Solar Salt Projects in Africa
Environmental Legal Issues

Introduction

This part of the webinar will concentrate on some of the environmental and legal issues that can arise in arbitration disputes, with specific reference to issues that can arise in developing markets.

Environment-related disputes by their nature involve a tension (and at times a direct conflict) between competing obligations of the State, on one hand, to promote foreign investment and, on the other hand, to protect its population and territory from environmental harm while responsibly managing its natural resources.

Environment-related provisions found in investment agreements tend to fall broadly within three categories:

1) To recognise environmental protection as a treaty objective – you might find this for example in a treaty preamble;
2) To preserve the right of States to regulate environmental matters – this is most common, reflected in the Pan-African Investment Code ("PAIC");
3) To ensure the continuing duty of States to enforce and promote environmental protection matters – for example, by not relaxing environmental standards for the purposes of encouraging trade, expressly recognised in the ECOWAS[1] Community Rules.

Currently, there appears to be significant investor demand to direct more capital toward climate transition investments in developing markets. For Africa, this can be a positive but it also creates a tension. Africa contributes just 3% of the global emissions but it is disproportionately affected by climate change, for example by floods or droughts. Whilst institutions may not immediately want to finance projects that create emissions, it may be necessary to do so. By way of example, Africa's electricity grids are weak and the need for an increase in electricity generation will almost certainly lead to a need to increase emissions by creating electricity from non-renewable sources. Put simply, renewables are unlikely in the short term to be a complete answer to Africa's need to generate power.

With that broad thought in mind, I thought I would concentrate on just a few environmental and legal topics that are relevant to and would apply to large infrastructure projects in developing nations, including Africa:

- Compliance with domestic environmental law;
- The 'S' in ESG; and
- The international move towards sustainable development and emission reduction.

[1] Economic Community of West African States

Compliance with domestic environmental law

An investor is likely to be obliged to comply with domestic laws of the host State governing environmental protection. This may be explicit in an investment contract or the applicable Bilateral Investment Treaty ("BIT") may require than an investment be made and maintained in accordance with host State law.

Many arbitral tribunals have recognised that jurisdiction may be denied for a failure to comply with domestic rules where a BIT has required the investment to be made in accordance with the host state's laws as a precondition to the investor being able to avail itself of the dispute settlement mechanism.

Metal-Tech Ltd v Uzbekistan

The tribunal came to the conclusion that corruption was established to an extent sufficient to violate the law of Uzbekistan in connection with the establishment of the Claimant's investment in Uzbekistan. As a consequence, the investment has not been "implemented in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made" as required by the treaty. Uzbekistan's consent to ICSID arbitration, as expressed in the treaty, was restricted to disputes "concerning an investment." Article 1(1) of the BIT defined investments to mean only investments implemented in compliance with local law. Accordingly, the present dispute did not come within the reach of the treaty and was not covered by Uzbekistan's consent. Accordingly, failing consent by the host state under the BIT and the ICSID Convention, the tribunal lacked jurisdiction over this dispute.

The same result arose in October 2018 in *Cortec Mining v Kenya*, where investors had failed to comply with the provisions of Kenya law requiring an environmental impact licence to be issued before the valid grant of any mining licence. However, critically in this case, the BIT in question did not include express wording requiring investments to be made in accordance with host state law. Nonetheless, the tribunal found that this could be implied into the interpretation of the BIT and the ICSID Convention.

The 2012 SADC Model BIT grants the arbitral tribunal the power to rule on whether the investor's breach of the treaty provisions protecting the environment and human rights should have a bearing on the merits of the dispute. More recently, article 37 of the PAIC requires member states to ensure that their laws and regulations protect the environment, but also places the onus on investors to protect the environment.

Alternatively, even where jurisdiction is established, parties that infringe on environmental standards risk counterclaims for environmental damage.

Burlington v Ecuador

The principal claim concerned an allegation that Ecuador had unlawfully expropriated Burlington's investment associated with oil exploration and exploitation.

The case is interesting from an environmental perspective because Ecuador launched a counterclaim for USD 2.5bn for soil clean-up costs, USD 265m for groundwater remediation costs, a further USD 3.3m for groundwater studies, USD 3.5m for the costs of abandonment of wells and damages of USD 17.4m with interest for the failure to return infrastructure in good condition to Ecuador. This was resisted, partly on the ground that this was argued to be a tactical retaliation fabricated after Burlington lodged its ICSID claim, with the objective of offsetting the significant damages that are owed to Burlington by Ecuador for its unlawful seizure of the oil fields.

Whereas the decision on principal liability ran to 183 pages, this part of the arbitration runs to another 469 pages.

Broadly, the Tribunal found that the Ecuadorian Constitution established strict liability for environmental harm. Fault was not a requirement and Burlington could not raise an argument to resist liability on the ground that it had acted diligently. Under the strict liability regime, causation was presumed. This meant that Burlington could only be exempted from liability if it proved that harm was caused by a *force majeure*, a third party or by Ecuador (or a related party) after the takeover of the oil fields.

Environmental harm was defined in Ecuador's 1999 Environmental Management Law as:

> *"any significant loss, decrease, detriment or impairment to the pre-existing conditions in the environment or one of its components. It affects the functioning of the ecosystem or the renewability of its resources."*

Accordingly, environmental harm was more than a mere "negative impact".

Ecuador could not sustain an argument that full reparation or restoration mandated a return to pre-human conditions - environmental harm was to be defined by reference to regulatory criteria and an oilfield operator could not be considered to have caused environmental harm if "permissible limits" had been observed. But the Tribunal held that under Ecuadorian law, any exceedance of applicable limits triggered extra-contractual civil liability and an ensuing obligation of full restoration back to those limits.

Following a site-by-site analysis, the end result was that Burlington were found to be liable towards Ecuador for the costs of restoring the environment in the two oil fields that were the subject of the dispute in the amount of USD 39.2m and for the costs of having to remedy the infrastructure in the sum of USD 2.5m.

This was offset against the amount that Ecuador were found to be liable to Burlington – amounting to almost USD 380m net.

The flip side

Bilcon v Canada

The majority of the tribunal concluded that Canada had violated certain of its NAFTA obligations when a federal-provincial environmental assessment panel recommended that the Respondents' proposed quarry and marine terminal project in Nova Scotia should not go forward. Based upon the findings of this assessment, the federal and Nova Scotia governments subsequently refused to approve the project. This finding of liability was based on the Tribunal's conclusion that the environmental assessment was not carried out in accordance with applicable federal and provincial legislation. The majority's liability finding was also based on its determination that the assessment was carried out in a manner that did not comply with the level of procedural fairness required by Canadian administrative law.

Consequently, the failure to properly apply environmental law at the environmental assessment stage resulted in an adverse finding against the State as it breached the requirement for fair and equitable treatment of the Investors, without justification.

That finding was upheld in spite of genuine policy concerns that relate to the ability of a State to regulate environmental matters within its jurisdiction and the potential for there to be a chill in the environmental assessment process as a consequence of the award. The end result was an award of USD 7m as compensation for the breaches of NAFTA.

That might be considered an unusual decision. Ordinarily a high degree of deference to a respondent State where they have regulated on the topic of the environment. In the context of Africa, the PAIC expressly protects a state's right to regulate, in particular with regards to 'measures relating to the protection of human, animal or plant life or health. This provision could encompass any environmental and health regulations. Nonetheless, this decision and the arguments put forward in an ultimately unsuccessful claim in *Allard v Barbados*, namely that the State had not taken adequate measures to prevent environmental degradation impacting on its investment in an ecotourism facility, do highlight the importance of a State properly considering its own environmental obligations.

The 'S' in ESG

We should identify that from a finance perspective within Africa, the 'S' of ESG that is often the most important – the social impact. Obtaining the relevant planning and permits may not be the biggest hurdle in countries that have the space to accommodate big infrastructure projects and are desperate for work and income (the promised consequences of a major infrastructure project). Nevertheless, the consequences of failing to engage with local communities likely to be affected by the project can be severe.

Kinangop Windpark Ltd vs Republic of Kenya

This case involves the cancellation of a wind farm project near Nairobi following opposition from local landowners and farmers. Whilst the project had been financed with backing

including from Norway and South Africa, the local community revolted on the day of the build. *Force majeure* was claimed over the contract, the project never happened and it resulted in a loss of some USD 42m and the turbines are still at port awaiting a second-hand buyer.

A claim was made against the Government of Kenya ("GoK") on the basis of a letter of support that had been issued by the GoK in which the GoK promised to indemnify the company for losses suffered if the project was prevented because of "political events". The award is not publicly available but it is possible to discern snippets from internet reports. The claim alleged that the GoK had failed to eliminate a political event emanating from community protests. Insufficient outreach efforts were at the root of the protest. The claim failed as the relevant company failed to establish that the protests were a political event within the meaning of the letter of support. There had been little or no community engagement and issues had arisen over compensation, relocation and how the land was leased. Arguably, the lack of community engagement meant that the company could not rely on the protections from the GoK.

A counterclaim by the GoK was also rejected.

International environmental law

Might there be an argument that private companies and consequently investing parties are bound by international law rules governing the environment?

Traditionally, it can be difficult to establish legal rights capable of enforcement against non-State actors by virtue of international law.

In the context of a counterclaim based on international human rights law, the tribunal in *Urbaser v Argentina* held that the investor could, in principle, be bound by international human rights obligations concerning the right to water. It could therefore be argued that investors are also directly subject to obligations arising from international environmental treaties.

However, the difficulty with this argument is that most international environmental treaties which address the activities of non-State actors assume that State parties will establish a domestic institutional framework for their operationalization. For example, the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal obliges contracting State parties to enact legislation to establish a domestic regulatory regime. It is difficult to read the provisions of that convention as establishing legal rights capable of enforcement against non-State actors. As a result it is unlikely that such treaties are capable of imposing obligations directly on investors.

54 African countries signed the Paris Agreement. And until Wednesday, it may also have been thought that international environmental treaties such as the Paris Agreement do not appear to impose any direct obligation on private companies. However, judgment in the District Court in the Hague suggests the opposite.

Friends of the Earth Netherlands v Shell

It was alleged that Shell's contribution to climate change violated the company's duty of care under Dutch law and human rights obligations. A ruling was sought that Shell must reduce its CO_2 emissions by 45% by 2030 compared to 2010 levels and to zero by 2050, in line with the Paris Agreement. Hearings took place in December and the decision came out yesterday.

Shell argued, among other defences, that there is no legal standard, statutory or otherwise, that would establish that Shell is acting in conflict with an unwritten legal standard by failing to comply with emissions caps. Shell also argued that plaintiffs' claims were too general to fall within the scope of ECHR Articles 2 and 8.

The Court held Shell in violation of the standard of care under Dutch law and ordered the company to reduce its emissions by 45% by 2030, relative to 2019, across all activities including both its own emissions and end-use emissions. The Court ordered that Shell, both directly and through the companies and legal entities that form the Shell group, reduce emissions by a net 45% across both emissions from its own operations and emissions from the use of the oil it produces. The Court made its decision provisionally enforceable, meaning Shell will be required to meet its reduction obligations even as the case is appealed.

The Court held that "RDS' reduction obligation ensues from the unwritten standard of care laid down in Book 6 Section 162 Dutch Civil Code, which means that acting in conflict with what is generally accepted according to unwritten law is unlawful."

> ***Article 6:162 Definition of a 'tortious act'***
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> ***- 1.*** *A person who commits a tortious act (unlawful act) against another person that can be attributed to him, must repair the damage that this other person has suffered as a result thereof.*
> ***- 2.*** *As a tortious act is regarded a violation of someone else's right (entitlement) and an act or omission in violation of a duty imposed by law or of what <u>according to unwritten law has to be regarded as</u> <u>proper social conduct</u>, always as far as there was no justification for this behaviour.*
> ***- 3.*** *A tortious act can be attributed to the tortfeasor [the person committing the tortious act] if it results from his fault or from a cause for which he is accountable by virtue of law or generally accepted principles (common opinion).*
>
> *(emphasis added)*

The Court concluded that the standard of care included the need for companies to take responsibility for Scope 3 emissions (all other indirect emissions that form part of a company's value chain, including those that result from the use of sold products), especially "where these emissions form the majority of a company's CO_2 emissions, as is the case for companies that produce and sell fossil fuels."

In applying this standard of care to Shell, the Court concluded that it must reduce its Scope 1, 2, and 3 emissions, across its entire energy portfolio. The Court gave Shell flexibility in allocating emissions cuts between Scope 1, 2, and 3 emissions, so long as in aggregate, the total emissions were reduced by 45%. The Court wrote, "With respect to the business

relations of the Shell group, including the end-users, this constitutes a significant best-efforts obligation, in which context RDS may be expected to take the necessary steps to remove or prevent the serious risks ensuing from the CO2 emissions generated by them, and to use its influence to limit any lasting consequences as much as possible. A consequence of this significant obligation may be that RDS will forgo new investments in the extraction of fossil fuels and/or will limit its production of fossil resources."

The Court rejected arguments by Shell that the EU Emissions Trading System ("ETS") pre-empted further emissions cuts ordered by the Court, and arguments that the reduction obligation would have no effect. The Court rejected the ETS argument on the grounds that the ETS only applies to some of the emissions in Europe that Shell is responsible for, and the ETS does not cover emissions outside the EU. The standard of care, on the other hand, requires Shell to reduce all global emissions that will harm Dutch citizens.

Further, the Court rejected the claim that a reduction obligation would have no effect because such emissions would be substituted by other companies. The Court wrote that it remains to be seen whether other companies will substitute Shell production in the face of Paris Agreement obligations and noted the causal relationship between production limitation and emissions reduction. The Court wrote, "The court acknowledges that RDS cannot solve this global problem on its own. However, this does not absolve RDS of its individual partial responsibility to do its part regarding the emissions of the Shell group, which it can control and influence."

The decision is likely to be appealed and it might be argued that it is highly fact specific, particularly given the wording of section 162. Nonetheless, one can sense the direction of travel. Following this decision and that of *Urgenda*, another Dutch case that concerned the duty of care owed by a State to its citizens in light of the danger posed by rising emissions, there is a rising tide requiring States and private companies to reduce global carbon emissions.

Concluding remarks

Decisions such as that in *Shell* will fuel investors desire to invest in climate transition investments in developing markets and pour cold water on investing in projects that will contribute to the production of carbon emissions. For the solar salt project, that may be good news. But as already identified, it isn't necessarily all good news for African prosperity and development. Developing markets need to balance investment and environmental benefit. Committing to net zero risks depriving developing markets the opportunity to develop.

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