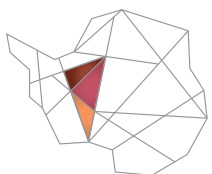




LAKE WHILLANS  
**ARBITRATION/  
RENEWABLE ENERGY  
WHITE PAPER**



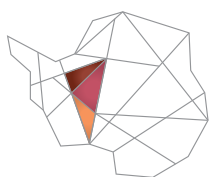
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**ABOVE  
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# INTRO TO RENEWABLE ENERGY AND CLEANTECH

The energy sector has undergone a major transformation in recent years, thanks to the rise of renewable energy sources that are rivaling the dominance of the major players of past decades, like coal, oil, and natural gas. The boom in renewables has sparked a new era of clean energy, coupled with innovation that aims to significantly reduce the costs and increase the efficiency of energy delivery.

The renewable energy sector encompasses a range of different energy sources and processes, all of which are natural and are capable of being constantly replenished. The most common renewable sources include solar, wind, electric, hydroelectric, biomass, geothermal, wave, and tidal energies.<sup>1</sup> These renewable energy sources are often referred to as “clean” because they do not pollute our air or water supply. As the proliferation of clean energy companies has been on the rise, so has investment in those companies. Dubbed cleantech,<sup>2</sup> the clean technology field includes not just energy, but also agriculture, transportation, and manufacturing. The common denominator between all cleantech companies is a focus on sustainability over profitability. In the late 1990s and early 2000s, venture capital companies determined that they stood to profit from investing in these environmentally friendly businesses and industries, boosting the growth of the cleantech industry.

Investment in cleantech continues to grow. According to UN Environment’s 2018 report on Global Trends in Renewable Energy Investment,<sup>3</sup> global investment in renewable energy exceeded \$200 billion in 2017 for the eighth straight year. The world has invested a total of \$2.9 trillion in renewable energy since 2004. Solar power garnered the most investment at \$160.8 billion in 2017, up 18% from the prior year. China led the way with \$86.5 billion in investments, making up over half the total

global investment in clean energy. In contrast, U.S. investment in clean energy continued to decline, totaling \$40.5 billion in 2017 (although in 2018, the U.S. ranked in second place behind China for the greatest investment in clean energy). Wind, solar, and hydropower are currently the fastest growing segments of renewable energy.

The Paris Agreement, which took effect on November 4, 2016, was a landmark agreement for the renewable energy sector, designed to combat climate change and lay the groundwork for a low carbon future.<sup>4</sup> The Paris Agreement’s ultimate goal is to keep global warming below 2° C. The agreement was ultimately entered into by 195 member states across the world, creating a catalyst for clean energy companies to expand their operations. Notably, the U.S. announced in June 2017 its intention to withdraw from The Paris Agreement, effective 2020.

Nonetheless, the renewable energy sector is likely to continue growing for the foreseeable future. According to [Mike Richmond](#), Co-Chair of McMillan LLP’s Power and Energy Law Group, at the international level, we’re seeing “very rapid development of the technology at an exponential pace.” New technologies like tidal power and biomass have become significantly more efficient in the last few years, while older renewable technologies like wind and solar have continued to

advance at a rapid rate. According to Richmond, as the price of the technology has been coming down for approximately the last 15 years, the increase in efficiency has been on an exponential upward curve, with technologies performing five times better each year than they were the year before.

Over time, arbitration has become an effective tool used to negotiate the outcomes of disputes within the ever-developing and -evolving renewable energy sector as new technologies come to the fore. In this white paper, we provide an overview of regulatory issues within the clean energy space, describe how international arbitration has been used to oversee claims within this arena, explain how renewable energy is connected to third-party arbitration funding, and how can this sort of funding can improve the outcome of such disputes.



# REGULATORY ISSUES IN RENEWABLE ENERGY

## A. Background

In order to survive, renewable energy companies and projects often rely on large, upfront investments that cannot be recouped in the short term. To encourage such investment, many countries, particularly members of the European Union, have enacted regulatory schemes that offer investors incentives like special rates or tariffs. Investors who front capital in reliance on these favorable regulatory schemes have a vested interest in the stability of the regulations and protection from policy changes that might functionally amount to expropriation of their investments.<sup>5</sup> These initiatives and regulatory schemes, particularly as they relate to alternative and renewable energy sources and their favoring of those sources over non-renewable resources, helped spur a significant increase in investment in the past decade.<sup>6</sup>

International law has become increasingly focused on the protection of foreign investments, which has had far-reaching implications in the renewable energy sector. As a result, a number of bilateral investment treaties (BITs) have been put in place both to encourage foreign investment and to guard those investments against non-commercial risks like discriminatory regulation or unlawful expropriation.<sup>7</sup> According to new research by the State University of New York at Buffalo, companies that invest in countries that have signed BITs are not only more likely to secure larger loans on more favorable terms, but are also more likely to invest in those countries in the first place. Moreover, the larger loans secured by investors in countries covered by a BIT were less likely to rely on risk-mitigating terms like collateral and financial covenants.<sup>8</sup>

The most prominent BIT to impact the renewable energy industry is the Energy Charter Treaty (ECT), signed in 1994 by 53 governing bodies and taking

effect in December 1998.<sup>9</sup> The ECT was enacted to provide a multilateral framework that would encourage international energy cooperation and promote energy security by creating an open and competitive energy market that still recognized state interests in sovereignty over resources and the promotion of sustainable development.

Relevant to the field of international arbitration, the ECT allows investors to bring claims before an arbitral tribunal against host states in order to allege violations of the treaty's investment protections. A common basis for invoking arbitration under the ECT is a violation of the treaty's "fair and equitable treatment standard," which is often alleged to occur when a state alters its subsidies or tariff regimes that impact renewable energy projects.<sup>10</sup> Arbitrations brought under the ECT are discussed in detail later in this paper,<sup>11</sup> as is third-party funding of such claims.<sup>12</sup>

## B. The Changing Regulatory Landscape

While states as legal entities don't change, the governments within those states do, as do the states' economic circumstances, especially in light of major events like the global financial crisis. When those factors combine, there is always the potential risk that a new government finds old policies to be unfavorable and feels that it can no longer honor previous commitments to investors.

As [Robert Kirkness](#), a barrister with Thorndon Chambers specializing in commercial, public, and international law, explains: "In the renewable context, in the early 2000s, a number of European governments decided that it would be a good idea to create incentives for investment into the renewable sector and came up with quite interesting tariff programs and other things to incentivize investors to put money into their jurisdictions and into renewable energy projects."

According to Kirkness, as the global financial crisis hit and governments changed, states "walked back on some of those previous, quite generous programs that have been held out. And as a result of that, you had a situation where some of these renewable energy investors had sunk capital into projects on one basis, only to subsequently be told that that was going to then change." Investors, in turn, decided to sue the states based on what they viewed as broken commitments, and third-party funding of such claims has been on the rise in recent years. Spain in particular is seeing many claims, which are largely coming out in favor of the renewable energy investors.

Similarly, in Canada, the province of Ontario passed the Green Energy Repeal Act, 2018, by which the new Ontario government repealed all previous green energy laws due to economic concerns and a lack

of local support. The act has served to halt all new investments in renewable energy in the province. One of the biggest subsidy programs impacted by the repeal is Ontario's Green Energy Act, which incentivized a significant amount of investment in renewable energy sources for the past decade. As a result, there are no new projects garnering investment in Ontario. Certain western provinces like Saskatchewan and Alberta are starting to offer clean energy procurement opportunities and see an uptick in renewable energy investments, but at nowhere near the scale of what was previously seen in Ontario. On a federal level in Canada, the new Greenhouse Gas Pollution Pricing Act also has the potential to impact investment in the renewable energy sector, though the actual effects remain to be seen as the act's provisions take effect and are implemented.

Likewise, in 2012, Japan created government incentives for clean energy in the wake of the 2011 Fukushima nuclear disaster, guaranteeing pricing for renewable energy sources. Thanks to an incredibly heightened demand for solar power, two years after the incentives were introduced, Japan was forced to adjust its rules in its favor, allowing utilities to strip renewable providers of grid access should they fail to comply with the terms of their contracts.

As Kirkness summarized, "Those countries that had tariff regimes or made commitments about the way you could invest in their jurisdiction in the renewable sector, and then changed them after the investors had sunk capital, are being sued."



# OVERVIEW OF INTERNATIONAL ARBITRATION

## A. Introduction

**Arbitration varies widely from country to country and region to region. For example, most European countries recognize a distinction between consumer and commercial arbitration, while the U.S. essentially applies one set of rules to all arbitrations (namely the Federal Arbitration Act).**

International arbitration is made up of two distinct kinds of disputes. The first and more established is international commercial arbitration, which is based on contracts and national laws. In recent years, however, international arbitration has expanded beyond the more traditional disputes among commercial parties and is increasingly used for disputes between commercial parties and states. Investment treaty arbitration (ITA), also commonly referred to as investor-state arbitration or investor-state dispute settlement (ISDS), is based upon specific investment treaties. As [Susan Franck](#), an expert in international law and the Chair of the Academic Council of the Institute for Transnational Arbitration, explains, the applicable law in investment treaty arbitrations comes from international law, including treaties, custom, and practice.

States have thus far fared well in investor-state arbitrations. “Using data from 159 final cases derived from 272 publicly available ITA awards [from 1990 to 2014] ... states reliably won a greater proportion of cases than investors; and for the sub-set of cases investors won, the mean award was US \$45.6 million with mean investor success rate of 35%.”<sup>13</sup>

International arbitration generally follows the English Rule, meaning that the losing party pays the costs of the winning party. However, according to Franck, it's been found that, in practice, this often functions as a one-way rule, as winning investors tend to benefit far more from cost shifting than winning states do.

International arbitration has expanded beyond its original roots in the West with the advent of new arbitral seats, tribunals, and processes, especially in Africa, Asia, and India. For example, while international investors in Asia typically used to opt for arbitration in Paris, Geneva, or London, today they are increasingly insisting on Asia seats and Asia-based arbitration centers as more and more of them appear. The increase of new seats and the new rules that come with them has injected a new level of uncertainty into the international arbitration process.<sup>14</sup> The various seats and international fora located around the world are discussed in detail later in this paper.<sup>15</sup>

## B. The Controversy Surrounding Investor-State Arbitration

The involvement of states as parties to arbitration has drawn attention to the integrity of the ITA process, both from within and outside the arbitration community. In particular, the areas of transparency and arbitrator conflicts of interest have been met with heightened scrutiny,<sup>16</sup> which will be discussed in further detail later in this paper.<sup>17</sup> Investor-state arbitrations brought under BITs have caused controversy for a number of reasons, not the least of which is the fact that they allow arbitral bodies to judge the sovereign acts taken by states, including the amendment of their own laws and regulations.<sup>18</sup> As Kirkness further explained:

**“I think the key point to remember is, the investors are not a party to any of these treaties. One of the things that gets overlooked a lot of the time is that these are states, including the states who eventually get sued, choosing to give investors the ability to sue them. When they start complaining about it, you have to remember that they write the rules of the road and they can change the rules of the road, too. We’re playing on their chessboard. The fact is, they created this very interesting mechanism, a number of years ago, whereby they said: To show our commitment to the standards that we say we’re going to uphold, we are going to give private investors, even though they’re not part of this treaty, the ability to sue us directly. And that was arbitration without privity, one famous arbitrator called it.”**

Others see the pushback against investor-state arbitrations as not entirely founded. As [Victoria Sahani](#), professor at the Sandra Day O’Connor College of Law at Arizona State University and an expert in international law, stated:

**“[T]here’s this hostility to investment arbitration and that’s something that is troubling, because the whole point of the investment arbitration regime in terms of its creation was to prevent war. What used to happen is, if you had a foreign entity that would invest in a host state and then that host state would then seize that property ... their recourse was to go to their home government and say: home government, I’ve been wronged by this host state, please do something. The home government could use diplomacy, or they could send their navy and they called it gunboat diplomacy, or engage in some sort of political or military solution, which was dangerous in some respects. The idea of the investment arbitration system was to prevent all that and to stop countries coming to the brink of war in some circumstances over this issue.”**

Nonetheless, investor-state disputes are not without their problems, and some question their legitimacy. Among potentially problematic issues flagged by UNCITRAL’s working group on investor-state dispute settlement were long duration, inconsistency, high cost, and lack of transparency.<sup>19</sup> ITA is garnering some positive attention, however, because the records of the proceedings are more readily available than the records in commercial arbitration, which are not public.



## C. The Growth of International Arbitration

Despite the lack of public records that would allow for concrete confirmation, the general consensus among experts is that international arbitration is continuing to grow across the globe.

Professor Sahani attributed the continued rise of international arbitration to the fact that companies have become increasingly comfortable with it thanks to the New York Convention,[20] which has been signed by 159 parties around the world and provides a mechanism by which an international arbitration award made in the territory of a member state can be enforced as a judgment of the court of another member state. She explained, “Because of that widespread, very robust enforcement regime, companies are very, very comfortable with international arbitration when dealing across borders and they often prefer it to litigation.”

Kirkness further explained that “arbitration continues to be on the rise, partly because awareness is increasing.” In an interconnected world, there will be more cross-border transactions, which are what drive international arbitration, along with the fact that there is not a court judgment equivalent of the New York Convention that allows for international enforcement. He concludes that “the New York Convention is the best way to guarantee that the outcome of your dispute is something that you can take and enforce in other jurisdictions.”

The number of investor-state disputes is also steadily on the rise. There is no sign that either investor-state arbitrations or other disputes invoking the ECT will decline in number any time soon.<sup>21</sup>

While international arbitration is continually increasing, it may be doing so at a slightly slower rate than in recent years. According to Robert Wisner, Co-Chair of McMillan LLP’s International Arbitration practice, we are currently seeing modest growth in international arbitration, in terms of both commercial and investor arbitrations, following a period of very rapid growth. From the early 2000s until two or three years ago, there were large increases in claims brought under treaties, while the increase in international commercial arbitration was steadier.

## D. Proposed Changes

As the prevalence of international arbitration continues to grow, so does scrutiny of it. To date, arbitration has lacked the structure of formal litigation in terms of governing principles, and much of the attention being paid to international arbitration is centering on filling that gap.

According to Franck, in order to create a universal approach, there is currently a lot of activity dedicated to creating rules for international arbitration. Perhaps the most notable effort is the work of the International Centre for Settlement of Investment Disputes (ICSID) to promulgate rules that apply across the international arbitration arena.

Arbitration is made up of two components: substance and procedure. As Franck explains, the focus in international arbitration has been on procedure, in the form of creating rules, because the substance is nearly impossible to alter, as it comes from some 2,000-3,000 different treaties. While the proposed ICSID rule changes have garnered hundreds of pages of comments from countries around the world, the U.S. has thus far remained silent on the matter, despite the major impacts the new rules could have on U.S. treaties and investors.

A variety of rule changes have been proposed to date, targeting different aspects of the international arbitration process. Some of proposed rule changes mirror mechanisms common in court disputes. One suggests the implementation of case management conferences, similar to what is seen in U.S. domestic litigation, which could serve to make arbitrations more efficient. Another proposes imposing on parties a general duty to act in good faith. Currently there is no equivalent to Rule 11 sanctions in international arbitration, which some fear gives bad actors leeway for bad behavior.

There has also been a push for transparency in investment arbitration. ICSID is aiming to revise its arbitration rules to increase transparency, which Professor Sahani explained as follows:

**“One of the rules they’re planning to adopt is that the default is going to be that the award will be published unless somebody objects, which is a total sea change. It’s the other way around really, where the default is privacy unless someone wants to publish. Now, the default is going to be to publish the award unless one of the parties objects. I think you’re going to get a lot more transparency with respect to at least the awards.”**

Another topic being addressed in great detail by the proposed ICSID rule changes is third-party funding. Funding and the proposed new rules governing it are discussed at length later in this paper.<sup>22</sup>



# INTERNATIONAL ARBITRATION FORA

## A. Overview of Global Institutions

In its earliest days, international arbitration was largely a Western phenomenon. As both the disputes and the nature of the process itself continue to change, international arbitration has increased its reach across the globe.<sup>23</sup> While certain fora unquestionably still dominate the international arbitration arena, arbitral bodies have sprung up in major cities across all continents. Although developing countries once believed international arbitration was solely used to protect Western business interests, that is no longer thought to be true, with major players in Asia, India, and Africa entering the scene. Whereas cities like London, Paris, or Geneva were once favored, that is not always the case today.

The Washington Convention<sup>24</sup> created the International Center for the Settlement of Investment Disputes (ICSID) within the World Bank. According to Professor Sahani, today ICSID “hears the lion’s share of investor-state disputes.”

ICSID is widely viewed as the top forum for resolving international energy disputes.<sup>25</sup> The second most prominent forum is the Stockholm Chamber of Commerce,<sup>26</sup> which is officially recognized as a forum for the resolution of energy disputes under the ECT.

The International Chamber of Commerce (ICC) created the International Court of Arbitration in 1926. The ICC is one of the biggest, oldest, and most respected arbitral institutions in the world. What makes the ICC an appealing option for many parties, Professor Sahani explained, is that it offers a unique feature called scrutiny by the court of arbitration before an award is finalized. What this means is that, once an ICC panel drafts a ruling but before it goes to the parties, a draft of the award is sent to the ICC,

whose staff reviews the award for issues of form, but not substance. This is not an appeal or review on the merits, but a chance to highlight things like unclear reasoning, computation errors, or issues that the award failed to address. The suggestions are then sent back to the arbitrators, who can choose whether or not to adopt them before finalizing the award and delivering it to the parties. The goal of scrutiny is to make sure the award is of a form that will be enforceable and will stand up in court if challenged by one of the parties.

Specialized dispute resolution institutions are continuing to be created around the world as the nature of investments, projects, and disputes continues to evolve. The European Union is currently exploring the idea of a multilateral investment court.<sup>27</sup>

China is also emerging as a potential source of a great number of disputes that will need a place to be heard. In March 2018, recognizing the potential for a large volume of disputes to develop from China’s

## INTERNATIONAL ARBITRATION FORA

Belt and Road Initiative,<sup>28</sup> the ICC announced its intention to launch a commission devoted solely to addressing those disputes. The Hong Kong International Arbitration Centre (HKIAC) has likewise formed an advisory committee and website to help parties to Belt and Road projects and disputes.<sup>29</sup>

The following is a non-exhaustive list of some of the most prominent international arbitration fora located around the world.

<p><b>Europe:</b> the ICC; the Stockholm Chamber of Commerce; the Permanent Court of Arbitration at The Hague; the London Court of International Arbitration (LCIA); the German Arbitration Institute (Deutsche Institution für Schiedsgerichtsbarkeit or DIS); the Milan Chamber of Arbitration</p>	<p><b>North America:</b> the American Arbitration Association (AAA); the International Center for Dispute Resolution (ICDR, the international arm of the AAA); JAMS; the International Institute for Conflict Prevention &amp; Resolution (CPR)</p>
<p><b>South America:</b> the Arbitration Center of the Brazil-Canada Chamber of Commerce</p>	<p><b>Middle East:</b> localized regional centers, including those in Dubai, Qatar, and Bahrain; the Jerusalem Arbitration Center</p>
<p><b>Africa:</b> the African Arbitration Association; regional tribunals with seats in Mauritius, South Africa, and Cairo, Egypt</p>	<p><b>Asia:</b> the Singapore International Arbitration Center (SIAC); the Hong Kong International Arbitration Center (HKIAC); the China International Economic and Trade Arbitration Commission (CIETAC)</p>
<p><b>Australia:</b> the Australian Centre for International Commercial Arbitration (ACICA)</p>	<p><b>Russia:</b> the Russian Arbitration Center at the Institute of Modern Arbitration; the Arbitration Center at the Russian Union of Industrialists and Entrepreneurs</p>

## B. Choice of Forum

As a relatively young industry, the renewable energy sector lacks the established industry practices that other more established industries enjoy, and is instead still in the process of developing contracting standards. As a result, many deals in the renewable sector still involve standard form or model contracts borrowed from related industries, which are amended to varying degrees as each individual deal is finalized. This approach opens contracting parties to the risk of uncertainty down the road when disputes do arise.<sup>30</sup>

Because arbitration arises out of contracts, parties have some degree of control over their dispute resolution mechanism. For this reason, Professor Sahani advises that parties thoroughly consider potential future disputes at the initial stages of contract drafting, not just when conflicts arise. She suggested certain considerations for parties to keep in mind as they negotiate their arbitration provisions:

**“You have to think about it at the outset, if you do have a dispute, how do you want that dispute resolved? Keeping in mind that you’re going to have to negotiate all those pieces with the other side, and so it’s going to be a compromise to some extent. Often, what ends up happening, at least my understanding of that happens, is that there are tradeoffs made. One party might really want a particular location for their arbitration, a particular seat of arbitration. Another party might really want a certain type of arbitration rules, and so they’ll trade. They get party A’s choice of rules and party B’s choice of seat for example — or the language of the arbitration or the applicable law.”**

The important thing for parties to remember is that they will not know at the time of contracting whether they will be claimant or respondent in a future suit, or what the nature of the suit will be. A balance must be struck between wanting to customize every aspect of an arbitration clause and running the risk of creating requirements that are so rigid they cannot later be fulfilled.

It is also important to note that a customized arbitration clause is not required for a dispute to proceed to arbitration. As Professor Sahani explained, every major institution has what it calls a model clause, which is the shortest and least detailed enforceable arbitration clause that can be included in a contract. Typically these clauses simply state that any disputes will be settled under a designated set of rules. Those rules then fill in the blanks to determine the rest of the process.

If opting to rely on institutional rules to structure future arbitration proceedings, most parties’ first choice is typically ICSID arbitration. ICSID creates delocalized arbitration where essentially ICSID itself is the seat. This option applies if parties put an ICSID clause in their agreement or if there is the option to submit a dispute to ICSID under a treaty. Such an option exists in most ECT cases.

If parties choose not to contract for ICSID arbitration or for some reason it is not a viable option, Kirkness explained that the next most common approach is to choose a set of governing rules, such as the ICC rules or the UNCITRAL rules.

When considering other potential fora, Wisner suggests that parties focus first on the quality of the arbitrators of any forum being considered:

**“I think the key thing for parties to look for in an institution is a well-qualified roster of arbitrators, so that the institution will appoint an arbitrator who will have the**

**qualifications that are appropriate for the type of dispute. In particular for the energy sector, it's very important to have industry experience so you don't have to explain the regulatory framework or the industry practices to the arbitrator."**

The foregoing considerations apply only in the context of commercial arbitration. For treaty arbitration, forum selection is accomplished by the claimant selecting from a list of forum options included in the treaty under which the arbitration is commenced. Most often, parties in that situation choose ISCID arbitration, Professor Sahani explained.



# ARBITRATION AND RENEWABLE ENERGY

The energy sector is one of the biggest players in the international arbitration arena, with some of the highest arbitral awards in history being handed down in energy-related arbitrations.<sup>31</sup> For example, in 2016, about 42 percent of the cases before the ICSID (ranging from shareholder disputes to investor/state disputes) came from the energy sector, and the heavy caseload continued in the years that followed. International arbitration has long been the primary dispute resolution mechanism for large-scale energy disputes.<sup>32</sup> An October 2018 International Arbitration Report published by Norton Rose Fulbright<sup>33</sup> lays out some informative statistics:

- According to ICSID, oil, gas and mining, or other power- and energy-related matters have made up 31% of all the cases ever initiated under the ICSID convention. For the year 2017, that percentage was 24%. All indications support the conclusion that these trends will continue in the future.
- In 2017, the total amount of cross-border mergers, acquisitions, and foreign direct investment greenfield projects in the energy sector equalled \$150 billion, making up just over 10% of total investment value that year. The United Nations Conference on Trade and Development (UNCTAD) predicted that foreign direct investment would increase globally by 5% in 2018. The natural assumption is that more investment will lead to more investment disputes.

According to Franck, “energy disputes are a core segment of the marketplace for international arbitration disputes.” She further noted that energy disputes are much more expensive than cases not related to energy.

Kirkness explained that, for sophisticated renewable energy companies that enter into cross-border transactions and are working in emerging markets, arbitration clauses will nearly always be in their contracts if they have competent law firms advising them. It stands to reason, then, that international

arbitration will continue to be a preferred means for resolving disputes in the renewable energy industry for the foreseeable future.

In addition to the more traditional commercial arbitration scenarios, the energy sector has seen a significant rise in investor-state disputes arising under various BITs. In particular, arbitrations brought under the ECT are not expected to decline any time soon. In the time since the first arbitration was brought under the ECT in 2001, there have been 114 recorded investment arbitration cases commenced under the treaty. Cases involving renewable energy are increasingly making up these numbers, particularly as a number of solar projects have challenged Spain over tax reforms.<sup>34</sup>

Another source of potentially large amounts of international arbitration to come is China’s Belt and Road Initiative.<sup>35</sup> The massive initiative focuses on ambitious energy, infrastructure, and transport projects that aim to connect China with the rest of Eurasia across the Silk Road Economic Belt and the Maritime Silk Road. To date, the initiative involves over 70 countries and investments equalling approximately \$900 billion. Because of the vast numbers of international contractors, developers, investors, and other parties involved, the present and future projects present a real potential for large-scale commercial disputes in the future.

## A. The ECT and Energy Disputes

The ECT was designed to level the playing field between countries looking to invest and countries rich in resources, creating a framework that would facilitate long-term investments in energy while protecting both investors and investments.<sup>36</sup> To date, it is the only agreement to successfully protect investments in the energy field that is still in force, and gave rise to a host of energy investment opportunities. As the global financial crisis hit in the late 2000s, many European countries began to scale back the initiatives and incentives they had previously put in place to encourage investment in renewable energy. Not surprisingly, those regulatory changes gave rise to a significant number of legal disputes brought by the investors, including several investor-state arbitrations brought under the ECT, particularly in Spain, Italy, and the Czech Republic.<sup>37</sup>

Spain is a prime example of how changes in regulatory incentives are giving rise to ECT arbitrations. The Spanish Promotion Plan for Renewable Energy subsidized new investments in solar energy, wind energy, and waste incineration by providing investors with tax incentives, grants, soft loans, and loan guarantees, including a feed-in tariff that allowed owners of renewable energy plants to sell power at a favorable rate for the first 25 years of operation. As a result, Spain quickly became one of the largest markets for investing in renewable energy, creating approximately 13 billion in renewable energy assets and attracting investors from around the globe.<sup>38</sup>

In 2008, however, Spain started to reduce the incentives, reportedly to address a tariff deficit caused by a failure of the subsidized prices to cover costs. By 2012, the government had almost entirely eliminated the incentives and began imposing new taxes on power generation. In response to the state's actions, investors began to bring arbitration claims against the state under the ECT, with at least 22 such arbitrations filed as of August 2016 at ICSID and still more disputes commenced before tribunals governed by the UNCITRAL or Stockholm Chamber of Commerce rules.

Similar feed-in tariffs formed the basis for a number of state-investor arbitrations involving the Czech Republic and Italy. Italy officially announced its withdrawal from the ECT on December 31, 2014, effective January 1, 2016.<sup>39</sup> As opposed to withdrawing from the ECT altogether, 22 European Union member states issued a political declaration on January 15, 2019, announcing that they would not to allow intra-EU claims to be arbitrated under the ECT at all.<sup>40</sup>

## B. ECT Arbitration

The ECT incorporates multiple dispute resolution mechanisms to address a variety of types of grievances that might arise if states fail to comply with their treaty obligations.<sup>[41]</sup>

Given the extremely high cost of transitioning from non-renewable to renewable energy sources in countries that lack access to modern, alternative forms of energy, private (typically foreign) investment is likely to be a deciding factor in whether

or not clean energy sources are ultimately developed and utilized around the world. Therefore, the ECT and its various dispute resolution mechanisms have the potential to play a major role in creating the kind of investment conditions that encourage that crucial investment, such as providing for orderly change and fair compensation in the event that existing investments are terminated or phased out earlier than initially agreed.<sup>[42]</sup>



## B. ECT Arbitration, Continued

Most ECT arbitrations base their claims on two specific provisions of the treaty:<sup>[43]</sup>

- 1) **The treaty's requirement that host states offer fair and equitable treatment to foreign investors; and**
- 2) **The treaty's prohibition on expropriation.**

### i. Fair and Equitable Treatment

One of the most common bases for investor-state arbitrations under the ECT is Article 10(1), the fair and equitable treatment clause.<sup>44</sup> Pursuant to Article 10(1), every ECT signatory promises to:

encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.

The fair and equitable treatment standards are balanced by provisions that emphasize the states' sovereignty over their own natural resources and their right to maintain flexibility when regulating in the public interest in light of changing circumstances.<sup>45</sup>

Similar fair and equitable treatment provisions appear in most BITs that are subject to international arbitration. These clauses generally require host states to act transparently and in good faith, avoiding arbitrary and discriminatory practices and respecting due process. The chief argument underlying these claims is that changes made to the regulatory incentives that led to investment frustrate investors' expectations and violate the fair and equitable treatment requirements.

A key factor in any fair and equitable treatment claim is the existence of legitimate expectations that are entitled to protection. In the case of the ECT and other BITs, the predominant argument is that states violate this standard by creating objective expectations in investors when they induce them to invest through favorable regulatory schemes and frameworks, and then abrogating or eliminating those favorable schemes.<sup>46</sup>

### ii. Indirect Expropriation

The other common basis for claims brought under the ECT is an indirect expropriation argument.<sup>47</sup> While the ECT does not have an express provision addressing indirect expropriations, Article 13 of the treaty prohibits the expropriation of investments unless it is "justified by public interest purposes, carried out under due process of law and accompanied by a prompt, adequate and effective compensation."

The argument underlying an indirect expropriation claim under the ECT is that, by changing or removing the incentives that led to investment in the first place, host states are, in essence, expropriating those investments without proper purpose, due process, or compensation.



# THE IMPACT OF CLIMATE CHANGE

One of the largest issues to dominate the geopolitical sphere in the 21st century is climate change, and one of its lasting impacts has been an increased scrutiny on the effects companies have on the environment, particularly those in the energy sector. This heightened scrutiny is opening doors to potential disputes relating to climate change involving private companies, states, or both. For example, while more than 1000 cases related to climate change have been filed globally, only a handful of them can be classified as “strategic climate litigation” (i.e., efforts to put pressure on governments or corporations to “mitigate, adapt or compensate for losses resulting from climate change.”)<sup>48</sup>

Both companies and state actors are under increasing scrutiny when it comes to any action or lack of action that might contribute to climate change. This is particularly true for actors in the energy sector. While many of these cases have garnered little attention, higher-profile claims with higher stakes have begun to emerge in recent years. For example, in *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497 (2007), the U.S. EPA was found in breach of its statutory duties to regulate GHG emissions under the Clean Air Act. More recently, in *Juliana v. United States*, a group of 21 youth plaintiffs filed suit in 2015, claiming that their rights to life and liberty had been violated because the federal government had not yet adopted reasonable methods to reduce greenhouse gas emissions. As climate-related disputes increase in number over the coming years, there is a great potential that arbitration will play a major role in enforcing environmental law and policy in international disputes.

While many cases involving public climate change policy are more likely to be brought in the court systems of the various countries, energy disputes that include climate change as simply one of many issues have a greater chance of ending up in arbitration.<sup>49</sup> Corporations need to stay abreast of climate change laws and regulations as they continue to change and evolve, as changes bring potential risk for entities involved in the energy industry.

Climate-change may also have an indirect effect, as climate-related incidents operate similarly to major events like the global financial crisis — both are external circumstances that create conditions giving rise to potential disputes. Climate change will drive energy policy, which “will, in turn, mean you might see changes in existing arrangements that might go against contracts or commitments made by governments” to energy companies, Kirkness explained. The scale of the climate crisis might potentially be so big that governments will be unable to honor commitments in either an economic or political sense, because the political or actual cost may simply be too high, which may lead to disputes with investors.

Climate change law is growing and adapting as the issues involved in climate change itself continue to change. With ongoing legal changes comes not only an increased risk for companies engaged in energy sector activities that have the potential to impact the environment, but a greater stage for plaintiffs to pursue meaningful recourse.

This new avenue for social change will make the availability of litigation funding even more important.<sup>50</sup> The significant role that third-party funding plays in renewable energy arbitration is discussed in greater detail in the next section of this paper.<sup>51</sup>



# LITIGATION FINANCE

Litigation finance, also referred to as litigation funding or third-party funding in various parts of the world, is the provision of funds to an individual, entity, or law firm that is pursuing a claim in litigation. The funded party may seek financing to enable that party to pay the costs of the litigation or arbitration, reduce or eliminate the balance sheet expense of pursuing the claim for strategic reasons, or to mitigate the risk of the litigation or arbitration. The third-party funder has no prior interest or involvement in the dispute at issue. In exchange for providing funds, the funder contracts to receive a portion of any proceeds recovered by the funded party in litigation or arbitration.

Third-party funding arrangements generally work on a non-recourse basis, meaning that recourse is limited to the recovered proceeds. If the funded party is successful on its claims or settles its claims for a monetary sum, only then does the funder recoup its investment according to the terms of the pre-agreed funding arrangement. In the event that the funded party is ultimately unsuccessful, it owes nothing to the funder.<sup>52</sup>

## A. History

Modern litigation finance started in Australia approximately 30 years ago, and was originally largely confined to personal injury and family law matters. Financing was common in class action lawsuits, providing individual plaintiffs with the funds they needed to allow them pursue claims and seek recovery from wealthy corporations with deep pockets.

Litigation finance quickly started to spread across the globe, migrating to the UK in the early 2000s and to the U.S. in the late 2000s. While third-party funding was initially limited to those three countries, today it has expanded to nearly every corner of the globe, with notable emerging markets in Singapore, Hong Kong, China, Europe, and Latin America.

As the litigation finance industry grew in global scope, its focus also started to change. Once focused on personal lawsuits and helping financially strapped individuals take on deep-pocketed corporations, third-party funding shifted its sights first to one-off commercial cases and later to portfolios of claims. Litigation funding ceased to be simply a way to help needy individuals pursue claims, and quickly became a financial mechanism for large corporations to reduce litigation risk and manage balance sheets.

## B. The Present State of Litigation Finance

With the increase in international arbitration in recent years, including an increase in investor-state arbitrations, has come an increase in third-party funding, both in terms of the number of funders in the market and the number of parties seeking funding. As international arbitration expands, costs increase, which, in turn, leads parties to seek out alternative ways to finance those costs. As of April 2018, the global market for the amount of third-party litigation and arbitration funding needed by claimants was estimated to exceed \$10 billion, and was expected to continue growing at a rapid pace.<sup>53</sup>

While there is a general consensus that third-party funding is on an upswing and that more parties are using it, Professor Sahani pointed out that it is impossible to say for certain, because arbitration proceedings tend to be private and the existence of funding doesn't have to be disclosed. Nonetheless, as Franck stated, third-party funding is "playing a massive role in international arbitration." She further speculated that the rise in litigation finance might be the result of hedge funds and other investors looking for a place to put their money after the recession, because litigation finance created a useful new asset class.

Initially, the typical company seeking third-party funding was a smaller company that was impaired or lacked a source of revenue to pursue its claims. Now, "there's starting to be a growing awareness amongst larger users of arbitration that third-party financing helps to defray the costs of bringing some of these cases and allows companies to hire their preferred counsel," Wisner explained. Usually large

firms do not work on a contingency fee basis, but litigation funding can allow an alternate type of risk sharing that is functionally similar to a contingency fee arrangement.

Wisner made it clear that litigation finance is no longer viewed as simply a solution for cash-strapped parties that are otherwise struggling to bring claims: "For companies that are solvent, it's a way to avoid the investment of a substantial legal claim while maintaining control over the process, and simply sharing some of the risk with a funder."

One approach is the funding of individual cases, which is how third-party funding got its start. However, litigation financing is no longer limited to one-off cases. A variation on the traditional case-by-case litigation funding model that has been growing in popularity among funders is portfolio funding. As Kirkness explained, "some funders are now more interested in portfolio funding, rather than single cases. They will fund a portfolio of cases, where the law firm which has a contingent stake in each matter basically agrees with the funder to put a set number of cases into a pool, which allows the funder to spread risk."

In portfolio funding, funders invest in a portfolio of business of a given law firm, which is typically made up either of various litigation matters for a number of different firm clients, or for a collection of distinct legal disputes on behalf of a single client. With portfolio funding, the amount the funding firm recovers on its investment is typically based on the overall financial performance of the portfolio, and not on the outcome of any particular claim within it.

Regardless of whether funders are funding individual claims or portfolios, the companies obtaining funding may have to invest nothing in litigation, which is useful if they lack liquidity. As Kirkness explained, massive companies are increasingly looking to not spend money on claims, because they see it as a waste of working capital. Instead, they turn to funding, because recouping less (typically

## B. The Present State of Litigation Finance, Continued

75% or 80% of what they would have otherwise recovered) is seen as a preferable tradeoff for having to invest none of their own funds into the claims.

As the litigation finance industry has expanded, a few non-traditional forms of third-party funding have emerged. One alternate form is not-for-profit funding. Perhaps the most popular example of this is Philip Morris v. Uruguay,<sup>54</sup> in which Philip Morris brought a case against Uruguay over regulations regarding plain packaging on tobacco. Uruguay lacked funds to handle the litigation, and a Bloomberg Foundation initiative called the Campaign for Tobacco-Free Kids provided Uruguay with significant funding to help the country fight the case, which it ultimately won.

Crowdfunding of litigation also now exists.<sup>55</sup> Companies like Litify and LexShares allow individuals to invest money to help fund particular cases. Professor Sahani summarized the changing landscape of litigation finance:

**“Third-party funding has changed so dramatically in terms of the structures of the actual transaction. There is still a subset of the market that is the classic ‘I don’t have enough money to bring my case, will you help me?’ There’s also a huge tidal wave of other types of funding that look like corporate finance or even equity investment in a company.”**

For large corporations that frequently get sued, litigation represents an unpredictable line item in the company budget because litigation costs fluctuate. To remove the uncertainty, these companies are increasingly entering into agreements to pay third-party funders a large, flat fee to handle their litigation and take on all the potential cost fluctuation. The funders get the same fee regardless of the risk involved, and the company gets a steady budget line item that helps their stock price.

While it may seem intuitive that an increase in litigation funding would increase the number of claims being brought, Professor Sahani explained that that is not necessarily the case. Due to these alternate funding arrangements like portfolio funding, many of the funded cases would have been brought without funding, but claimants are simply choosing to accept funding as a business and risk allocation tool.

## C. Third-Party Funding in Investment Arbitration

According to Franck, third-party funding in the ITA space is primarily a phenomenon of the past five years. In that time,<sup>56</sup> the practice has been met with a significant amount of controversy and scrutiny. “Most of the outrage about third party funding has taken place in the investment arbitration context more so than the commercial arbitration context,” Professor Sahani stated. It is worth noting, however, that third-party funding has become such a staple in investor-state arbitration that issues related to such funding have been addressed by multinational treaties (e.g., the Comprehensive Economic and Trade Agreement deal between Canada and the EU specifically mandates that all outside funding must be disclosed).<sup>57</sup> In fact, according to a recent survey by the Queen Mary University of London and White & Case LLP, 97 percent of respondents said they were aware of third-party funding in international arbitration, and a majority said they had a “positive” perception of it (with that positive outlook increasing if a respondent had a personal interaction with third-party funding in his or her work).

Nevertheless, much of the controversy surrounding third-party financing in investor-state arbitrations stems from the positioning of the parties to the disputes. Professor Sahani explained:

**“In investment arbitration, the idea is you have a private entity and you have a state. With respect to that state and with respect to the way that the regime is structured, the treaty by which you can bring an investment arbitration claim provides for rights for the**

**investor, rights for the private company, and obligations for the state. In that way it’s one-sided. There are no rights of the state in most treaties. There are a few modern treaties in which they’re creating or adding in some rights for the state that the state can sue based upon, but in the classic free trade agreement, classic bilateral investment treaty, it’s one-way. The investor gets rights and the state gets obligations. What does that mean structurally? That means the investor is always the claimant and the state is always the respondent.”**

Funders get paid out of claimant funds. In a one-sided system where investors are always the claimants and the state is always the respondent, the only “claim” states have is that they have no liability and should not have to pay money. This means that there is no funding on the state side, since there is no recovery from which to take a share. Therefore, all funding is on the claimant side. When that fact is coupled with the fact that international arbitration typically follows the English rule of shifting costs to the loser, the state could potentially be required to pay the costs of funding. The result is that money from the public treasury is going to private entities and not allegedly injured parties, which has garnered a fair bit of criticism.

## D. Proposed Changes

The trends discussed above, along with the criticisms levied against investor-state disputes, have led to heightened scrutiny of third-party funding from all corners of the international arbitration industry, including national regulatory authorities, trade negotiators, scholars, and arbitral institutions themselves, particularly in the areas of confidentiality, arbitrator conflict of interest, privilege, and costs.<sup>58</sup>

One of the strongest criticisms of third-party funding is that it lacks any oversight, regulation, or governing standards. One major initiative aimed at addressing those shortfalls in the context of international arbitration is the ICCA-Queen Mary Taskforce on Third-Party Funding.<sup>59</sup> Established in 2013 as a joint task force between the International Council for Commercial Arbitration (ICCA), a global NGO committed to promoting and improving the process of international arbitration, and Queen Mary University of London, a leading UK research-focused institution and one of the largest University of London colleges, the project consists of international arbitration experts from around the globe with a diverse range of expertise and experience.

As Professor Sahani explained, the goal of the task force was to study the issue of third-party funding in international arbitration from a variety of perspectives and determine whether there should be any guidelines or norms adopted by the global international arbitration community. The key issues the task force dealt with included disclosure of funding, arbitrator conflicts of interest, the reimbursements of costs, and best practices regarding how third-party funding relationships should be entered into and what funding contracts should contain. In April 2018, the taskforce issued a voluminous report<sup>60</sup> identifying and addressing major issues in third-party funding.

ICSID, the tribunal that hears the majority of today's investor-state disputes, has also proposed several rules that would govern international arbitration proceedings. While the proposed rules are currently still under revision, they contain provisions that would require disclosure of the existence of third-party funding and the identity of the funders. Professor Sahani explained that part of the reason for the proposed disclosure rule is that it would allow for the checking of arbitrator conflicts of interest.

According to Professor Sahani, there is also a trend among other entities, such as the International Bar Association, toward releasing guidelines on arbitrator conflicts of interest in international arbitration and allowing arbitrators to ask parties to disclose funding information.

## E. Industry Views

Despite the challenges presented by third-party funding in international arbitration and the criticism it has drawn, among arbitration practitioners there is a general consensus that litigation finance is a good thing.

The major focus is not on whether or not funding is proper, but rather on the actions of the funders themselves. As Professor Sahani explained:

**“Whether or not it’s good or bad depends on whether or not the practitioners in the space are acting in a scrupulous way and following guidelines, and whether or not**

## E. Industry Views, Continued

**there’s oversight in the sense that there are always going to be bad apples. There are bad apples among lawyers, right? But we have regulation, we have oversight, we have ethics, we have disciplinary proceedings for lawyers that behave badly. That does not exist for third party funding, at least in any generalized sense.”**

She continued:

**“The danger I see is the industry exploding with a lot of little players that aren’t well established and may not be well capitalized that think they’re going to dabble in this space in a way that is harmful to clients, potentially without any oversight. My view is it’s not necessarily bad yet, but it could become bad as the market explodes and more investors want to invest. I think we do need some sort of ground rules. To the extent that third party funding might be viewed as bad, it would be because there aren’t any ground rules, in my view.”**

Kirkness agreed. In his view, the question “isn’t is funding good or bad? It’s which funders are good or bad?” He likened working with funders to working with clients — “you work best with people whose values align with yours. You trust the ones that operate ethically, that have good financing, and are transparent about their sources of it.” Good funders instantly ask good questions, even if the case is not in their specialty field. They also understand that if it is a very valuable case, they might have to put quite a bit of funding into it.

With the proper ground rules and structures in place, litigation funding has the potential to be a positive thing to the extent that it might give law firms more options for raising capital. As Franck explained, third-party funding can also have a significant impact on litigation if it allows parties to hire the counsel of their choice, as counsel plays an important role in prevailing in international arbitration.<sup>61</sup>

Professor Sahani most succinctly summarized the current state of third-party funding in international arbitration: “Whether it’s good or bad, we’re past that. It’s here to stay, it’s a reality.... The tidal wave is acceptance of the practice, but let’s regulate it.”

As international commercial arbitration, investor-state disputes, and third-party funding all continue to grow in volume and prominence, the industry is likely to see an increase in regulation and oversight in the years to come.

Renewable energy arbitration and climate change disputes are rapidly expanding platforms, and as such, it is critical that all parties involved are aware of the possible benefits third-party funding can have on their claims.



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