Updated OECD Policy Framework for Investment Supports Green Investment Arbitration

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In June 2015, the OECD shared an updated Policy Framework for Investment ("PFI") with the international community. The OECD aims to continue contributing to the international investment landscape by guiding investors and governments, while supporting dialogue between these parties and promoting sustainable development. The PFI's main objective is to establish cooperation and balance between the expectations and requests of investors, compared to government investment policies.

The update PFI addresses 12 aspects of international investment:

- Investment policy,
- Investment promotion and facilitation,
- Competition,
- Trade,
- Taxation,
- Corporate governance,
- Finance,
- Infrastructure,
- Developing human resources,
- Responsible business conduct,
- Public governance,
- Support of green growth.

The updated PFI introduces major reforms with regard to environment aspects. Within the investor-state arbitration system, the arbitral tribunal can potentially rule that public measures imposed by governments through environmental policies and regulations are actually contrary to the country's international investment obligations and liabilities.

Accordingly, the updated PFI regime will play a significant role in setting governments' environmental policies and ensuring compliance with international investment law. Governments can use the new PFI to determine whether current or prospective environmental policies or applications respect essential investment law principles. Thus, environmental policies and international investment treaties can be better designed from the outset, assisting the parties to avoid becoming involved in later disputes.

To predict the new PFI's effect on green growth and environmental-related disputes, it is important to first consider the current status of environment-related clauses under international investment treaties and jurisprudence.

Current Status of International Investment Treaties and Jurisprudence

Public awareness has increased in recent years about the importance of sustainable development. Accordingly, governments' environmental actions have rapidly increased. Environmental policies and relevant regulations have undergone fundamental changes since the 2000's. However, environmental actions by governments can lead to sudden and unexpected adverse impacts on expensive and well-planned investments. The number of environment-related disputes has risen and taken on a new significance. International investment undertakings and customs require governments to promote and facilitate international investment. However, running contrary to this are governments' obligation to protect public and environmental health. These competing obligations inevitably lead to conflicts between governments and investors.

International investment treaty jurisprudence shows that arbitral tribunals tend to consider environment-related disputes based on facts, rather than strict legal provisions. During arbitral proceedings, governments generally refer to police powers when discussing the importance of environmental measures in public health. The state party will generally claim that its regulation and measures imposed are non-discriminatory, non-arbitrary and in line with reasonableness and proportionality.

Most investment treaties only include a general clause about protection of the environment, rather than specific environment-related provisions or exceptions. Therefore, most treaties do not specifically refer to the environment and do not adopt a systematic approach to environmental issues.

Having said that, environmental protection and public health and safety are not the primary objectives of international investment treaties. Therefore, investment treaties simply state that governments can regulate environmental matters, as well as promote or impose environmental protection measures, when necessary and to the extent required. The effect of these widely-drafted clauses is that governments have a considerable margin of interpretation. Therefore, arbitrators may decide that government measures or actions are arbitrary or discriminatory. To date, arbitral tribunals have generally adopted approaches and interpretations of environment-related clauses which weigh in favor of investors.

It is normal for governments to seek to protect public and environmental health by suspending or removing certain investor rights and privileges, or by forcing investors to comply with new provisions. However, due to the lack of well-designed environment-related provisions in international investment treaties, governments generally bear the burden of proof. During disputes, the state party must submit relevant scientific evidence, as well as demonstrate compliance with international principles and requirements.

International investment treaties are drafted as one sided undertakings; most do not regulate investor obligations and liabilities. Therefore, since investors are not parties to the investment treaties, arbitral tribunals generally tend to prevent governments filing counterclaims against investors.

Arbitrators' assessments and evaluations were mainly based on material facts, rather than legal instruments. The limits of government police powers and underlying motives should be clear, predictable and understandable for parties to international investment treaties, as well as to arbitral tribunals. Therefore, international investment treaties should include specific clauses and clear environmental policy goals. Accordingly, a new policy or a guide was necessary, to determine appropriate standards for current and future government environmental activities, as well as allow environment-related arbitral proceedings to be based

on clear legal provisions, as well as material facts.

The Updated PFI

To support investment for green growth, the OECD determined key issues for policy makers when planning, negotiating and executing international investment treaties:

- Ensure strong government commitment to support the green growth and catalyze private green investment, at national as well as international levels;
- Improve the coherence of investment promotion and facilitation measures to support green growth as a means to sustainable development, including aligning the broad system of investment incentives and disincentives, as well as phasing out inefficient fossil-fuel subsidies;
- Reform policies to enable green investment, including applying essential investment policy principles such as non-discrimination, transparency and property protection in areas which tend to attract green investment. For example, renewable energy, water resource management, or multi-modal, climate-resilient transport infrastructure systems;
- Address market and regulatory rigidities that favor incumbent fossil-fuel and resource intensive technologies and practices, for instance in the transport, electricity or water sectors
- Provide public financial tools, instruments and funds to facilitate access to financing and attract co-financing for green projects (including attracting long-term institutional investment), while ensuring value for public money;
- Enhance co-ordination and improve public governance across and within levels of government, especially among environment and natural resource management, energy and investment authorities;
- Establish policies to encourage environmentally responsible business conduct and broad stakeholder participation in green growth, including green investment strategies; and

Address other cross-cutting issues, such as:

- Establishing policies to support effective private sector participation (international or domestic) in green infrastructure projects, including through joint ventures or public-private partnerships;
- Addressing outstanding barriers to international trade and investment in environmental goods, services and projects.

Arbitral proceedings initiated against governments regarding environmental issues have increased and seem likely to continue increasing. The updated PFI recommends governments ask themselves either:

"*Is the government addressing green protectionist measures (such as local content requirements) that are increasingly being challenged in investor-state dispute settlement (ISDS) and international treaty claims? At the same time, is the government monitoring whether investment treaties are interfering with environmental policies?*"

Or alternatively:

"*Does the government respect core investment principles such as investor protection, intellectual property rights protection and non-discrimination in areas susceptible to attract green investment?*"

Conclusion

To maintain sustainable development, governments should revise their existing investment treaties and environment-related policies to bring these in line with the OECD's updated PFI. However, regulations issued or amended in response to the updated PFI could give rise to disputes if the changes have retrospective effects over investments.

For now, it seems difficult for governments to recognize and prioritize environmental protection above promotion of international investment and foreign direct investment. However, governments must adopt sustainable efforts to regulate precise exception clauses for environmentally sensitive sectors. Such clauses will allow investors to predict possible government measures or actions, then invest accordingly. Increased certainty will allow investors to avoid and resolve disputes more easily, without taking recourse to courts or arbitral tribunals. Well considered and clearly drafted exception clauses ensure more protection for governments, compared to general clauses related to public health and safety. Such an approach enables governments to clearly identify environmental areas which are exempt from investment claims.

Current treaties are drafted exclusively from the point of view of governments, with governments unilaterally undertaking to promote and respect foreign investment. Therefore, while it is investors which seek relief in nearly 100% of environmental-related disputes before arbitral tribunals, governments generally do not bring counterclaims against investors. If treaties contained explicit consent from investors in relation to governments' rights to file counterclaims, the arbitral tribunal would not need to consider whether it is qualified to hear such a claim and the state party may be more eager to file counterclaims.

Within this context, the updated PFI recommends that investors engage in responsible business conduct. Investment treaties can be modified to include a right for governments to file counterclaims before an arbitral tribunal if investors fail to fulfill obligations and responsibilities related to environmental and public health and safety matters.

Governments can include clauses in investment treaties stating that environment-related disputes arising from investor or government actions will be subject to the Optional Rules for Arbitration of Disputes Relating to the Environment and/or Natural Resources.

The Optional Rules were prepared by the Permanent Court of Arbitration and are based on the United Nations Commission on International Trade Law Arbitration Rules. Since environment-related disputes require scientific and technical analysis, the Optional Rules assist the parties and arbitrator to review and evaluate scientific matters.

Governments should regularly and carefully monitor their international investment treaties in light of their own environmental policies. International investment treaties should be clearly drafted, specifically considering environmental matters and be a reflection of national environmental policies. Such an approach allows arbitral tribunals to effectively address, analyze, review and conclude environment-related disputes, as well as ensure scientific evidence is assessed against consistent minimum standards.

Related Practices

- Commercial Arbitration and Mediation
- Foreign Investment and Business Set-up
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