors – although, based on a systematic survey conducted by the author of 189 treaties signed between 2010 and 2019, that approach is apparently less common than often supposed.[28]

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[23] *See* The Bahrain Chamber for Dispute Resolution (BCDR), *Report on Panel 1: Should investment disputes be submitted to international arbitration or to a permanent investment court?* ("Dr. Lavranos noted that, under the EU-led investment court proposal, states would be able unilaterally to select judges of their choosing, and have some sway over their conduct as they would be unlikely to reappoint judges whose past rulings they disagreed with.").

[24] *See* Luke Eric Peterson, '*Venezuela Surprises the Netherlands With Termination Notice for BIT; Treaty Has Been Used By Many Investors to "Route" Investments Into Venezuela'* (May 16, 2008), https://www.iareporter.com/articles/venezuela-surprises-the-netherlands-with-termination-notice-for-bit-treaty-has-been-used-by-many-investors-to-route-investments-into-venezuela/.

[25] *See* Kavaljit Singh and Burghard Ilge, *India overhauls its investment treaty regime*, FT.com (July 15, 2016), https://www.ft.com/content/53bd355c-8203-34af-9c27-7bf990a447dc.

[26] *See* Zafar Bhutta*, Pakistan to terminate 23 bilateral investment treaties,* THE EXPRESS TRIBUNE (Aug. 5, 2021), https://tribune.com.pk/story/2313937/pakistan-to-terminate-23-bilateral-investment-treaties. *See also*, Ecuador had terminated all its BITs and exit the ICSID Convention, but was forced to change this policy due to investments' shortage (Juan Carlos Herrera-Quenguan, *Explaining Ecuador's shifting position on FDI, investment treaties, and arbitration*, Investment Treaty News (Oct 5, 2020), https://www.iisd.org/itn/en/2020/10/05/explaining-ecuadors-shifting-position-on-fdi-investment-treaties-and-arbitration-juan-carlos-herrera-quenguan/).

[27] *See Netherlands Model Investment Agreement*, INVESTMENT POLICY HUB (Mar. 22, 2019), https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5832/download; Ministry of Foreign Affairs, *IOAB evaluation - Trading interests and values, Evaluation of the international trade and investment policy of the Netherlands IOB Evaluation*, Nr. 442, Sep. 2021, pp. 129-13 .

[28] *See* Gunjan Sharma, *New Procedural Mechanisms for Investor-State Arbitration as Found in 189 Recently Signed Treaties*, in International Arbitration in Times of Economic Nationalisation (Bjorn Arp, Rodrigo Polanco, eds.) (publication pending) (on file with author).

Thus, companies with energy investments ideally should not limit themselves to depending on the protection of IIAs. They should also be using a variety of other ways to mitigate political risk, including not only IIAs, but by examining local law, considering political risk insurance and negotiating appropriate contract protections (among others). The possibility of a sustained "backlash" against IIAs means that there is an impetus to emphasise these other means of investment protection.

In particular, companies should likely be pressing (to the greatest extent possible) for terms in energy contracts (or other regulatory instruments) that guarantee legal protections and the neutral adjudication of disputes, such as:

i. Clauses referring all contract disputes to international arbitration in a neutral jurisdiction.

ii. Governing law clauses that provide for a neutral, well-established legal system to govern the contract in lieu of the host state's law.

iii. Clauses that measure the company's performance, including environmental obligations, to specific industry norms and standards and not inchoate standards such as found in certain documents of certain international organisations.

iv. Stabilisation clauses that freeze the regulatory regime applicable to the contract to the date of execution. However, reliance on stabilisation clauses should be predicated on performing significant research on whether the applicable law of the contract would enforce a stabilisation clause. Certain jurisdictions (such as Israel) have declared that certain stabilisation clauses may be unconstitutional or otherwise unenforceable.[29] Where a stabilisation clause is or may not be available, the investor should strongly consider a clause that permits an independent arbitrator to the re-balance of contract's economic terms in the event of regulatory changes.

[29] *See* HCJ 4374/15 (Israel), The Movement for Quality Government in Israel v Prime Minister, Judgment, 27 March 2016.

v. If possible (and the host state agrees), replicating some of the protections found in IIAs in energy contracts themselves, such as guarantees of fair market value compensation in the event of expropriation, the free transfer of funds, and non-discriminatory treatment.

Companies should also consider the possibility of obtaining unilateral guarantees from the State that certain core conditions on which a project is based – for instance, the price calculation in an off-take agreement – will be maintained throughout the project's life. Ideally, such guarantees would appear in a bilaterally signed contract that could not then be amended without the company's consent. However, where no bilateral promise is possible, a unilateral guarantee, in writing, can later provide strong evidence of a breach of an international legal norm.

Companies should also consider on-the-ground measures to protect foreign investments, such as (to the extent legally possible) maintaining sensitive operational information outside the host state. As an example, $240 million of Canadian mining company's $1.03 billion settlement of its IIA claims against Venezuela was attributed to Venezuela's acquisition of the company's mining data related to one of those mines.[30]

[30] *See Gold Reserves gets $40 million of $1.03 billion settlement deal with Venezuela*, REUTERS.COM (June 16, 2017), https://www.reuters.com/article/us-gold-reserve-arbitration-venezuela/gold-reserve-gets-40-million-of-1-03-billion-settlement-deal-with-venezuela-idUSKBN1972O7.