

## **EXPLANATORY NOTE TO THE MODEL TREATY ON PROMOTION AND PROTECTION OF GREEN INVESTMENT**

1. This commentary relates to the draft Model Treaty on Promotion and Protection of Green Investment. The commentary should be read in conjunction with the text of the draft Treaty.
2. The Treaty pursues climate change mitigation and adaptation objectives and provides clear, understandable and foreseeable regulatory platform for promotion and protection of green investments, while at the same time recognizes the right of the states to regulate its own market.
3. The Treaty as presently drafted contemplates a bilateral relationship between two States or Regional Economic Integration Associations. The Treaty could nonetheless be revised for use between more than two Contracting Parties.
4. In adherence to the UN Sustainable Development Goals, more specifically Climate Change Mitigation and Adaptation, the Treaty is specifically dedicated to promote and protect green investment.
5. The Treaty has a high potential to encourage foreign investment in climate change mitigation and adaptation for the following reasons:

### ***a) States' action in promotion of green investment***

Article 2 of the Treaty provides for obligations of States towards climate change mitigation and adaptation. Those obligations include the obligation on reciprocal cooperation and the introduction of specific policies and incentives in the national legislations in order to promote green investment.

The policies and incentives provided in this Article reflect the best practices of states in the field of promotion of renewable energy & efficiency as supported by MENA-OECD Task Force on Energy and Infrastructure, and indicated in global surveys such as Global Renewable Energy Guide, KMPG International "Taxes and Incentives for Renewable Energy".

The list of provided policies and incentives is also based on the practice of Spain and Czech, which policies, if used reasonably, have the potential to attract a significant number of investors.

### ***b) Extended territorial and temporal scope***

The term Area in the Treaty means not only the territory under sovereignty, but also under jurisdiction of the Contracting State, which may cover the territories leased under international law and occupied territories. The Area as well includes the different maritime zones of the Host State, which may be important for investors carrying out the projects for generation of renewable energy in the seas.

The Treaty includes a so called "survival" clause, which effectively preserves a treaty standards and protection for a number of years after the Treaty is terminated. It provides a long-term legal security to investors engaged in long-term investment projects involving substantial commitment of capital (e.g. construction of energy production facilities). In order to pursue balanced approach and not to limit the States' ability to regulate excessively, the "survival" period is not too long (five years), in comparison to ECT which provides for 20 years of "survival" period.

### ***c) Promotion and protection during all phases of Investors' activities***

The Treaty provides non-discriminatory treatment to investors both during the pre-establishments and establishment phase of investment activities. Not all of the investment treaties,

including ECT, provide for the guarantees of free non-discriminatory entry of investments on the same conditions as nationals of the host state.

**d) *Balance of the rights and obligations of Investors and Host States***

The balance of the rights and obligations of Investors and Host States is reflected:

- in the *Preamble* of the Treaty by recognising both the states' right to regulate and the objective of promotion and protection of investment. So the Preamble is not binding upon states, its text may ensure that tribunal will apply balanced approach while interpreting the Treaty.
- in Article 6 (*Fair and equitable treatment*) by determining limited scope of obligations of states and ensuring protection of legitimate expectations of investors. The fair and equitable treatment clauses (FET clause) are the most often basis for claims brought by investors to international arbitration and the most successful basis for awards in favor of an investor. That resulted in the lack of willingness of states to provide an absolute unlimited protection under FET clause. Therefore, the Treaty provides for an exhaustive list of obligations of states, and still protects the legitimate expectations of investors.
- in Article 7 (*Employment of staff*). On the one hand, providing the right to employ foreign specialists without regard to nationality may help to attract investment in such highly technological sphere as climate change mitigation and adaptation. At the same time, the immigration procedures of the Host State remain in force, with only one exception (priority of the Host State's nationals).
- in Article 10 (*Expropriation and Compensation*) and Article 11 (*The rights to regulate*). The Treaty covers both direct and indirect expropriation and provides a clear definition of measures that may be recognised as expropriation, which provides full and clear protection of investment. At the same time the Treaty recognises the range of regulatory measures, that does not amount to expropriation. It shall also be noticed, that the definition of expropriation does not contain indication of the loss of economic value of investment, as it is not recognised as expropriation by investment tribunal in recent cases involving renewable energy.
- in Article 13 (*Obligations and responsibilities of Investors*). Inclusion of such obligations and responsibilities of investors in the Treaty may further improve the compliance with their obligations. Without this provision the only way to enforce national law and regulations of the Host State was through the national court, while according to the Treaty the conduct of investors may be taken into account while evaluating the standard of protection provided by the Treaty. It shall be noted, that the Treaty reflects soft approach, as it does not permit states to deny the protection of the investment because of investors' misconduct.

**e) *Clear and foreseeable regulatory framework***

According to Article 6 (3) of the Treaty the Contracting States retain the right to introduce changes to its legislation and regulatory framework for investments, provided that those changes are non-discriminatory and foreseeable.

In the recent case *Charanne vs. Spain* (ICSID) the tribunal observed that foreseeability of the change is the decisive factor in deciding whether the legitimate expectations are foreseeable. Therefore, Article 6 (*Fair and equitable treatment*) together with Article 8 (*Transparency*) ensures the adherence of the State to its commitment towards investment, foreseeable change of the regulatory framework and knowledge of the investors concerning the changing circumstances.

**f) *Clear limits to investments***

The notion of investment in the Treaty is three-fold. Firstly, this is a general description of investments as every kind of assets, Secondly, there is an illustrative list of investment's. Thirdly, there are clear exceptions that are excluded from the definition. The exceptions are stipulated based on the most controversial disputes that have arisen in international investment arbitration under ICSID Convention, UNCITRAL Arbitration Rules and the ECT.

As follows from *travaux préparatoires*, the drafters of the ICSID Convention intended to exclude from ICSID jurisdiction such disputes that follow from mere commercial transactions, such as sale and purchase. This has been further confirmed in *Fedax vs. Venezuela* and *Salini v Morocco* cases as well as in the practice of ad hoc tribunals under UNCITRAL Arbitration Rules in *Romak vs. Uzbekistan* and *Alps Finance vs. Slovak Republic* cases. Given this common practice we therefore excluded *ad hoc* and short-term commercial contract for the sale of goods or services from the definition of investment. In *Romak vs. Uzbekistan* there also been extensive argumentation of the tribunal as to why arbitral award do not fall within the meaning of investment, in particular, as claims to money.

Therefore, the notion excludes judgements and awards as well.

**g) *Extended range of Investors***

The Treaty recognises as investors the companies or other organisations owned or controlled by the Contracting Party unless they are acting as agents for that Contracting Party or discharging an essentially governmental function. This provision is important as the State-Owned Energy Companies frequently act as investors in the sphere of renewable energy.

In the ICSID cases *CSOB vs. Slovakia* and *Rumeli Telekom v Kazakhstan* it was disputed by the parties, whether the state-owned company may be an investor. For the avoidance of any doubt, the standard suggested by Mr. Aron Broches (“Broches Test”) is reflected in the Treaty. The Preamble of the Treaty mentions the objective of “stimulation of business activities”, which helps to exclude organizations carrying out governmental, but not commercial functions from the regime of protection.

**h) *Discretionary approach***

The Contracting Parties are entitled to choose:

- which policies and incentives for promotion of green investments shall be introduced to the national legislation (Art. 2);
- in which situations the Host State is not obliged to accord to the foreign investors the standard not less favourable that to the investor of the Host State (Art. 3).

**i) *Saving time and costs by promoting ADR***

ISDR clause in the Treaty stipulates a mandatory amicable settlement of the dispute prior its submission to arbitration. In comparison to ECT and other BITs, the Treaty promotes the use of conciliation and mediation to resolve the dispute, not applying a classic negotiations requirement. This will reduce the number of arbitration disputes as well as save time and costs for the parties they otherwise should have paid in arbitration.

**j) *Simplified access and increased transparency in ISDR***

The Treaty expanded the scope of investor-state dispute settlement mechanism allowing Investors to arbitrate not only disputes that relate to an Investment, but all disputes when an Investor alleges any breach under the Treaty. Furthermore, the Treaty does not establish a cooling-off period (with the purpose to allow the parties to settle the dispute amicably through conciliation

or mediation) and does not require an Investor to exhaust local remedies to submit the dispute to arbitration. An Investor may choose from the range of dispute resolution forums and both Contracting Parties consent to all of them by virtue of signing the Treaty.

The provision of investor-state dispute settlement allow amici curiae to submit a written statement and/or audio-visual or photographic material. However, the provision is balanced by the admission of only such submissions that are relevant to the dispute at hand and not treating these submissions as a part of the case file. This provide the tribunal with the discretion not to consider and evaluate every single submission. Express permission for the participation of amici curiae in the proceedings increase the transparency in investor-state dispute settlement.

***k) Direct enforceability of arbitral awards***

The Treaty ensures that Investors and Contracting States will be able to have their award enforced as if they were final judgment of a national court. This possibility is a safeguard for Investors, as they will not run a risk that their award will not be enforced due to, for example, unclear public policy reasons. At the same time, to ensure the award will be rendered without violations that are usually taken as a basis for setting the awards aside under article 5 of New York Convention, we inserted a rather stringent provision in Article 19 about arbitrators qualification. A party may only appoint an arbitrator, who has experience in the settlement of disputes in energy sector as well as practice in the sphere of international arbitration at least for 7 years prior the appointment.

The possibility of direct enforceability is advantageous in comparison to the enforcement mechanism under the ECT and BITs, which require acknowledgement and enforcement under the New York Convention.

There are concerns as to whether states would agree to the effect of awards under the Treaty. The agreement of the states to this very mechanism under Article 54 of ICSID Convention may be explained by the narrow scope of ICSID jurisdiction *ratione materiae* and *ratione personae*. The scope of the present Treaty is even more limited with respect to the notion of investment and the definition of investor.

Therefore, there is no reasons for the States to reject this provision.