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€190M Award Fans Flames Against Investor-State Arbitration

By **Caroline Simson**

Law360 (September 14, 2022, 10:28 PM EDT) -- An international tribunal's award last month of €190 million to a British energy company after Italy banned oil and gas projects off its coastline has provided more fuel to a movement in Europe to end investor-state arbitration, even as others say the tribunal simply upheld the rule of law.

The tribunal **held unanimously** in its Aug. 23 award that Italy had breached its obligations under the Energy Charter Treaty by refusing to allow Rockhopper Exploration to proceed with a project to exploit the Ombrina Mare oil field, located off Italy's eastern coast in the central Adriatic Sea.

The decision by the International Centre for Settlement of Investment Disputes panel followed Italy's reintroduction of a general ban on oil and gas exploration and production activity within 12 miles of the coastline. The restriction had originally been introduced in 2010 and was repealed in 2012, before being reintroduced in 2016.

Although most of the documents from the arbitration remain confidential, it is believed Rockhopper argued that Italy unfairly changed its laws surrounding oil and gas investments. The company told its investors in August 2015 that it was on track to receive approval from the Italian government for the project, but that all changed six months later, when the Italian government nixed the endeavor under the reintroduced ban.

The announcement of the award last month sent environmental groups into a frenzy, fanning the flames of an increasingly loud movement in Europe and elsewhere to ban investor-state arbitration. Critics of the system argue that it paves the way for investors in oil and gas and other "dirty" industries to claim hundreds of millions of dollars in damages after a country bans their projects for environmental reasons.

Güneş Ünüvar, a senior research fellow at the Max Planck Institute in Luxembourg and of counsel at the Turkish firm OUB Legal, told Law360 that the Rockhopper case proves that these concerns are not unfounded.

The award "definitely adds to this controversy and let's say, the legitimacy crisis, of investor state arbitration," he said. Ünüvar emphasized that his opinions are his own and do not reflect the position of MPI Luxembourg and OUB Legal.

But it's not just green groups that are criticizing investor state arbitration, particularly claims brought under the increasingly controversial Energy Charter Treaty. Many EU member states have also increasingly gone sour on the mechanism.

Italy formally withdrew from the ECT in January 2016, but under a sunset clause in the treaty, it can still face claims from investors for an additional 20 years after its withdrawal. The country was also one of numerous EU member states that agreed to terminate their intra-EU bilateral investment treaties following a decision from Europe's highest court holding that arbitration clauses in investment treaties between member states are precluded under EU law.

That precedent — contained in several decisions since 2018 — has made clear that investors from within the bloc cannot pursue investor-state arbitration against member states, although international tribunals are not bound by this case law and have largely rejected it.

The United Nations Conference on Trade and Development issued two publications earlier this month analyzing the interaction between international investment agreements and climate action, concluding that "the risk that [investor state dispute settlement] be used to challenge climate policies is a major concern."

And the ECT member states announced earlier this year that they had reached an agreement to modernize the ECT that would immediately bar European investors from filing investor-state claims against EU member states. The draft agreement would also phase out protection for existing fossil fuel investments after 10 years and for new investment in fossil fuels made after Aug. 15, 2023. This provision would apply in the EU and the United Kingdom, but not in the other contracting states as of now.

Still, experts in international arbitration say that this particular decision isn't an example of investment treaty arbitration gone wrong. Covington & Burling LLP partner Miguel López Forastier said he was able to review an in-depth analysis of the award, and based on that information, any criticism from environmental groups is not well-founded.

"The tribunal made clear that the drilling ban was a sovereign decision that Italy was free to adopt. However, Italy was required to compensate claimants for their deprivation of their right to be granted a concession under Italian law caused by that sovereign decision," he told Law360. "There is nothing controversial about this, particularly when Italy had already conducted and approved an environmental impact assessment for the project. The tribunal simply upheld the rule of law."

Experts also say that blanket criticism that the ECT protects less eco-friendly investments is only half the story. In fact, dozens of claims have been brought by renewable energy investors against countries like Spain, Italy and the Czech Republic over a change in the regulatory framework that reduced their subsidies.

"The ECT is agnostic regarding different forms of energy, and on the basis that they ultimately produce electricity, the ECT protects most forms of renewable energy," said Graham Coop, a partner at Volterra Fietta who served for seven years as general counsel to the Energy Charter Secretariat, a Brussels-based international organization responsible for the ECT.

Moreover, "neither the ECT nor any other investment treaty offers a blank check for investors," Coop added. "In order to succeed in their claim, an investor must show that the respondent — the state, or the government — has violated one of the international legal norms which is set out in the treaty. It isn't sufficient for the claimant to show just that the respondent has taken some action which may reduce its profits."

Others argue, too, that the investment protection treaty regime is essential to encourage companies to invest in projects where they're needed throughout the world.

Marcus Williams is the global head for energy and extractive industries at the Multilateral Investment Guarantee Agency, the political risk insurance and credit enhancement arm of the World Bank Group. During a recent seminar on investment protection treaties and the clean energy transition put on by Volterra Fietta, he said such treaties are "terribly important."

"It's clear that this is a framework that particularly, I think, sophisticated investors are looking at and relying upon," he said. "Like so many agreements, they need to be tended to and maintained and updated ... but I think they are really an important backbone to commercial decisions that people are taking."

Nevertheless, despite efforts in recent years to tighten up the wording in investment treaties to make clear that countries are free to make policy aimed protecting the environment or public health without worrying about claims from investors, it has become evident that problems remain.

For one, those provisions are often worded in such a way that tribunals can interpret them broadly. That happened last year in a case brought by Canadian precious metals company Eco Oro Minerals Corp. after Colombia blocked its mining project in an effort to protect surrounding wetlands.

The tribunal found Colombia liable for damages despite an exception for environmental measures in the underlying treaty.

Such broad interpretations could be what prompted the European Commission to clarify certain provisions in the Comprehensive Economic and Trade Agreement, or CETA. The idea is to provide "a more precise definition of the concepts of 'indirect expropriation' and 'fair and equitable treatment' of investors," the commission said in an August statement. Those provisions are often relied upon by investors to assert claims against states.

But such clarifications may not work as intended. On his International Economic Law and Policy Blog, Simon Lester wrote about how a leaked draft text of those clarifications in CETA raises new questions. Lester is the former legal affairs officer at the Appellate Body Secretariat of the World Trade Organization.

"Back in 2014, I did a post about a leaked CETA text in which I said: 'With each attempt to clarify the "minimum standard of treatment" in investment obligations, the scope becomes less clear to me.' I have the same feeling this time," he wrote.

And the Eco Oro case provides an example of how these clarifications may not solve the problem of treaty provisions being interpreted too broadly, said Ünüvar. Although the clarification of the indirect expropriation provision in that treaty did head off certain claims in that case, the arbitrators still found Colombia liable.

"Long story short, it really depends on how you clarify it," he said.

Moreover, these cases all show that the parties' choice of arbitrators is often a determining factor in how such cases are decided. In most cases, parties to an arbitration won't be able to challenge the tribunal's interpretation of a treaty since annulment proceedings are extremely limited.

"If Rockhopper has gone the other way, I wouldn't have stopped worrying about the implications of investor-state dispute settlement for climate, because you just don't know," said Kyla Tienhaara, an assistant professor at Queen's University in Ontario, Canada, where she is also the Canada research chair in economy and environment.

"That uncertainty is what can really contribute to regulatory chill," she continued. "Because if a government puts in a policy and an investor says we're going to sue you, and they don't know whether their policy is going to be defendable, then maybe they'll just back down if they don't feel like they can afford to pay an award."

--Editing by Jill Coffey and Emily Kokoll.