The Development of Investor State Mediation and its Future in supporting Energy Transition

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Abstract

This Article provides updates on the recent developments in Investor State Mediation and sheds light on some of the efforts undertaken by several institutions to regulate and promote this amicable mode of dispute resolution. This development is particularly important in the light of climate change and the efforts being made by governments to reduce greenhouse gas (GHG) emissions in order to meet the long-term temperature goals established in the Paris Agreement. As States and private enterprise move forward to put in place sustainable energy systems and to eliminate fossil fuel emissions, this will lead to a seismic shift in the way we deal with energy production. This, in turn, will lead to disputes based on current investments and contractual commitments in heavy emitting industries. States, in particular, will be vulnerable to investment claims as they make changes to domestic energy policy and environmental regulations become more stringent over time. This article will seek to explore how mediation might be used as an effective mechanism to deal with these investor state climate related disputes.

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Introduction

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In 2015, the Paris Agreement was adopted by 196 countries, marking a historic shift in the global fight against climate change. The Paris Agreement sets a long-term goal to hold increases in global average temperatures to well below 2°C above pre-industrial levels and to pursue efforts to limit the increase to 1.5°C. Parties to the Paris Agreement have committed to establishing individual emissions reduction targets or "nationally determined contributions" (NDCs) in order to collectively achieve the Agreement's purpose and its long-term temperature goals. This has propelled sweeping regulatory change at the national level to align domestic policies with climate change commitments, which in turn, has given rise to a transformation of the current global energy system based primarily on fossil-fuels towards a sustainable system based on renewable sources of energy.

The Paris Agreement allows parties to use a variety of international market mechanisms to meet their NDCs including emissions trading systems, taxes and subsidies to encourage investment in renewable energy infrastructure and technology. It also incorporates a sustainable development mechanism, which encourages emission reduction investment projects in the territory of any other state party. It recognizes the need to incentivize the private sector to participate in mitigation efforts, and it has been noted that a considerable increase in foreign direct investment will be required to meet the climate objectives of the Paris Agreement.[3]

The Paris Agreement has sent a clear signal to energy producers and consumers about the need to decarbonise the energy sector in order to achieve its overarching goal. In addition, several factors have caused the energy transition to gain momentum and accelerate, including: the declining costs of electricity from renewable sources; pressure from corporates and investors to reduce carbon footprints; and public pressure on governments and the private sector to mitigate the dangerous effects of climate change. It is clear that the energy transition cannot be achieved without adversely affecting directly or indirectly many existing commercial actors. Statistics show that, in order of significance, the following sources are the largest contributors to GHG emissions:

- Electricity & heat (24.9%)
- Industry (14.7%)
- Transportation (14.3%)
- Agriculture (13.8%)
- Other fuel combustion (8.6%)

This list encompasses most human activities across the globe and the transition will therefore impact us all to a certain extent. The greatest and most imminent impacts will be felt by fossil fuel energy producers, transportation, carbon heavy industries and agricultural practises, including their investors. This includes investments made in furtherance of the Paris Agreement, as well as those negatively impacted by environmental regulatory change, which will all inevitably result in

[3] OECD, UN Environment and World Bank Group (2018), Financing Climate Futures: Rethinking Infrastructure, OECD Publishing, Paris, https://www.oecd.org/environment/cc/climate-futures/policy-highlights-financing-climate-futures.pdf

international conflicts and disputes. Already in the last decade, the number of investment disputes with environmental components has increased steeply, and it is anticipated that there will be many more arising out of policies enacted to align domestic law with international commitments under the Paris Agreement.[4] Disputes arising due to this transformation will detract from the ultimate objective to meet emissions reduction goals in the very short time frame left.

It is trite to say that traditional mechanisms of dispute resolution are costly, time consuming, destructive to relationships and do not ultimately provide an adequate remedy for the environmental issues at hand. While such methods might clarify legal rights between specific parties, this is not the solution to the broader issue of meeting climate goals. To make real progress, we require collaboration and compromise to find lasting solutions. The achievement of the environmental sustainability goals in the short timeframe left therefore requires innovation in the approach to international dispute resolution.

There are also many stakeholders involved in the process and each has a voice and a need to participate to ensure social adhesion, which simply is not provided by traditional dispute resolution mechanisms. Just as we will have to be innovative in rethinking the way we approach our environment, energy consumption and lifestyles to meet the needed drastic reduction in emissions, traditional methods of dispute resolution will have to be recalibrated to meet the challenges of creating a green economy.

Governments in particular, will be instrumental in meeting the challenges not only of the transition, but also in dealing with the impact that changes to domestic environmental and energy regimes will have on both domestic players and foreign investors. Here the very concept of Investor State Dispute Resolution (ISDS) as it developed in the post war era, will also have to be analysed to ensure that the appropriate balance between a States' right to regulate in the public interest and investment protection can be met in a context never contemplated when this system was established 60 years ago. While arbitration has played a crucial role in ISDS, for these particular disputes arising from challenges to energy transition and climate change policy, the potential use of mediation as a more effective resolution mechanism must be considered

Mediation: building international faith in its potential

Mediation has not always been fully accepted as an effective mechanism for the resolution of international disputes. As a matter of standard practice, many international contracts provide for international arbitration as a means of dispute resolution. However, efforts to include mediation provisions in international contracts can prove difficult - particularly when dealing with States or State-owned entities. State representatives are often reticent to provide for mediation due to lack of familiarity, or perceptions that it is a process too ill-defined for State officials to be involved with. States are also guided by political, social and economic considerations, which go beyond simple commercial concerns. This leads to difficulties between States and investors when

[4] Several investment disputes related to the energy transition and the Paris Agreement have already arisen. See e.g., *RWE v Netherlands* ICSID Case No. ARB/21/4; *Uniper v Netherlands* ICSID Case No. ARB/21/22.

investment conflicts arise. Their objectives are simply divergent and dispute resolution mechanisms to help bridge that gap, rather than amplify it, are needed

The terms of the older investment treaties contributed to this reluctance, as mediation simply was not contemplated in the context of the ISDS. ISDS had its own unique dispute resolution system that has grown out of bilateral investment treaties (BITs) negotiated between individual States or on a multi-lateral basis between larger groups of States such as NAFTA (USA, Mexico and Canada) and the Energy Charter Treaty (ECT). Historically, and by way of alternative dispute resolution, these agreements contemplated that arbitration would be used to resolve disputes between investors and States in what emerged to become its own discipline of "investment arbitration". Mediation was not mentioned or contemplated to have a role in these disputes. Many BITs would usually provide for a cooling-off period, which was generally used to prepare for arbitration rather than to try to find a mutually agreeable solution to the dispute. Some treaties would provide for conciliation under the International Center for the Settlement of Investment Disputes (ICSID), part of the World Bank Group. ICSID conciliation rules were not, however, a form of mediation, but rather a tribunal that heard the dispute and then rendered a non-binding opinion. Most parties never used conciliation and moved directly to arbitration.

In the interim years, arbitration, as a mechanism for resolving investor State disputes has increasingly come under attack from many quarters. Some recent developments help to emphasize this such as the agreement for the termination of Intra-EU BITs,[5] and efforts to reform international investment treaties, such as the ECT. The former implements the March 2018 European Court of Justice judgement *Achmea* Case, where the Court found that investor-State arbitration clauses in intra-EU BITs are incompatible with EU Treaties.[6] This development has created a more challenging landscape for investors trying to bring claims under international investment agreements and enforce awards rendered by investment tribunals in the intra-EU context. The latter was instigated in part due to criticism that international investment agreements that incorporate ISDS do not reflect climate change and clean energy transition goals.[7] At the top of the reform agenda is the extent to which the revisions should ensure alignment with the Paris Agreement's objectives.

Also, it was no surprise considering the criticism of the investment arbitration regime, and the extraordinary measures taken by States to handle the unprecedent global crisis caused by COVID 19 that the Columbia Center on Sustainable Investment (CCSI) has called for a moratorium on all arbitration claims by private corporations against governments using international investment treaties.[8]

This disenchantment with arbitration was the seed to explore mediation efforts on the investor-state disputes front. Mediation has indeed been expanding in commercial and non-commercial

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[5] European Commission "EU Member States sign an agreement for the termination of intra-EU bilateral investment treaties" (5 May 2020) https://ec.europa.eu/info/publications/200505-bilateral-investment-treaties-agreement_en;
[6] See also Case C-741/19 *Republic of Moldvoa v Komstroy LLC* reference for a preliminary ruling on the inapplicability between EU member states of the Energy Charter Treaty
[7] Energy Charter Secretariat, Decision of the Energy Charter Conference (6 October 2019) https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2019/CCDEC201908.pdf
[8] Columbia Center on Sustainable Investment "Call for ISDS Moratorium During COVID-19 Crisis and Response" (6 May 2020) https://ccsi.columbia.edu/content/call-isds-moratorium-during-covid-19-crisis-and-response

fronts, in court and out-of-court, locally and internationally with significant expansion across the globe. These efforts culminated in the signing of the Convention on International Settlement Agreements Resulting from Mediation (known as the "Singapore Mediation Convention"),[9] in August 2019. This was a major landmark giving mediation a new credibility as an internationally recognized process for the resolution of commercial disputes (as is discussed in detail in different articles in this issue) and was a celebrated moment for mediation practitioners worldwide.

In parallel, several institutions have actively engaged in developing their own mediation rules to tackle more effectively investor-state disputes such as the Energy Charter Conference (ECC); ICSID; the United Nations Commission for International Trade Law (UNCITRAL) working Group III, and the International Bar Association (IBA). The following sections highlight the efforts of the ECT and ICSID in encouraging the use of mediation.

Energy Charter Treaty

Five years ago, the Energy Charter Treaty Secretariat (ECS), driven by its General Counsel Alejandro Carballo Leyda, began a process to investigate how mediation could be introduced into its Rules.[10] The Rules provide for arbitration to resolve disputes with investors and contained a reference to conciliation, without any specific process defined. The Secretariat was interested in filling the gaps by providing for the possibility of mediation, as well as arbitration. A mediation guide was developed to provide Member States an outline of the mediation process and how it might be used in investor state disputes. Ultimately, the Guide on Investment Mediation (the Guide) was published on the 19th of July 2016.[11] It was later recognized that the Guide alone was not enough. States have largely not mediated because of the lack of an internal framework, through which the mediation process could be carried out objectively and transparently. Issues such as authority to settle, transparency vs confidentiality, responsibility, liability for taking decisions, and state budgets were all a factor.

The ECS went on to review with the member States a model framework that could be adopted within state structures, through which these issues could be dealt with. This resulted in the publication of the Model Instrument on Management of Investment Disputes (the Model Instrument) in December 2018, which has been adopted in the interim by several Member States.[12] The Model Instrument now provides for States to create the capacity to mediate disputes, which was almost entirely missing in the past and precluded negotiation or mediation of disputes with

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[10] The Energy Charter Secretariat assists the Energy Charter Conference in monitoring the implementation of the ECT. The ECT is a multilateral treaty for the promotion of international cooperation in the energy sector. The ECT provides for a number of dispute resolution mechanisms to facilitate the enforcement of rights and obligations under its terms. As of 17 October 2018, the ECT has 55 Signatories and Contracting Parties, including international organizations, with other States and regional intergovernmental organizations as Observers.

[11] The Guide can be found at https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2016/CCDEC201612.pdf. The Guide was prepared with the support of ICSID, the Arbitration Institute of the Stockholm Chamber of Commerce (SCC), the International Court of Arbitration of the International Chamber of Commerce (ICC), the UN Commission on International Trade Law (UNCITRAL), the Permanent Court of Arbitration (PCA), and the International Mediation Institute (IMI). (https://imimediation.org/2016/08/03/ect-adopts-guide-on-investment-mediation/).

[12] https://www.energychartertreaty.org/model-instrument/

States. In other words, it provides the internal structure which authorizes State officials to mediate and settle disputes within a State sanctioned framework. The Model Instrument provides States with the mechanism to introduce mediation as a toll to deal with climate related disputes.

ICSID

Another important development is the fact that ICSID - the organization through which most of investor-state arbitrations are administered - has given its full support to promoting the use of mediation. This effort has been spearheaded by Meg Kinnear the Secretary-General of ICSID and Frauke Nitschke a senior counsel in the organization. In December 2019, ICSID proposed its own investor state mediation rules which are to form part of its Additional Facility Rules. To remedy the fact that there are very few treaties that contain a mediation clause, the ICSID Rules are applicable to mediation and can be invoked by treaty application or by one party's invitation to another even if neither is party to the ICSID Convention. In the latter case, the ICSID Secretary General will assist in seeking the consent of the invited party. This expanded scope of application is an excellent step in increasing access to mediation and attests to ICSID's endorsement of its effectiveness. Such endorsement should help improve the credibility of mediation with both investors, their counsel and States and is a strong step forward in making mediation part of the ISDS process.[13]

ICSID, the International Mediation Institute (IMI), and the Centre for Effective Dispute Resolution (CEDR) have also been working to develop investor state mediation awareness programs and training for mediators and States. It was recognized that without proper awareness-raising on what mediation can bring and the distinction between mediation and other dispute resolution modalities, the knowledge required for States to mediate these disputes would not exist. In addition, to give the process credibility a cadre of mediators, who not only understood mediation, but also ISDS, had to be trained. Since 2017, several annual IS mediator training courses have been held and mediators capable of handling these cases are now prepared and a panel for IS mediators will shortly be launched in co-ordination between CEDR and the ADGM in Abu Dhabi.

The future seems promising for mediation with these developments, especially the fact that mediation has already proven some success in ISDS. In fact, there have already been several important investor State disputes where mediation has now been used. The most recent reported case (as many are not reported), was that of the Dominican Republic and Odebrecht that was mediated in January 2020 by well-known international mediator Mrs. Mercedes Tarrazón. The matter was mediated under the ICC mediation rules and led to a settlement agreement between the parties.

Benefits of Mediation in Investor State Disputes arising out of the Energy Transition

Given the development of a dispute resolution process within ISDS that contemplates the use of mediation, this mechanism will be particularly well suited to assisting in the resolution of disputes arising out of the energy transition. Mediation being a process whereby a neutral third party works with the disputing parties to facilitate an amicable resolution to the dispute has many advantages

[13] https://icsid.worldbank.org/services/mediation-conciliation/mediation

over an adjudicative approach to dispute resolution where a court or tribunal renders a decision. The key benefits for climate-related investor states conflicts include the following:

- helps preserve relationships and potentially permits the investment to continue or be restructured over a transition period, which will be critical for the phase out of GHG emissions. This simply cannot be achieved through litigation;
- can be attempted at an early stage in a conflict, which will permit for an organised and most cost-effective transition to take place;
- is relatively inexpensive and quick, which is critical given the 2030/2050 emissions reduction/elimination timeframe;
- saves lost opportunity costs spent in years of litigation;
- allows for solutions that go beyond the remedies available to a court or arbitral tribunal, which will be needed for heavy emitting entities to effectively transition without massive social and economic upheaval;
- allows for a range of stakeholders to take part (not solely the disputing parties) so that a more robust and inclusive settlement can be reached, which will be essential to obtaining social by-in to energy transition agreements;
- allows for face-to-face contact between the Government, investor and other stakeholders, so that they retain the ability to structure an agreement, rather than having it imposed by a tribunal;
- provides route to a win-win solution and allows a party to save face; (important for politically sensitive situations), which will permit solutions that include scheduled phase out, financial aid for exiting fossil fuel industries, carbon credits, investment opportunities in new sustainable energy projects (the list of possible solutions through mediation are endless, while remedies available in litigation and arbitration are largely financial);
- takes into account cultural norms and concerns which a Court or Tribunal cannot consider;
- few enforcement issues as the parties have themselves agreed the settlement and will therefore be committed to it, which is not the case if a judgement is imposed on a reluctant party;
- the process is as confidential or transparent as the parties wish it to be, so great flexibility in public announcements and press releases;
- the parties can choose the mediator or co-mediators best qualified to assist with the dispute at hand, which will be critical for climate-related disputes, this process is simply not available when a court is involved;
- does not disrupt budgets the way a judgement/award would be as payments can be planned over time, rather than imposed.

Mediation as a Tool for Climate Change Related Disputes

States must do what is possible to create an amicable framework for resolution of climate change related disputes. One key element is having a perceived transparent and fair system for resolving investor issues. Clearly, early dispute resolution will play a role in this. Some States have already implemented ombudsperson programs and in addition, have a stated policy of mediating disputes

as a prerequisite to arbitration. In essence, this is much in line with the premise that disputes must be regulated, meaning that there is a process in place that gives scope for resolution through various steps along the way (IMI mixed-mode dispute resolution).[14] Several States have adopted the ECT Model Instrument providing a proactive framework to utilize mediation at an early stage of disagreements with investors.

COVID-19 has created a situation in which many investment agreements cannot be performed strictly in accordance with their terms. This could be on the investor's part, but also on the part of the State, which may suddenly have seen its circumstances, policy priorities and budgetary commitments dramatically altered. Investments impacted by the energy transition are likely to suffer the same fate, but perhaps on even a larger scale. The range of climate change related measures that will impact the energy sector is extremely wide and includes: the removal of fossil fuel subsidies, the introduction of carbon taxes, stricter emissions standards and electric vehicle mandates, denial of permits for exploration and development, transport or use of coal, gas or petroleum resources, and planned phase-out of certain energy sources.[15] These measures when implemented will undoubtedly have direct impacts on specific investments in the energy sector, including leaving investors and States with the problem of stranded assets. These regulatory and investment policy changes therefore pose a significant litigation risk for States as market actors in the fossil fuel industry invoke investment protections under IIAs to challenge measures taken in furtherance of the Paris Agreement.

The CCSI's call for a moratorium on ISDS addresses this particular issue head on. There must be a constructive alternative which allows the parties to negotiate the future of an investment that may no longer be viable when considering mitigation commitments under the Paris Agreement. Mediation provides the platform whereby with the assistance of neutrals the parties can agree terms for winding down an investment or transforming it into a more sustainable undertaking. The CCSI and the steps being taken by the EU will not be the only call for revision of ISDS, as States struggle to realign many types of policy and regulatory initiatives due to energy transition demands and the need to drastically reduce carbon emissions in the coming decade. This is precisely where mediation can play a vital role, in helping the investor and the State to restructure their respective legal commitments and in some cases permit the investment to continue for a transitional period or in a different form or, alternatively, to bring it to an end on agreed terms. Neither Courts, nor arbitration can provide these remedies and, in any event, enforcing an arbitral award against a State that cannot or seeks to avoid payment because of environmental public policy concerns, hardly makes good business sense.

Funders of energy transition initiatives will also play an important role in encouraging the use of mediation in potential disputes, including by encouraging the use of mediation in disputes clauses. This will be particularly important in projects where States are a party. Funders will be at the heart of phasing out old fossil fuel energy providers and industries and in their place funding new

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[14] https://www.imimediation.org/wp-content/uploads/2017/11/Mixed_Mode_Pepperdine_Summit_Written_Summary_April_27_2017.pdf

[15] Brooke Güven and Lise Johnson 'International Investment Agreements: Impact on Climate Change Policies in India, China, and Beyond' *Trade in the Balance: Reconciling Trade and Climate Policy, Report of the Working Group on Trade, Investment and Climate Policy*, (2016) Columbia Center for Sustainable Investment, https://ccsi.columbia.edu

sustainable energy projects. They will want to ensure that this process is not interrupted and delayed by expensive, inefficient disputes. Funders can therefore mandate in their lending criteria the use of mediation.

The narrative is clear. States now must do all that is possible to create a climate of investment facilitation and compromise with investors who in good faith made investments based on energy policies that were acceptable in the past, but now no longer sustainable. One key element is the perception of a transparent, compromise oriented, and fair system for resolving investor tensions and disputes. Clearly, early dispute avoidance and regulation, rather than adversarial engagement will play a role in this. The time for mediation to become an integral tool of investor State dispute resolution as part of a State's energy transition plans is, therefore, now.

Conclusion

Sustainable energy projects and emission reduction commitments made by States must be implemented rapidly in order to meet the long-term temperature targets of the Paris Agreement. It is therefore imperative that lengthy disputes do not disrupt progress. Clearly, traditional methods of dispute resolution, such as litigation, are not the answer to an effective prevention or management of these disputes. Mediation can play a critical part in fulfilling this role. To ensure that mediation becomes part of the energy transition plan, Governments and funders will play an important part in dictating its use. Institutions will play an equally important role in ensuring that the rules, structure and adequately trained investor state mediators are all in place.

It will also be essential that all stakeholders understand what mediation is, how it can be employed to ensure that global environmental sustainability is achieved and that they are encouraged to utilise it effectively. Only then can we feel secure that achieving a sustainable future is not derailed by disputes and that State commitments and targets can be met in time to avoid an environmental catastrophe.