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International Investment Law and Climate Change



International Investment Law and Climate Change: Introduction to the Special Issue

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Climate change is one of the greatest challenges of our times. Echoing a four-decade-old warning, the Intergovernmental Panel on Climate Change (IPCC), which has contributed to raising an international consensus based on solid foundations, highlighted in its 2021 Report the reality of climate change: ‘Human-induced climate change is already affecting many weather and climate extremes in every region across the globe. Evidence of observed changes in extremes such as heatwaves, heavy precipitation, droughts, and tropical cyclones, and, particularly, their attribution to human influence, has strengthened since’ the previous report. It also outlines the worst-case scenarios for the future of our planet, announcing ‘the possibility of abrupt and irreversible

changes to the climate'.¹ As stated by UN Secretary-General António Guterres, the Working Group's report is nothing less than 'a code red for humanity'.²

To cope with this challenge, the Paris Agreement was adopted at the United Nations Framework Convention on Climate Change³ Conference of the Parties (COP) 21 in 2015 after long and chaotic international negotiations. The Agreement, which is quasi-universal now with 194 Parties, provides for the reduction of carbon emissions in order to limit global warming to well below 2°C, preferably 1.5°C above pre-industrial times (Article 2.1(a) of the Paris Agreement) and for making '[f]inance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development' (Article 2.1(c) of the Paris Agreement).⁴ Reaching the Paris target for global warming requires that global greenhouse gas emissions reach net zero by 2050.⁵ Many States and regional organizations have already made pledges to this effect, including some of the world's major economic blocks, such as the European Union (EU) and the United States.⁶ Existing pledges, however, are far from sufficient⁷ and remain inconsistent with the temperature target set in the Paris Agreement. This is established annually by the United Nations Environment Programme (UNEP) in its report entitled 'The Emissions Gap', which is released before each COP. The latest report, published in 2022, estimates that even if the parties' contributions are taken altogether, they do not come close to 2°C, but rather 2.8°C.⁸ This is undoubtedly progress compared to the 4 or 5°C expected by so-called 'business-as-usual' scenarios, but we are still very far from the objective set out in the Paris Agreement and, perhaps even more importantly, from the safe operating range of our planet.⁹

- 1 Intergovernmental Panel on Climate Change (IPCC), 'Climate Change 2021: The Physical Science Basis' (IPCC, 2021) 8 <www.ipcc.ch/report/ar6/wg1/> accessed 16 October 2022.
- 2 'Environment and Climate Change' (*UN News*, 9 August 2021) <<https://news.un.org/en/story/2021/08/1097362>> accessed 16 October 2022.
- 3 United Nations Framework Convention on Climate Change (adopted 9 May 1992, entered into force 21 March 1994) (UNFCCC) 1771 UNTS 107.
- 4 Paris Agreement Under the UNFCCC (adopted 12 December 2015, entered into force 4 November 2016) (Paris Agreement) UN Doc FCCC/CP/2015/L.9/Rev/1.
- 5 IPCC, 'Global Warming of 1.5°C' (IPCC, 2018) 95 <www.ipcc.ch/sr15/> accessed 16 October 2022.
- 6 See United Nations, 'The Race to Zero Emissions, and Why the World Depends on It' (December 2020). On countries' commitments, see IPCC, 'Climate Change 2022 – Mitigation of Climate Change' (IPCC, 2022) ch 4, table 4.5 <www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_Full_Report.pdf> accessed 16 October 2022.
- 7 IPCC (n 5) 20.
- 8 UNEP, 'Emissions Gap Report 2022: The Closing Window. Climate Crisis Calls for Rapid Transformation of Societies' (UNEP, 2022) xvi.
- 9 Will Steffen and others, 'Planetary Boundaries: Guiding Human Development on a Changing Planet' (2015) 347:6223 *Science* 736.

However, the Paris Agreement and the whole international climate protection process, which was launched in 1992, is designed to drive States to increase progressively the level of ambition of their contributions; thus, even if it takes too long, a deep transition is underway. The G20 and the COP 26 have confirmed and reinforced national and regional pledges on climate neutrality. The COP 26 has, for the first time in the history of the climate regime, opened the discussion on the phasing-out of fossil fuels. Even if the wording has finally been weakened in the COP 26 overarching decision, phasing 'out' becoming phasing 'down', there has been a series of new pledges, many on novel issues that had not been addressed before in the negotiations. Side-agreements on reducing methane, halting deforestation, phasing out coal, stopping coal financing, moving beyond oil and gas, and transitioning from petrol cars to electric vehicles, among others, offer real potential for tangible progress. These numerous initiatives do not represent strong commitments from a legal point of view, and it remains to be seen if they will stimulate a new dynamic and be effectively implemented. However, if they do, such pledges will require State measures and regulations to transition from a brown to a green economy in all economic sectors, including but not limited to drastic breaks on fossil fuel production and consumption¹⁰ as well as major investments into renewable energies and other technologies that help reduce carbon emissions.¹¹

At both fronts – in incentivizing green investments and limiting carbon emissions of traditional, fossil-fuel based economic activity – State measures and regulations will bring about significant changes to the regulatory framework governing all economic sectors, whether in energy production, agriculture, transport, industrial production, services, or finance. On the one hand, such measures will result in changing and upsetting the legal frameworks that have so far existed for business operation in the brown economy. Examples are phase-outs of coal-fired power plants or prohibitions to unearth hydrocarbons.¹² On the other hand, new regulatory frameworks will have to be created and administered for channeling investments into the green economy, such as renewable energy or hydrogen production.¹³ Measures in all

10 See 'How Some International Treaties Threaten the Environment: Investor-State Dispute Settlement Provisions Are Blamed for Impeding Government Action' (*The Economist*, 5 October 2020) (estimating the value of stranded fossil fuel assets at USD 1.8 trillion).

11 See International Energy Agency (IEA), 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (IEA, 2021) 81 (estimating the annual amount of clean energy investments required to achieve carbon neutrality by 2050 to rise from currently USD 2 trillion to USD 5 trillion by 2030, and USD 4.5 trillion by 2050).

12 IPCC (n 5) 12–221.

13 See Organization for Economic Co-operation and Development (OECD), 'The Alignment of Finance Flows Under the Paris Agreement' (7th Annual Conference on Investment Treaties, Background Note, 10 May 2022); United Nations Conference on Trade and

of these sectors are likely to bring about high-value claims for breach of the protections international investment agreements (IIAs) establish for foreign investments. This concerns not only measures that limit so far permissible, carbon-intensive activity,¹⁴ but also situations where incentive schemes for low-carbon or carbon-neutral activity are adapted after their initial creation or where such schemes create other problems in their administration. This calls for an assessment of how climate change measures fare under IIAs and how IIAs and climate change interact.

On the one hand, concerns are raised that commitments under IIAs constitute obstacles to effective re-regulation of the brown economy either by requiring States to compensate foreign investors for regulatory change or by chilling regulation and making States abstain from needed regulations out of fear of investment claims and the mere risk of having to pay compensation. This is due not least to a lack of established case law of investor-State dispute settlement mechanisms. Prominently, the Intergovernmental Panel on Climate Change has acknowledged this risk in its 2022 Report.¹⁵ This perspective on the relationship between IIAs and climate change has given rise to calls to reform or even dismantle the IIA regime in order to ensure that regulation of the brown economy is not chilled in a way that contributes to missing the Paris target.¹⁶ It is supported by challenges to IIA commitments before human rights bodies.¹⁷

On the other hand, the potential for commitments under IIAs and the dispute settlement mechanisms they offer to make a positive contribution towards ensuring predictable and sufficiently stable legal frameworks and to mitigate political risk to channel investments into climate-friendly technology and energy production is stressed. This perspective on the relationship between IIAs and climate change, which is explored currently as part of the

Development (UNCTAD), 'International Investment in Climate Change Mitigation and Adaptation. Trends and Policy Developments' (UN, 2022).

14 See Kyla Tienhaara and others; 'Investor-State Disputes Threaten the Global Green Energy Transition' (2022) 379 *Science* 701 (discussing and quantifying claims in the fossil fuel sector); Joe Tirado and Alejandro I Garcia, 'Rise of Renewable Energy Claims' (2015) 16 *Renewable Energy Focus* 14 (providing an overview over cases resulting from the re-regulation of renewable energy investments).

15 IPCC (n 5) 14–81 (stating that 'there are still examples of international cooperation having a chilling effect on climate mitigation, particularly through financing and investment practices, including legal norms designed to protect the interests of owners of fossil assets').

16 See eg Tienhaara and others (n 9).

17 See Linnéa Nordlander and Alessandro Monti, 'New Variety of Rights-Based Climate Litigation: A Challenge Against the Energy Charter Treaty Before the European Court of Human Rights' (*EJIL:Talk!*, 22 June 2022).

work of the Organization for Economic Co-operation and Development on investment treaty reform,¹⁸ considers IIAs as part of the legal framework to make finance flows consistent with reaching carbon neutrality, as laid down in Article 2.1(c) of the Paris Agreement, while stressing the need to avoid negative effects of IIAs on regulating carbon-emitting industries.

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The contributions to the Special Issue, which resulted from the presentation of draft papers received in response to an open call for papers at a webinar held under the auspices of our respective institutions on 18 and 19 November 2021, analyze the tensions between international investment law and climate change measures and explore responses of different actors involved in the IIA regime to those tensions, including most importantly States and investment arbitrators.

In the first contribution, Mala Sharma provides an overview of the tensions between the investment and climate change regimes, attributing them to a problem of institutional and structural fragmentation.¹⁹ She then argues that all actors in the investment treaty regime, that is, States, arbitrators, arbitration institutions, and counsel, bear responsibility for resolving resulting tensions and have an obligation to mitigate climate change. While States can and should engage in redrafting investment treaties to make them climate compatible, arbitrators should develop interpretive approaches to alleviate tensions, arbitration institutions should adapt the procedural law and practice to confronting climate change, and counsel should develop the arguments tribunals can then draw on in their decision-making.

The two contributions that follow then zoom in on changes States make to investment treaty language that aim at responding to the climate challenge. Markus Gehring and Marios Tokas look at changes to treaty language that are geared towards integrating investment liberalization and protection, on the one hand, and climate change, on the other.²⁰ Building on the EU's approach to not only adapt its internal policies to confronting climate change, but also to make its trade policy and trade agreements consistent with its

18 See OECD (n 12) 13–17. See also the discussion on IIA reform for climate action in UNCTAD (n 13) 13–22.

19 Mala Sharma, 'Integrating, Reconciling, and Prioritising Climate Aspirations in Investor-State Arbitration for a Sustainable Future: The Role of Different Players' (2022) 23(5–6) JWIT 746.

20 Markus Gehring and Marios Tokas, 'Synergies and Approaches to Climate Change in International Investment Agreements: Comparative Analysis of Investment Liberalization and Investment Protection Provisions in EU Agreements' (2022) 23(5–6) JWIT 778.

climate ambitions,²¹ they survey the new generation IIAs the EU is negotiating and note positive developments in how these agreements create synergies between investment liberalization and regulation and climate change policies.

Johannes Tropper and Kilian Wagner then turn to the current modernization process of the Energy Charter Treaty (ECT), a sector-specific trade and investment agreement that has given rise to numerous arbitrations by foreign investors both in the fossil-fuel and renewable energy sector and that bears great responsibility for the concerns expressed about IIAs being an obstacle to successfully mitigating climate change.²² They analyze the EU's proposal to adapt the ECT – which includes limiting protections to fossil-fuel investments and enhancing States' right to regulate and their commitment to sustainable development – and is partly reflected in the agreement in principle reached by the ECT members in June 2022.²³ Despite positive developments, Tropper and Wagner cast doubt on whether the EU proposal is sufficiently protective of climate-friendly investments and could hence serve as a more general model for a climate-friendly IIA.

The next set of contributions turns from State-led reform of IIAs to the role that interpretation and application of investment treaties to climate change measures before investment tribunals can play in meeting climate objectives. Josephine Dooley focuses on the question of whether traditional investment treaties that have not been reformed specifically to confront climate change indeed limit States' policy space to take mitigation measures.²⁴ She examines classical investment law doctrines, such as the police powers doctrine, as well as other widely accepted principles of international law, such as the prevention and precautionary principles, and considers to what extent these can be used, in tandem with States' specific commitments under the Paris Agreement, to interpret and apply old-generation investment treaties in order to confront climate change without incurring international responsibility.

21 See Council of the EU, 'Council Conclusions on Climate and Energy Diplomacy – Delivering on the External Dimension of the European Green Deal' (3784th meeting, Brussels, 25 January 2021).

22 Johannes Tropper and Kilian Wagner, 'The European Union Proposal for the Modernisation of the Energy Charter Treaty – A Model for Climate-Friendly Investment Treaties?' (2022) 23(5–6) JWIT 813.

23 See European Commission Directorate-General for Trade, 'Agreement in Principle Reached on Modernised Energy Charter Treaty' (News Article, 24 June 2022) <https://policy.trade.ec.europa.eu/news/agreement-principle-reached-modernised-energy-charter-treaty-2022-06-24_en> accessed 11 October 2022.

24 Josephine Dooley, 'The Co-Existence of Mitigation and International Investment Law: A Practical Assessment of Climate Change Action Under Less "Green-Friendly" Investment Agreements' (2022) 23(5–6) JWIT 849.

Dooley concludes that old-style IIAs provide sufficient room for interpretation and therefore can be applied in a way that leaves broad policy space. They do require, however, that States carefully plan and tailor their measures so that they are non-discriminatory and proportionate.

Gian Maria Farnelli then considers the potential for a quite different use of investment treaties, namely whether the treaties can be used actively by foreign investors to hold States accountable for not complying with environmental obligations, including those to mitigate climate change, whether under domestic or international law.²⁵ This perspective is particularly important for investors in climate-friendly technologies, renewable energy productions, and investments that depend in other ways on the protection of the environment and climate. While precedent is still scarce, Farnelli shows that investment treaty tribunals possess the jurisdictional basis to entertain such claims, can hear environmental arguments, and are in a position to apply environmental law. This way, investment tribunals could make an important contribution to making States comply with their environmental and climate-change-related promises, including those made in the implementation of the Paris Agreement.

Finally, Laura Létourneau Tremblay assesses whether and how investment treaty language that has been reformed to permit measures for the protection of the environment and to mitigate climate change can make a difference in the resolution of actual disputes and whether it secures the policy space States need for that purpose.²⁶ To answer this question, Létourneau Tremblay takes the majority decision on liability in *Eco Oro v Colombia*²⁷ and ‘re-writes’ its reasoning on fair and equitable treatment as if it were based on reformed and more policy-space-friendly treaty language. While the underlying dispute did not concern a climate change measure, but the protection of the investor’s interest to mine in a given area against public concerns in the protection of the local ecosystem, the re-writing exercise indicates that reformed treaty language can be effective in giving States additional policy space. The same could apply by implication to climate change measures. At the same time, investment treaty reform, Létourneau Tremblay argues, will only achieve piecemeal change and take away the hardest edges of investment protection, but it will not lead to fundamental paradigm shifts and will maintain certain protections of investments.

25 Gian Maria Farnelli, ‘Investors as Environmental Guardians? On Climate Change Policy Objectives and Compliance with Investment Agreements’ (2022) 23(5–6) JWIT 887.

26 Laura Létourneau Tremblay, ‘In Need of a Paradigm Shift: Reimagining *Eco Oro v Colombia* in Light of New Treaty Language’ (2022) 23(5–6) JWIT 915.

27 *Eco Oro Minerals Corp v Republic of Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum (9 September 2021).

The final two contributions turn from more general questions, namely approaches to treaty interpretation and treaty reform, to more specific concerns in the relationship between international investment law and climate change. Ji Ma's contribution departs from the observation that confronting climate change will not only require adaptation of classical economic activity, but also make use of enhanced digitalization in the move towards a green economy.²⁸ In this context, forced technology transfer especially in developing economies, which may interfere with intellectual property rights (IPRs) of foreign investors, are increasingly important and could lead to investment disputes. Ma's article assesses the strength of such claims and argues that the interaction between investment protection, IPRs, and climate change measures adds complexity that must be further researched and taken into account in tailoring responses to climate change, not only in the real, but also the digital economy.

Last but not least, Matteo Fermeiglia moves away from exploring the limits the substantive standards of treatment in IIAs set for climate change mitigation and considers the calculation of quantum in case State measures require compensation or the payment of damages.²⁹ His focus is on changes to legal frameworks that aim at incentivizing investments into climate-friendly technologies, which may become necessary because of the long-term horizon of such investments and the difficulties of maintaining absolute stability over time because of changing economic variables, such as technology-specific risk premiums or the evolution of interest rates, or changes in the underlying technology that may upset initially promised incentives. While not arguing that such changes necessarily should be permissible under investment treaties, Fermeiglia argues that the calculation of quantum should be revisited to make re-regulations less costly for States, while still maintaining sufficient protections of foreign investors in climate-friendly investments. Although addressing a specific factual context, the more general conclusion to take from this article is that tensions between investment law and climate change cannot only be addressed by granting additional policy space at the level of primary norms, but also by arbitrators and States revisiting remedies and the calculation of compensation.

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28 Ji Ma, 'Moving from the Brown Economy to the Green Economy: The Battle over International Intellectual Property' (2022) 23(5–6) JWIT 947.

29 Matteo Fermeiglia, 'Cashing-In on the Energy Transition? Assessing Damage Evaluation Practices in Renewable Energy Investment Disputes' (2022) 23(5–6) JWIT 982.

All in all, the perspectives, specific topics, and methodologies of the contributions to this Special Issue are varied and cannot comprehensively address the relationship between the investment treaty and climate change regimes. Still, they are agreed that tensions exist and that reform of the IIA regime and its dispute settlement mechanism is an important and feasible avenue to alleviate, if not avoid conflicts with the climate change regime. In fact, as the contributions show, the IIA regime is already changing, and tools exist not only for avoiding that the IIA regime stands in the way of the objectives of the Paris Agreement but that it becomes part of the required transformation of the economy and the legal framework necessary for this purpose. As such, the contributions may only be pieces in a larger puzzle, but they show that the tools for adapting the investment treaty regime to the climate challenge are there. It is now for them to be used accordingly, urgently.