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SPURRING GLOBAL PRIVATE INVESTMENT IN RENEWABLES

THE ROLE OF TREATY-BASED INVESTOR-STATE DISPUTE SETTLEMENT

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Cross-border investors in renewables do not consider investment treaties with so-called investor-state dispute settlement (ISDS) a relevant factor when making investment decisions. This key finding from a recent survey among private investors adds to a wider body of evidence that questions the effectiveness of ISDS mechanisms. The findings suggest that other approaches to shifting capital into clean energy must be prioritised.

The world is seeking to scale investment in clean energy and renewables for greater energy and climate security. Especially now that higher interest rates and greater economic uncertainty are pushing up investment costs, the regulatory and diplomatic tools employed need to be as effective as possible.

Investment treaties with ISDS are deployed to allegedly spur cross-border investment by addressing "political risks". They enable foreign investors to challenge a government if a change in regulatory conditions affects their revenues. Discussions over reforming, discontinuing or even extending these types of treaties are currently under way.[1]

This briefing highlights headline findings from a recent survey of private investors, including renewable energy project developers and sponsors of those projects, as well as specialised consultants. The survey was designed to

[1] For example, in the context of the Energy Charter Treaty or within new trade agreements.

understand the relative role ISDS mechanisms play in spurring foreign investments in clean energy.[2] The implications for policy makers are that:

1. More effort is needed to understand the key drivers for clean energy investments.
2. Diplomatic efforts should move from marginally improving existing investment agreements to building the right domestic conditions to spur investments.
3. Expansion of ISDS treaties should be halted.

The results

Foreign investments in renewable energy are driven by domestic factors
Clear long-term policy signals and strong institutions are the elements that really provide a "pull" factor for renewable investments. Regulatory stability in the energy sector, domestic provisions for investor rights, non-discriminatory administration of laws, and transparent rulemaking within countries are the top tier factors (Box 1).[3] This suggests that the conditions created domestically are the most critical determinants for investments in renewable energies.

Legal factors shaping investment decisions in renewable energy

Top tier

> Regulatory/legal stability in energy sectors.

> Domestic laws protecting and enforcing investment/investor rights, security, and property.

> Fair and non-discriminatory administration of laws and regulations.

> Transparent legal and administrative rule-making processes.

[2] The survey, supported by E3G, was designed and administered by the **Columbia Center on Sustainable Investment** (CCSI) in June and July 2022. The survey assessed the role and relevance of a range of financial, regulatory and political factors in investment decision making. CCSI will publish the results of the survey in October 2022.

[3] Based on the survey results, the factors were grouped into three tiers; within each tier the importance is relatively similar while there is a marked difference between groups.

Medium tier

> Adherence of host state to multilateral treaties governing human rights, workers' protections, controlling corruption, etc.

> Adherence of local business partner(s) to international corporate codes of conduct.

> Effective and efficient domestic grievance mechanisms.

> Access to reliable and impartial domestic legal assistance.

> Domestic tax laws and regulations.

> Independence and impartiality of domestic judiciary.

Bottom tier

> Recognition of intellectual property rights.

> Tax treaty between investors' host and home state.

> International investment treaty between investors' host and home state.

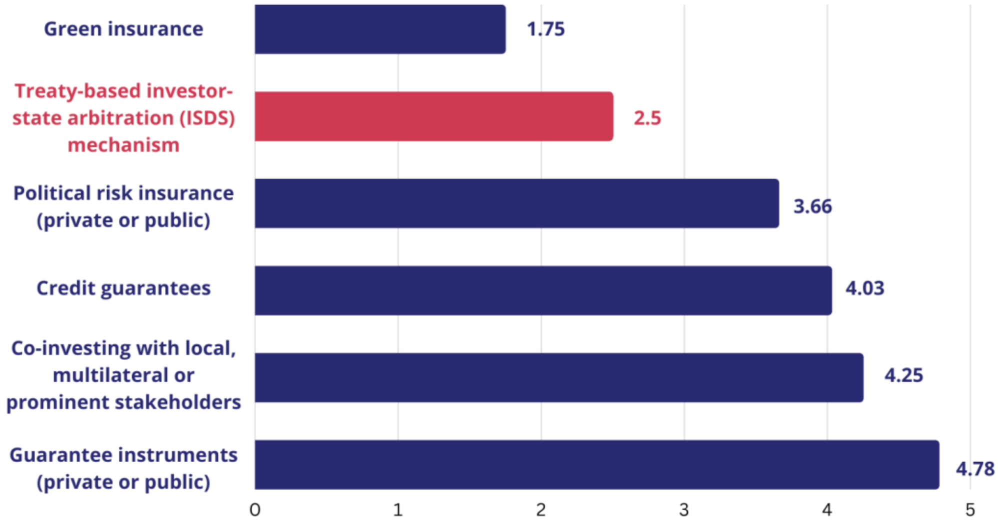
> Access to investor-state arbitration (ISDS).

No significant role for ISDS mechanisms can be detected

The importance of access to investor-state arbitration is within the bottom tier of factors for foreign renewables investment. Only 3 out of 32 respondents said the absence of an investment treaty would deter them from investing in a new foreign market. Through the survey and follow-up interviews, it was clarified that commercial arbitration – that is, arbitration based on a commercial contract between two private parties – seemed more relevant and useful than treaty-based ISDS to foreign investors in case of disputes with their host states.

Once a decision has been made to invest, **ISDS mechanisms seem to play a complementary rather than a primary role in risk management strategies of investors.** When asked about the relative importance of six risk management tools, treaty-based ISDS was ranked second to last, with respondents on average ranking its importance at 2.5 out of 6 (Figure 1). Other risk mitigation tools, including guarantee instruments and investing alongside other "prominent" or public investors, came out on top.

Figure 1: How foreign investors rank the importance of risk mitigation tools in their investment decisions. (1 lowest, 5 highest). Treaty-based ISDS ranks only second to last.



There are other ways to minimise the risks of investing into renewables

As the data above illustrates, guarantees have proven to be an important risk sharing instrument between the public and private sector, as they can address a multitude of risks. Credit guarantees such as by the International Finance Corporation (IFC) or export credit agencies (ECAs) play a critical role. They can also be issued by multilateral development banks (MDBs) and other development finance institutions (DFIs). Yet, so far only one export credit agency globally has fully turned from fossil to clean (the UK), while France, Sweden and Denmark announced plans to achieve this.[4]

Also, more tailor-made solutions have been tried and tested. In markets with higher political uncertainty, a tailored approach to de-risking that pulls in the IFC and development banks alongside a portfolio (rather than project-based) deployment strategy can achieve a lot. An example of this is the RenovAr programme in Argentina.[5] However, the program suffered from Argentina's balance of payments problems, implying currency risks must also be addressed.

[4] Cécile Camilli, January 2022, **Export Credit's Urgent Role as a Catalyst For Decarbonisation And Social Good**.

[5] Greenmap – **RenovAr**.

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The implications

These results contribute to a wider body of evidence that strongly questions the role of ISDS mechanisms in spurring foreign investment. The main role they have been playing is in providing excessive stabilisation to past investments, the large extent of which are fossil fuel investments. Instead, other elements are much more critical to incentivise investments into the clean transition. For policy makers concerned with shifting capital into clean energy this means:

1. **More effort is needed to understand the key drivers for clean energy investments**. This study just gives a small flavour focused on renewable energy. Factors will be very context specific and may also vary depending on investment size or type.

2. **Diplomatic efforts should move from marginally improving investment agreements to building the right domestic conditions to spur investments.** Investment agreements with ISDS are not key to foreign investment in renewables. They possibly provide a drag on allocating capital from fossil to clean by protecting the latter's expected revenues and limiting states' capacity to regulate fossil fuels.[6]

3. **Expansion of ISDS treaties should be halted.** Instead, based on this study, policy makers should focus on:

    a. **Supporting strong regulatory frameworks that increase investment certainty.** Some diplomatic initiatives already exist that support countries with this, such as the global offshore wind alliance.[7]

    b. **Developing de-risking instruments for foreign renewable investments.** Roll out initiatives such as RenovAr, support mechanisms for currency de-risking, and ensure that export credit agencies and the IFC scale their support to issue clean guarantees.

    c. **Maximising the public investment in clean energy** – for example via MDBs. To date, only 49% of total investment by MDBs, DFIs and ECAs is into clean energy.[8] Clearer commitments by public institutions to finance the energy transition – in the form of targets and a focus on less high-cost markets[9] – will incentivise private investors to move in alongside.

[6] E3G, September 2022, **New Energy Charter Treaty will keep hindering climate action.**

[7] Global Wind Energy Council, September 2022, **New global alliance taps into offshore wind's enormous potential**.

[8] Oil Change International, April 2022, **Using international public finance to unlock a just transition: key trends and opportunities**.

[9] International Energy Agency, September 2022, **Capital cost observatory**. The IEA gives an indication of where this focus may be most critical.

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Annex: Summary of the methodology

Survey date: June–July 2022

Respondents

Number of responses: 32

Respondent characteristics:

> All were senior officers or executives.

> Comprise various categories of investors in the renewable energy space, including: renewable energy companies or their asset holders; sponsors (for example, capital development fund, public or private banks); and consultancy firms that provide strategic investment advice to renewable energy companies or financiers.

> All were employed by companies that made an investment in a foreign market in the past 10 years.

> Half were employed by companies that have more than 250 employees.

Questions

4. What are the top barriers that deter renewable energy investors from investing in a new foreign market?
5. Which specific legal or regulatory elements are most critical to renewable energy respondents considering investing in foreign markets?
6. How are international investment treaties evaluated as part of the legal/regulatory factors that renewable energy respondents consider when choosing a foreign market for their investment?
7. How important is treaty-based investor–state arbitration (ISDS), compared to other mitigation tools, when renewable energy respondents are choosing to invest in new foreign markets?
8. What are the views of high-level decision-makers in renewable energy investments of the existence, relevance, and importance of the international investment treaty system?

In addition, 10 of the respondents were interviewed subsequently to follow-up on certain issues and obtain clarification on others.

Limitations

> The survey is not based on a statistically significant sample. It therefore offers only descriptive and qualitative insights.

> It does not include attention checks to ensure respondents have fully understood the questions. Subsequent interviews indicate that attention may have been an issue for some participants taking the survey.

> No definitions were provided to keep the survey as short as possible, and to avoid bias. This means that the same terms may have been interpreted differently or inconsistently by the respondents.

> The methodology for question 2 above asked respondents to score each factor independently on a scale from 1 (not at all important) to 5 (critical). Thus, the relative importance of these factors is determined by the average score across respondents.

About E3G

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