Overcoming International Investment Agreements as a Barrier to Climate Action:
A Toolkit to Safeguard Fossil Fuel Measures from Investment Treaty Claims
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Executive Summary

The science is unequivocal: Fossil fuels are the overwhelming driver of climate change, and rapidly ending dependence on them is essential to avoiding further, catastrophic harm. Yet governments that take action to accelerate the transition away from oil, gas, and coal face an escalating risk of legal challenge from foreign investors over the perceived impacts of such measures on their investment returns or other costs imposed. Fossil fuel companies are among the biggest users of investor-State dispute settlement (ISDS), which allows foreign investors to bring arbitration claims against governments to obtain compensation for losses they claim to incur as a result of government regulations or decisions.

The prospect of such claims, which often involve substantial costs and awards reaching the millions or even billions of dollars, may dissuade governments from undertaking urgently needed climate actions. Judgments that award fossil fuel companies compensation ultimately force States to pay polluters, rather than make polluters pay for the climate consequences of their operations. Policymakers and experts around the world are increasingly recognizing ISDS as a significant legal barrier to the necessary phaseout of fossil fuels. But it is not an insurmountable one.

Understanding how to prevent, minimize, and manage ISDS risk is essential to preserve policy space and enable States to fulfill their legal obligations concerning climate change, including the duty to regulate business conduct that foreseeably harms people and the environment. This toolkit discusses measures States and advocates can pursue to remove the risk of ISDS, reduce States’ exposure to investment arbitration claims, and respond to claims if and when they arise.

Just as States created the investment law regime, States can dismantle or modify it in accordance with evolving needs and priorities. Certain measures can effectively eliminate ISDS risks, whereas others can mitigate or manage such risks. Among the strategies available to States to prevent the use and abuse of ISDS to challenge climate policies is the withdrawal from or termination of existing investment agreements that provide for investor-State arbitration. Exiting or ending agreements can be justified on distinct legal grounds, including instances where fundamental changes in circumstances warrant departure from or suspension of a specific treaty regime. States can also exclude certain sectors, such as fossil fuels, or certain policy measures, such as greenhouse gas (GHG) emissions regulations, from the scope of investment agreements between them, or from laws that allow ISDS. Other options include removing ISDS-related clauses from existing agreements or withdrawing State consent to arbitration. Implementing such measures is not without challenge, but various legal procedures and arguments can be invoked to support States in removing or limiting ISDS.

Additional options are available to reduce the risk of ISDS. States can strengthen environmental or public policy exception clauses in investment treaties or clarify their interpretation to reduce the viability of investor claims against State climate action, and thereby deter investors from bringing challenges. States can also design and adopt climate measures in a way that minimizes their vulnerability to challenge under investment law, including by ensuring transparency,
proper adherence to due process, and non-discrimination against foreign investors, and by expressly grounding the rationale for such measures in States’ concurrent legal duties to act on climate.

If an investor lodges an arbitration claim against State action on climate generally, or fossil fuels specifically, States can assert a number of jurisdictional responses to preclude adjudication, as well as substantive legal arguments on the merits or challenges to the valuation of fossil fuel investment assets and the compensation owed, among other defenses. Non-disputing States can intervene in an action to clarify the interpretation of the relevant investment agreement if they are a party to it, thereby potentially influencing the outcome and mitigating the risk of similar claims against them in the future. Non-parties, including interested civil society organizations and communities, can, in turn, raise the public profile of the dispute or seek to make a submission to the arbitration tribunal when they can demonstrate that their involvement and expertise would assist in the resolution of the dispute.

This toolkit serves to elucidate these various measures for removing, reducing, or responding to ISDS risks within the context of the transition away from fossil fuels. It aims to equip readers with an understanding of potential pathways to blunting the threat of investment arbitration. While largely focused on ISDS in the energy sector, particularly in relation to oil, gas, and coal, the toolkit remains relevant to other environmentally sensitive activities. It is a dynamic document, subject to periodic updates to accommodate evolving developments and emerging facts. The strategies and tools outlined herein are neither exhaustive nor prescriptive; States and advocates navigating this domain may find some approaches and arguments more appropriate than others depending on national circumstances and capacities.

The scale, pace, and severity of the climate crisis demand coordinated action to tackle its chief cause: fossil fuels. Individually or collaboratively, States are encouraged to pursue available and effective options to overcome the obstacle that ISDS poses to urgently needed climate action. Our collective futures and those of generations to come depend on it.
Introduction
Confronting Investor-State Dispute Settlement Risks to Climate Action

The unprecedented and accelerating global climate crisis demands urgent government action to curb its primary cause: the production and use of fossil fuels. Oil, gas, and coal generate the overwhelming majority of planet-warming greenhouse gas emissions. They also have significant adverse impacts on the environment, health, and human rights. Ending reliance on fossil fuels is essential to avoid further, catastrophic climate change. However, necessary State measures to halt new extraction of oil, gas, and coal, phase out their production and use, shut down existing fossil fuel facilities, and accelerate the transition to fossil-free, renewable alternatives may face legal challenges from investors under international investment arbitration. Provisions under some treaties, contracts, and national laws allow foreign investors to sue a State for compensation when regulation, denial or revocation of licenses, or other State action allegedly harms their returns. Some fossil fuel companies have already done so, and others may follow. The purpose of this toolkit is to assist States and advocates in confronting the challenge of investment claims in the context of fossil fuel-related environmental action. It provides strategies for eliminating, minimizing, or addressing the risk of investor-State dispute settlement (ISDS).

To date, the fossil fuel industry has been a dominant user of ISDS, with at least 231 known treaty-based ISDS claims involving fossil fuel investments — noting that there are many more claims based on investor-State contracts or national laws. Recent years have demonstrated that the threat of ISDS claims over fossil fuel-related climate mitigation measures is not hypothetical. As an example, German energy companies Uniper and RWE initiated arbitration proceedings against the Netherlands under the investment protection provisions of the Energy Charter Treaty (ECT) — a multilateral framework for energy cooperation that includes investment obligations — alleging that the government’s plan to phase out coal by 2030 in line with the Paris Agreement constituted expropriation without adequate compensation. Foreign investors have similarly brought claims against Canada for measures to phase out coal-fired electricity generation, revoke a permit for oil and gas exploration, and reject a proposed liquefied natural gas (LNG) project. The United States (US) is also currently facing arbitration claims arising from the Biden Administration’s revocation of the permit for constructing and operating the Keystone XL Pipeline. And after a legislative ban on offshore oil and gas drilling thwarted its plans to develop an oil project off the Italian coast, a British oil and gas exploration company brought an arbitration claim against Italy under the ECT, receiving an award of over €180 million (plus interest). These instances could mark the beginning of a broader trend. International investment agreements (IIAs), investor-State contracts, and local regulations protect a considerable number of projects related to fossil fuels. However, to limit the increase in worldwide average temperatures to 1.5°C, governments must forgo the development of numerous identified fossil fuel reserves. Such action means many investment-protected fossil fuel projects may be forced to cease or shut down early, potentially leading to legal claims under investment laws.

Even in the absence of actual claims, the looming prospect of arbitration can deter climate initiatives. Arbitration tribunals (also referred to as arbitral tribunals) lack the authority to suspend or overturn regulations, meaning ISDS claims cannot compel the amendment or repeal of domestic measures. Nevertheless, these tribunals wield authority to grant substantial monetary compensation for breaches of investment protection standards, often reaching values in the millions or even billions of US dollars. The potential obligation to pay such significant sums and the expenses associated with defending against arbitration claims can exert a “chilling effect” on domestic measures intended to implement environmental or climate action.
The opaque nature of ISDS proceedings and methodological challenges make it impossible to quantify precisely how many State measures and regulations have been subject to ISDS claims, let alone how many contemplated or proposed measures have succumbed to the threat of ISDS. However, the risk of facing a substantial arbitration award and the costs of arbitration defense have become a potent disincentive for States to pursue certain climate policy measures that could adversely impact foreign investors. For instance, Denmark and New Zealand have acknowledged that the threat of ISDS hindered their climate policy ambitions. This chilling effect has been recognized in reports presented at the UN General Assembly, as well as by the Intergovernmental Panel on Climate Change (IPCC) and arbitrators.

While the risks associated with ISDS accumulate, the supposed benefits of investment arbitration have failed to materialize. Experts have argued that ISDS is a valuable tool to attract investment. However, recent research reveals little evidence of the touted benefits of IIAs and ISDS, but unexpectedly high costs. Although defenders of IIAs, particularly the ECT, often assert that it has a positive influence on foreign direct investment inflows in the renewable energy sector, various studies have failed to support this argument. Therefore, it is difficult for States to justify the continuation of their investment agreements, especially those that include ISDS provisions.

Investment disputes may emerge from breakdowns in coordination within governments. For instance, conflicts may arise when environmental ministries, in their pursuit of more rigorous environmental and social impact assessments, conflict with the commitments outlined in IIAs, domestic laws, or investment contracts. This could include canceling fossil fuel licenses, permits, and contracts for exploration or exploitation of oil, gas, or coal. Likewise, trade ministries might introduce IIAs, investment contracts, or investment laws that, in practice, diverge from environmental and human rights obligations and regulations. To avoid, prevent, and mitigate potential conflicts, it is crucial to enhance coherence across various ministries and the broader approach of States to international investment law. This requires alignment between any investment treaties, laws, and contracts with environmental and human rights laws and obligations at international and domestic levels. Such coherence ensures that these instruments collectively advance the public interest and are consistent with States’ policy objectives and legal obligations.

In this context, States have ample tools to neutralize the threat of ISDS. Just as States established international investment law and the ISDS system, States have the power to dismantle the system or reform it, to limit its scope and impacts. As awareness of the threat ISDS poses to environmental and climate change policy has grown, States have started implementing various measures at international, regional, bilateral, and national levels. Some have opted to terminate their investment treaties, either unilaterally or by consent (with or without renegotiation). Others have decided to pursue reforms of ISDS bilaterally, multilaterally, or under the auspices of different forums. Some of those reforms have aimed at altering the substantive provisions in IIAs, while others address the procedural rules governing ISDS or the scope of ISDS in contracts and national laws.

This toolkit lays out some of those options and other strategies that States have to remove, reduce, or respond to treaty-based threats of ISDS. Part I describes measures that can eliminate treaty-based ISDS risks. Part II discusses options that can mitigate but not fully eliminate these risks. Drawing on recent cases and analysis, Part III reviews avenues that States and other actors can take if ISDS claims arise. The measures discussed in this toolkit are not intended to be comprehensive or exhaustive; they offer a sample of possible approaches States may pursue in the face of ISDS threats. Not all options will be equally appropriate or feasible for every State at all times. The suitability of a given approach will depend on a State’s unique circumstances and the timeframe for addressing ISDS-related risks — whether in the short, medium, or long-term. States can choose individual or cumulative measures based on their national context and adopted plans. What is clear and uniformly applicable, however, is that investment law must not impede urgently needed climate action, without which all countries will suffer.
Part I
Removing the Risk: Options to Eliminate Treaty-Based ISDS Risks

To eliminate the risk of treaty-based ISDS, States can employ various measures, including the termination or withdrawal from investment treaties (1.1), implementing treaty carveouts (1.2), removing ISDS provisions (1.3), and withdrawing consent to ISDS (1.4).

These measures do not carry the same legal implications. States choosing between these measures should consider their specific circumstances and desired outcomes. Termination or withdrawal from investment treaties (1.1) signals a State’s exit from certain treaty obligations, while treaty carveouts (1.2) involve specific provisions to exclude certain sectors or measures from treaty protection. Removal of ISDS provisions (1.3) entails a deliberate decision to eliminate the mechanism from existing agreements, and the withdrawal of consent to ISDS (1.4) represents a more targeted approach, indicating a State’s refusal to engage in ISDS proceedings. Each measure has distinct legal consequences and strategic considerations that States should weigh based on their unique national circumstances and approaches.

1.1 Termination of or Withdrawal from Treaties

Treaty termination and withdrawal are common practice.

Treaty termination and unilateral withdrawal are routine occurrences under international law. In the context of IIAs, the United Nations Conference on Trade and Development (UNCTAD) has documented a trend of more treaties being terminated than adopted: “[I]n 2022, countries concluded 15 IIAs. For the third consecutive year, the number of effective treaty terminations exceeded that of new IIAs, with 84 terminations.”26 Similarly, a study found 1,547 instances of denunciation and withdrawal from 5,416 multilateral agreements registered with the UN between 1945 and 2004.27 Based on these findings, the study concluded that “denunciations and withdrawals are a regularized component of modern treaty practice.”28 In the context of fossil fuels, termination of IIAs is likely to increase due to their incompatibility with the pace of decarbonization of the energy sector and the intensity of emissions reduction efforts needed to comply with State duties to act on climate change.

States can unilaterally indicate their intent to terminate all or some of their investment treaties — and some have already done so. Experience with the ECT may be a harbinger of what is to come. For example, in 2022 and 2023, several European Union (EU) Member States announced their intention to unilaterally withdraw from the ECT on the basis that the Treaty, even if reformed in line with a modernization proposal, is inconsistent with urgently needed climate change policies.30 The European Parliament and Commission have both adopted the position that the EU and its Member States should pursue a coordinated withdrawal from the ECT.31

Conditions and legal effects of termination and withdrawal from investment agreements

Termination of or unilateral withdrawal from an IIA is, in principle, the strongest way for a State to eliminate the risk of ISDS. It frees the State from treaty obligations and potential ISDS claims. The practical effect of termination or withdrawal from an IIA can be delayed if the treaty includes a sunset clause, which provides for continued application of the treaty’s protections to covered investments for a specified period of time following termination (see Sunset clauses below).

Termination of an IIA typically refers to the unilateral or mutual end of the entire agreement by one or both parties. Barring any applicable sunset clause, a terminated agreement is without legal effect, and the parties are no longer bound by its terms. Termination can arise for diverse reasons, including a party’s failure to fulfill obligations, the occurrence of
a specified event or condition, or a mutual decision between the parties. **Withdrawal**, however, is a specific action that one State takes to exit or discontinue its participation in an IIA. Withdrawal does not necessarily terminate the agreement, and the agreement itself may continue to exist between other parties. In the context of multilateral investment agreements, some States may seek to exit the treaty, while others may choose to remain parties to it.

According to the Vienna Convention on the Law of Treaties (VCLT), the termination of a treaty: “(a) releases the parties from any obligation further to perform the treaty; [and it] (b) does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination.” The same principle applies in the case of a withdrawal, and it takes effect at the moment the withdrawal becomes effective. In the context of IIAs, if there is no sunset clause when termination or withdrawal becomes effective, States’ obligations to foreign investors under the treaty cease to exist, while States retain obligations under customary international law and other existing legal instruments.

According to the VCLT, distinct legal grounds may justify withdrawal from or termination of agreements. Typically, bilateral (and multilateral) investment treaties contain termination provisions, which detail the applicable procedure for the termination of the treaty and its legal consequences. While the specific wording and content of these provisions vary from IIA to IIA, they usually indicate the period of notification prior to the expiry of the treaty’s validity, typically ranging from 6 to 12 months. If the treaty does not have a termination clause, then other provisions of the VCLT apply. They include:

- Article 54 (b), which provides that withdrawal or termination can take place “at any time by consent of all the parties after consultation with the other contracting States”;
- Article 60, which addresses the termination or suspension of a treaty’s operation due to a material breach by one of the parties, providing a unilateral option for the aggrieved party when there is a substantial violation of the treaty’s terms; and
- Article 62, which outlines the possibility of withdrawal or termination in case of a fundamental change of circumstances, unforeseen at the time of the treaty’s conclusion, and recognized as affecting the essential basis of the consent of the parties to be bound.

These legal provisions offer a framework for States to withdraw or terminate treaties based on specific circumstances and reasons.

**Withdrawing from Enforcement Regimes:**

Another way to remove or reduce the risk posed by ISDS

Besides IIA termination, States can also opt to withdraw from other agreements, such as the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention) or the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

The ICSID Convention is an international agreement under the auspices of the World Bank Group that establishes a global framework for settling investment disputes between contracting States and investors of other contracting States. Member States Party to the
ICSID Convention agree to submit investment disputes to arbitration tribunals, resulting in the tribunal’s being conclusive and enforceable. The ICSID Convention also facilitates recognizing and enforcing arbitral awards in Member States while incorporating a restricted annulment mechanism reserved for exceptional cases. As of 2023, there are 165 signatories to the ICSID Convention, 158 of which have ratified the Convention in accordance with their own constitutional procedures.  

By withdrawing from the ICSID Convention, a State is no longer obliged to use ICSID’s dispute resolution mechanisms for future investment disputes or to enforce ICSID arbitral awards. States may withdraw from the ICSID Convention by giving six months’ written notice to the depositary of the Convention.  

After denunciation (withdrawal), the Convention continues to apply to investment disputes existing prior to the denunciation. In this respect, several countries have withdrawn from or never joined the ICSID Convention, including Bolivia, Ecuador, Venezuela, and Brazil. In 2007, during the Fifth ALBA-PTA Summit, Bolivia, Venezuela, and Nicaragua proclaimed their intention to withdraw from ICSID in order to guarantee their sovereign right to regulate foreign investment on their national territories and to reject “legal, diplomatic and media pressure” exercised by some multinational companies.  

Importantly, withdrawal from the ICSID Convention does not extinguish the risk of arbitration entirely. IIAs, as well as domestic laws and investment contracts, may still rely on arbitration as a mechanism to resolve investor-State disputes. However, withdrawal from the ICSID Convention eliminates the option for investors to directly access investment arbitration under ICSID and the enforceability of investment awards.

The New York Convention is designed to streamline the global recognition and enforcement of foreign arbitral awards by national courts. As of 2023, the Convention counts 172 States Parties. It seeks to ensure that courts respect arbitration agreements by preventing access to judicial forums when a case is subject to arbitration. The New York Convention applies to the enforcement and recognition of foreign arbitral awards. However, each State may reserve the application of the New York Convention to arbitral awards arising out of commercial disputes. Whether awards rendered in the context of investment treaties qualify as commercial under the New York Convention will depend on the reservations made by States. Some national courts have concluded that investment treaty arbitration can be considered commercial for the purposes of the New York Convention.

Although no State has done so to date, any State Party may denounce the New York Convention by written notification to the Secretary-General of the UN. Denunciation takes effect one year after the Secretary-General receives such notice.

Similar to the withdrawal from the ICSID Convention, withdrawing from the New York Convention has the legal effect of rendering investment arbitration awards non-enforceable in the jurisdictions that are Party to the Convention. Thus, withdrawing from this Convention would impact the enforceability and recognition of arbitral awards in the signatory countries, potentially creating challenges in executing awards across borders.
States can terminate agreements individually and may even decide to terminate multiple agreements at once. For the latter, States can terminate treaties through bi-, pluri- or multilateral agreements, although simultaneous termination requires coordination and agreement with other parties. As an example of a plurilateral termination agreement, in 2020, EU Member States decided to terminate all their 190 intra-EU bilateral investment treaties (BITs) through a single termination agreement. This decision followed a determination by the European Court of Justice in March 2018 that investor-State arbitration clauses in intra-EU BITs were not compatible with EU law, specifically the Treaty on the Functioning of the European Union (TFEU). Coordinated action on IIA termination (or other coordinated actions such as in the context of interpretative statements, carveouts, or withdrawal of consent, see 1.2, 1.4, and 2.2 below) can be seen in other regions. For example, in Africa, States have worked together on IIA policy and recently negotiated the African Continental Free Trade Area Investment Protocol, which calls for the termination of existing intra-African BITs — including their sunset clauses — within five years of entry into force.

To date, one of the limitations on IIA reform has been the lack of coordinated action or approaches between States. Despite a growing consensus on the need for reform, current reform processes are fragmented, leading to different approaches and scopes. The varying mandates and priorities of different negotiating forums further complicate the coordination or integration of ISDS reform.

Treaty termination or withdrawal due to a fundamental change of circumstances

One of the ways States can justify unilateral termination or withdrawal of an IIA is by invoking a fundamental change of circumstances under the VCLT. This approach has garnered attention in public discussions and academic literature, with specific reference to its application in the context of the ECT.

Article 62 of the VCLT allows for the termination, withdrawal, or suspension of a treaty’s operation in cases where unforeseen circumstances arise, leading to a fundamental change in the party’s obligations under the treaty. Also known as the *rebus sic stantibus* doctrine, its purpose is to counterbalance the principle of *pacta sunt servanda* found in Article 26 of the VCLT, which holds that States remain bound by the obligations under a signed agreement as long as the treaty obligations persist. Article 62 of the VCLT places two limitations on the invocation of a fundamental change of circumstances, namely: “(a) if the treaty establishes a boundary, or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.”

According to Article 62 of the VCLT, five conditions need to be fulfilled to successfully invoke a fundamental change of circumstances:

(i) The change of circumstances must be fundamental in nature. This requirement implies an impactful change of circumstances preventing States from invoking any change as grounds for treaty termination. A “fundamental” change “must be an objective change in the factual circumstances relating to the treaty and its operation, and not merely a subjective change in the attitude towards the treaty of the party invoking the principle.” Moreover, in its jurisprudence, the International Court of Justice (ICJ) considered “the traditional view that the changes of circumstances which must be regarded as fundamental or vital are those which imperil the existence or vital development of one of the parties.”

(ii) The “fundamental change” must apply to circumstances that existed when the treaty was concluded. In this context, the circumstances upon which the treaty parties based their consent are considered significant. The circumstances can be virtually any type, such as “factual, political, legal, economic, or social.”
(iii) The parties did not foresee the change when the treaty was concluded (meaning when the final text was agreed). Article 62 of the VCLT stipulates that the fundamental change in circumstances argument may only be invoked if parties did not foresee the change at the time they established the agreement. While the Special Rapporteur on the law of treaties has talked about an objective change of circumstances, not just a change in how the circumstances are perceived, the criterion regarding foresight turns on what the parties subjectively foresaw, not what a reasonable party could have foreseen.  

(iv) The circumstances that have changed constituted an essential basis of the consent of the parties to be bound by the treaty. For a change to qualify as altering the circumstances that were an indispensable foundation of the parties’ consent, it must impact the facts that led the parties to give their consent.

(v) The effect of the change radically transforms the extent of obligations still to be performed under the treaty. The International Law Commission has not clarified what constitutes a radical transformation. Based on the plain meaning and connotation of the word “radically,” the parties’ obligations must be affected significantly or to a large extent. Addressing a State’s argument in one case that a change of circumstances justified treaty termination, the ICJ noted that “[t]he change must have increased the burden of the obligations to be executed to the extent of rendering the performance something essentially different from that originally undertaken.”

The provision’s wording and previous jurisprudence indicate that the conditions stipulated in Article 62 of the VCLT apply cumulatively.

As of January 2024, no State has invoked Article 62 of the VCLT to terminate an agreement in the context of climate change. However, recent publications suggest that climate change could constitute a plausible basis for invoking Article 62 of the VCLT to terminate certain IIAs, particularly the ECT. Article 62 depends on what the State or States in question actually foresaw and necessitates a treaty-by-treaty assessment. The arguments outlined below may not be universally applicable to all investment agreements. Instead, they necessitate an individualized analysis for each specific case. However, they can offer some insights into how Article 62 could be relevant to investment agreements amid climate-related changed circumstances, particularly those pertaining to fossil fuels.

Climate change presents an existential threat to humanity, jeopardizing the very existence of certain States. The escalating severity and rapid acceleration of climate change impacts exceed many prior projections, necessitating a reevaluation of the scale, types, and timing of required mitigation and adaptation measures.

For example, it has been argued that climate change was widely acknowledged as a risk during the negotiation of the ECT in 1994. Still, Parties’ understanding of the extent of that risk and forecast of the nature and speed of necessary response measures has fundamentally changed since. The 1990 IPCC report, which informed the 1992 UN Framework Convention on Climate Change (UNFCCC), outlined various greenhouse gas emission scenarios for 2025, contingent on government policy actions. While the IPCC identified energy, and particularly fossil fuels, as the primary source of anthropogenic radiative forcing, it discussed various strategies for addressing climate change. Decreasing reliance on fossil fuels was just one option, among many others. The ECT was drafted amid this context and cited to the UNFCCC in its preamble, with an apparent understanding that the promotion of fossil fuel production, trade, and utilization could align with the objectives of the climate Convention.

However, that assumption has since been proven wrong. Climate science is now clear that the only viable approach to achieving the objective of the UNFCCC— “stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system” —is the rapid and substantial
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— namely, measures to rapidly end the production and use of fossil fuels. Performing the State’s obligations under an investment treaty that protects fossil fuel projects is “essentially different” in these changed circumstances, because it conflicts with the duty and possibility to protect human rights and the planet. In fact, those incompatibilities have become so present that experts and authoritative institutions are increasingly pointing out the incompatibility of IIAs with climate mitigation measures.  

Furthermore, the impacts of climate change have proven to be more severe and occur earlier than initially anticipated. In other words, if the current circumstances were present when some IIAs — including the ECT — were signed, parties may have structured them with significantly different terms or not entered into them at all. In the context of the ECT, the fact that many States, even after having spent years renegotiating the Treaty’s provisions, are terminating their participation due to its incompatibility with climate action illustrates this point.

Under customary practice and principles of good faith and transparency in international relations, States wishing to invoke Article 62 of the VCLT would be advised to cite a fundamental change of circumstances in their termination notification.

Sunset clauses and their neutralization

Sunset clauses — sometimes also referred to as survival or grandfathering clauses — guarantee that all investments made before the termination of a treaty continue to be protected for a certain period, typically ranging from 5 to 20 years beyond the treaty’s termination or a party’s withdrawal. Sunset clauses create an “entrenchment effect” that can limit governments’ ability to be released from their treaty obligations immediately. Therefore, if a State terminates or withdraws from a treaty, it may remain bound by some or all of the provisions as contained in the treaty by virtue of the triggered survival clause. In the case of IIAs, survival clauses ensure the continued protection of investments made before the termination of or withdrawal from the IIA for a given period. Consequently, investors
can sue or submit claims before an arbitration tribunal under the IIA after its termination and within the survival period. For example, Italy withdrew from the ECT in 2016 but was later involved in the ISDS case submitted by the UK Company, Rockhopper, regarding the ban on coastal oil drilling.

States can agree to terminate sunset clauses by mutual agreement before terminating an IIA. The neutralization of survival clauses in IIAs is not without precedent. For example, when Indonesia and Argentina reached a mutual agreement to terminate their BIT, they reportedly neutralized the sunset clause by mutual agreement before withdrawing from the treaty. In its termination agreement, the EU also removed the legal effects of the sunset clauses contained in any intra-EU BIT. By January 2024, no claims have been based on a neutralized survival clause, and no arbitration tribunal has thus been confronted with the question of jurisdiction under such circumstances. It, therefore, remains to be seen whether arbitration tribunals will uphold or reject jurisdiction because of neutralization, should such a situation arise. However, evolving practice indicates that neutralization is effective, as it manifests the will of the contracting parties and decreases the likelihood of success of claims for the investor when pursuing arbitration.

In the event of a successful application of Article 62 of the VCLT (pertaining to a fundamental change of circumstances) to terminate a treaty, such termination would likely extend to the entire IIA or BIT, including any associated sunset clause. This termination would consequently relieve the parties of their obligations under the treaty. Notably, when a State invokes grounds for the termination of a treaty’s operation under the VCLT, it can only do so with regard to the entire treaty. Therefore, applying Article 62 of the VCLT to terminate an IIA or BIT could also encompass any associated sunset clause, leading to the termination of such obligations.

1.2 Treaty Carveouts

Another potential avenue to preserve policy space for climate mitigation is to render measures aimed at reducing reliance on fossil fuels immune to challenges through ISDS. In the context of IIAs, excluding specific policies or investments in certain economic sectors from the scope of the entire treaty eliminates the possibility of these policies or investments triggering liability in either investor-State or State-State disputes. Carveouts act as limitations on the scope of a treaty. States aiming to avoid complete withdrawal from investment treaties yet seeking to safeguard specific measures or leave certain economic activities out of IIAs may employ mechanisms such as side agreements between treaty parties.

Because the term “carveout” lacks a universally agreed-upon definition, it is used inconsistently by various commentators and tribunals. Frequently, it has been treated as synonymous with exception clauses — provisions within IIAs that exempt States from liability for specific types of measures. However, the two are distinct. Unlike carveouts, exception provisions are considered affirmative defenses, the applicability of which is not addressed until a breach of a substantive obligation has been established. Relying on exceptions can result in arbitration-related costs and the potential for regulatory chill (see Adopting and Enforcing Exceptions, Right to Regulate, and Valuation Provisions).

In contrast, carveouts describe provisions that remove certain sectors or measures from the scope of coverage of the IIA or prevent ISDS claims regarding certain sectors or measures. They can usually be identified by language that excludes the relevant measures from the treaty’s operation, by certain obligations that use phrases such as “does not apply to,” or if the provision declares certain measures to be “exempt from the provisions of this Agreement.” If a carveout applies, the host State cannot be liable under the IIA for any damage caused by such a measure or to an investor in that sector. Investment tribunals will need to determine whether the State’s
action (or the investment) falls within the scope of the carveout provision. If it does, the tribunal will lack jurisdiction to hear the case, resulting in the dismissal of the investor’s claim.

Carveouts can address all substantive standards of treatment in IIAs at once. One key advantage is that they are considered at the outset of any dispute, preceding the analysis of potential breaches of substantive obligations. This preemptive consideration avoids the need for evaluating the merits of an investor’s claim, contributing to the swift and expeditious resolution of disputes.

Carveouts not only preclude ISDS claims from specific investors or against particular measures but also eliminate the basis for State liability to pay compensation. However, they do not strip investors of all avenues for recourse in cases of alleged harm or compensable injury by the State. Investors can still pursue claims directly in the domestic courts of the host State, akin to domestic investors and other entities, if they contend that the State’s actions violate applicable domestic or international law.

**Carveout design:**

sectoral or purpose-based

Carveouts can take a sectoral form, such as a fossil fuel carveout, or be purpose-based, like a climate change carveout. Each approach has its merits and drawbacks.

**Climate change carveouts** have the potential to exclude from the scope of an IIA, measures aiming to implement the State’s duty to address climate change effectively. However, if too broad or imprecise, purpose-based carveouts may introduce ambiguity and face challenges. Some recent proposals have referred to the UNFCCC and/or the Paris Agreement in defining covered measures (e.g., “any measure linked to the objective and principles of, or commitment to, the UNFCCC”), potentially leading to interpretive discrepancies and unnecessary complexity. Moreover, limiting a carveout to these agreements might overlook measures related to other concurrent State duties, such as human rights obligations to prevent climate-induced harm, which may require more or different measures than do the international climate instruments. To enhance clarity, States could negotiate a non-exhaustive yet illustrative list of “climate measures,” incorporating actions like reducing or eliminating fossil fuel exploration, production, or use.

**Sectoral carveouts**, particularly those targeting fossil fuel investments, may seem too narrow when considering the broader scope of activities that induce climate change. While fossil fuels are responsible for the overwhelming majority of planet-warming emissions, other sectors also pose climate risks. A potential approach could involve defining a carveout to exclude sectors with climate-destructive or emissions-intensive activities, citing specific sectors (e.g., fossil fuels) and concrete measures (e.g., reducing reliance on fossil fuels) as examples. Such sectoral carveouts, removing treaty protection for identified categories of climate-damaging investments, could be specific enough to ensure that investment treaties are not encouraging investments inconsistent with obligations under the Paris Agreement, human rights law, and international environmental law more broadly. Moreover, an added benefit is that a sectoral carveout extends beyond measures specifically designed to combat climate change. It could preclude challenges against any measure affecting fossil fuel investments, encompassing, for example, actions to curtail the adverse health impacts of fossil fuel production and use, as well as regulations addressing other human rights or environmental impacts.

A notable example of a proposed sectoral climate change carveout is evident in the agreement in principle for the modernization of the ECT (Revised ECT), where the EU and its Member States and the UK proposed to commit to exclude some fossil fuel investments in their territories from treaty protection. The EU and the UK proposed to carveout fossil fuel-related investments from investment protection under the Revised ECT, including existing investments after ten years from the entry into force of the relevant provisions and new investments made after 15 August 2023 with limited exceptions.
While the proposed modernization of the ECT suffers from significant weaknesses, it demonstrates the possibility of an agreement to carveout fossil fuel-related investments from investment protection and/or ISDS regimes.

States could think about potential strategies for optimizing the advantages associated with both sectoral and purpose-based carveouts. One possible strategy could be to adopt a purpose-based carveout framework, concentrating on measures dedicated to mitigating greenhouse gas emissions. This could be complemented by specific applications drawn from sector-based carveouts, ensuring that specific sectors, such as fossil fuel investments or other emissions-intensive industries, are explicitly excluded from the ambit of treaty protection.

Parallel to the concept of “carving out,” States can opt for an alternative strategy by crafting new IIAs or amending existing ones to safeguard only specific investments. They can do so by constraining the agreement’s application to certain sectors or types of investments, allowing States to proactively shape the scope and coverage of the IIA. The ECT is a prime illustration of this strategy, as it focuses on investments in the energy sector. This targeted approach exemplifies how States can employ sector-specific IIAs to ensure that only predetermined investments benefit from the treaty’s protections and advantages.

**Individual modification of treaties or a multilateral agreement**

Various legally viable mechanisms exist for implementing carveouts in specific IIAs or across a broader set of IIAs. On an individual IIA basis, carveouts can be incorporated through renegotiation. However, this process can be resource-intensive and time-consuming, particularly when States are party to numerous IIAs at the same time. To address multiple IIAs simultaneously, States supporting the need to implement carveouts for climate measures or specific economic sectors can opt for a plurilateral treaty. Parties could then use the treaty to amend multiple IIAs simultaneously, provided that parties to the original IIA are signatories to the plurilateral treaty. A similar legal architecture has been proposed to implement ISDS reforms agreed upon at the UN Commission on International Trade Law (UNCITRAL) Working Group III and for the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

Ambitious States could lead such a plurilateral agreement, resulting in an opt-in mechanism that opens the door to new joiners. It would then produce legal effects between signatory States. In terms of content, such mechanism could contain (i) the carveout, (ii) the process to govern its application, and (iii) provisions that address its relationship with existing IIAs (e.g., stipulating that the carveout is automatically integrated into IIAs covered by the opt-in treaty and takes precedence over conflicting clauses in covered IIAs) to ensure its efficiency.

Implementing carveouts in IIAs can be further fortified by declarations or inter se modifications of conventions like the New York Convention and ICSID Convention. In these declarations, States could unequivocally express their commitment to (i) prohibit the conduct of arbitral proceedings within their territory when those carveouts are invoked and (ii) maintain a strict stance against enforcing arbitral awards that contravene those carveouts. These declarations or inter se agreements would underscore States’ dedication to fulfilling their duties and protecting their sovereign interests within IIAs. Proposals for a new international legal instrument to coordinate the managed decline of fossil fuel production and use, such as a Fossil Fuel Non-Proliferation Treaty, could incorporate such carveout provisions. Alternatively, it could include a protocol by which parties could exclude fossil fuel investments from ISDS under IIAs to which they are party, and/or withdraw consent to ISDS concerning fossil fuel-related investments or measures covered by the instrument.
1.3 Removal of the ISDS Clause

States can decide whether to include or remove the ISDS clause in their IIAs. In recent years, several countries have made notable decisions to terminate, renegotiate, or amend their IIAs to remove or modify the dispute settlement provision.\footnote{97}

States commonly have various options to address the ISDS mechanism in their existing IIAs. A prevalent strategy involves renegotiation, where States amend the ISDS provision to better conform to their policy objectives or, in certain instances, remove the ISDS provision altogether. If renegotiation proves unsuccessful, States may opt to terminate the agreement. Another option is the negotiation of new bilateral or multilateral agreements, which can replace or override existing IIAs and introduce a different conflict resolution mechanism. In other cases, a State may unilaterally issue a declaration indicating its withdrawal of consent to the ISDS provision — but such actions can lead to legal challenges (see 1.4).

The legal ramifications of removing the ISDS provision from an IIA can be complex. Such a decision typically entails a loss of ISDS rights for foreign investors, compelling them to resort to domestic legal remedies in the home or host State, or alternative avenues like State-to-State action. However, the host State remains obligated to safeguard foreign investments under other treaty provisions. Investments and disputes that were already subject to the ISDS provision before its removal will continue to be governed by the terms and conditions of the original agreement. This means that the legal consequences of the removal, such as the loss of ISDS rights for new investments, may not retroactively apply to existing disputes or investments.

In instances where ISDS is embedded in domestic law, the host State’s national legislation might explicitly outline the consent to arbitration in investment disputes, with national investment laws stipulating the conditions under which arbitration is a viable recourse. Additionally, ISDS provisions may be included in investment contracts, serving as contractual clauses that establish the framework for resolving disputes between investors and host States. These provisions may cover essential elements, including but not limited to the scope of covered disputes, arbitrator selection, arbitration rules and procedures, the designated arbitration seat, and the applicable legal framework. Consequently, even if States opt to eliminate the ISDS provision from their IIAs, foreign investors may still invoke domestic laws that provide protection and incorporate ISDS as the preferred method for dispute resolution and investment contracts that contain ISDS provisions.

1.4 Withdrawal of Consent to ISDS

Investment treaty arbitration, like other forms of arbitration, is based on consent.\footnote{98} In commercial arbitration, the parties consent to resolve their disputes before arbitration tribunals by including an arbitration clause in a treaty or national law.\footnote{99} Under investment treaty arbitration, the signatory State to an IIA provides a unilateral offer of consent to arbitration through an ISDS provision, which the investor “perfects” with its consent by filing a claim.\footnote{100} However, States can agree to explicitly suspend the application of the ISDS provision by withdrawing consent to arbitration.\footnote{101}

This approach can limit or eliminate fossil fuel companies’ use of ISDS.\footnote{102} States can withdraw their consent to treaty-based arbitration of claims by foreign investors bilaterally or multilaterally, just as they initially granted that consent by including an ISDS clause in the treaty.\footnote{103} This withdrawal of consent can encompass claims related to measures aimed at reducing reliance on fossil fuels and the right of their nationals to bring such claims against the other State parties to a given IIA.

The Columbia Center for Sustainable Investment (CCSI), the International Institute for Sustainable Development (IISD), and the International Institute for Environment and Development (IIED)\footnote{104} have proposed an opt-in instrument to facilitate the withdrawal of consent.\footnote{105} Such an instrument could be adjusted by interested States to include claims arising
from measures to reduce reliance on fossil fuels. Importantly, although one party could unilaterally withdraw consent, coordinated State action would increase efficiency and clarify the legal and political meaning of such steps.\textsuperscript{106}

In terms of legal effects, withdrawing consent to treaty-based arbitration does not lead to the termination of substantive investment protection and is not retroactive, applying only to claims not yet initiated at the time of withdrawal. Importantly, if investors file an ISDS claim before withdrawal, tribunals may find that mutual consent was established, rendering the withdrawal ineffective. Challenges to the withdrawal may arise, with a treaty counterparty contending that it violates the withdrawing State’s treaty obligations.

**Part II**

**Reducing the Risk: Options to Mitigate ISDS Risks**

Besides measures that remove ISDS-related risks, other options exist to mitigate those risks. Those options include adopting and enforcing exceptions, right to regulate, and valuation provisions within IIAs (2.1); adopting interpretative statements wherein the explicit clarification of treaty provisions can serve as a preventive measure against potential ISDS challenges (2.2); and the deliberate design of climate-related measures in a manner that minimizes vulnerability to ISDS claims (2.3).

Importantly, these mitigation measures are not mutually exclusive and can be implemented cumulatively. Furthermore, they can complement efforts aimed at eliminating ISDS risks, as discussed in Part I. By combining diverse strategies, policymakers have a versatile toolkit to customize the most suitable approaches and strategies based on the specific conditions of the State, including the existence, number, and status of fossil fuel projects, extent of foreign investment, and nature of its investment agreements.

**2.1 Adoption and Enforcement of Exceptions, Right to Regulate, and Valuation Provisions**

States can include various provisions and clarifications in their IIAs to safeguard their policy space. Those include exception clauses, provisions concerning the right to regulate or valuation, or references to the application of other international legal sources and obligations, such as international climate change, environmental, and human rights agreements (see 3.1). Those provisions and clarifications can be included either within the text of new IIAs or by amending older ones. In the context of new IIAs, States have the flexibility to negotiate and draft provisions that align with their (i) evolving policy priorities, (ii) interpretations of their concurrent legal obligations, or (iii) international investment objectives. For older IIAs, States can also seek to amend and update the agreements to incorporate these provisions. Amendments require mutual consent from the parties to the existing treaty and typically involve a process of negotiation and formal agreement to modify the terms of the IIA.

The provisions mentioned serve distinct but interconnected roles within IIAs. The right to regulate is a foundational principle acknowledging a State’s sovereign authority to legislate and regulate in the public interest.\textsuperscript{107} It is a broad and overarching concept that underpins the entire agreement, ensuring that States maintain their regulatory autonomy. Some IIAs acknowledge the right of States to regulate for legitimate objectives or public purposes, often found in the preamble or exception clauses.\textsuperscript{108} While these provisions aid States in defending against investor compensation claims arising from regulatory actions that allegedly result in financial losses,\textsuperscript{109} incorporating a stand-alone right-to-regulate provision does not replace more precisely circumscribed investor protections, such as carveouts or exceptions for States’ regulatory conduct. The right to regulate is an inherent sovereign prerogative, regardless of its explicit mention in a treaty, and a general affirmation of this right alone may not sufficiently safeguard against overly expansive substantive investment provisions.
Exception clauses are specific provisions that clarify the scope of the agreement and exclude certain measures from the realm of ISDS. They are usually used to justify measures inconsistent with the treaty’s substantive obligation and to insulate the State from indemnification.110 Those provisions are often modeled after Article XX of the World Trade Organization’s (WTO) General Agreement on Tariffs and Trade 1994 (GATT) and Article XIV of the General Agreement on Trade in Services (GATS).111 However, in practice, contrary to carveouts (see above 1.2), exceptions clauses and right-to-regulate provisions are treated as affirmative defenses,112 meaning that their applicability is not addressed until after a breach of a substantive obligation has been established113 — leading to procedural costs and potential regulatory chill. Some tribunals have even interpreted exception clauses in such a manner as to eviscerate their effect.

Valuation provisions establish the criteria and methods for valuing investments and losses in cases of expropriation or other adverse actions. They are crucial in establishing how to determine compensation. Recent arbitration trends have been marked by a significant increase in compensation awards, with cases now involving large sums that can pose challenges, particularly for developing countries.114 Valuation principles initially designed for expropriation disputes are now applied to a broader range of scenarios, departing from previously established international legal norms.115 One major factor contributing to this trend is the growing use of projections of investments’ expected future income, often calculated through the discounted cash flow method.116 By including or reforming valuation provisions in IIAs, it is possible to mitigate the risks of excessive compensation awards and inconsistent treatment of claims. Options for designing or reforming the compensation provisions within IIAs include, for example, (i) capping compensation at the amount invested by the investor, (ii) combining compensation calculations with considerations of whether the host State benefited from the investment, or (iii) requiring the tribunal to apply the host State’s law regarding compensation determination.117

Furthermore, while provisions like the right to regulate, exception clauses, or valuation provisions can offer valuable safeguards for States in IIAs, they are not without limitations. One notable limitation is their susceptibility to diverse interpretations by States and international arbitration tribunals concerning their scope and application. Additionally, the effectiveness of these provisions in safeguarding a State’s regulatory autonomy may hinge on factors such as the specific language of the clause, the prevailing legal context, and the approaches adopted by arbitration panels. In practice, the efficacy of the right to regulate and exception clauses may not always guarantee absolute protection against investor claims, as disputes may arise over whether a regulatory measure genuinely serves a public policy objective. This determination depends on the tribunal’s assessment of a potential treaty violation. Therefore, while these provisions seek to balance investment protection and State sovereignty, their effectiveness can vary, and their application remains a topic of ongoing debate and legal interpretation.

### 2.2 Specification of Substantive Obligations to Protect Legitimate Climate Measures

States can delineate the scope of substantive obligations within IIAs to prevent ISDS tribunals from interpreting measures to decrease reliance on fossil fuels as violations of IIAs when applicable.118 As highlighted by UNCTAD, “Several countries have recently issued joint interpretations for existing IIAs and/or established joint bodies in their IIAs with a mandate to issue binding interpretations of treaty provisions. This can help reduce uncertainty and enhance predictability for investors, contracting parties and tribunals.”119

Interpretative statements can clarify the State’s understanding of and the intent behind any treaty provisions. They can address the content of certain IIA obligations or the grounds under which there is (or is not) a breach of investment obligations. Interpretative statements can also clarify environmental provisions, exception clauses, or carveouts,
thereby constraining potential ISDS claims, influencing existing claims, and preserving flexibility for domestic policymaking.

For instance, in 2022, the EU and Canada developed a draft interpretative statement to elucidate certain aspects of the Comprehensive Economic and Trade Agreement’s (CETA) investment chapter, an agreement between Canada and the EU. The primary objective of such an interpretative statement was to secure the signing of the Agreement following significant criticism from civil society and concerns expressed by some EU Member States regarding the ISDS system. Later, the EU and Canada agreed to clarify CETA’s aims “to support [their] common objective of climate protection” by preparing a text that clarifies certain provisions of the CETA.

While this later interpretative statement does not specifically address measures that reduce reliance on fossil fuels, it demonstrates that interpretative statements are a possible course of action by States to mitigate potential ISDS claims related to climate measures. As an example, CETA’s joint interpretative statement has clarified that “[i]n light of the need for an effective and progressive response to the urgent threat of climate change, the Parties reaffirm that non-discriminatory measures of a Party that are designed and applied to combat climate change or to address its present or future consequences do not constitute indirect expropriation unless the impact of a measure or series of measures would appear wholly disproportionate in that it would be perceived as undeniably unreasonable in light of its purpose.” Additionally, CETA’s interpretative statement also provides that the provisions of CETA’s investment chapter “shall be interpreted and applied by the Tribunal by taking due consideration of the commitments of the Parties under the Paris Agreement and their respective climate neutrality objectives and in a way that allows the Parties to pursue their respective climate change mitigation and adaptation policies.”

Carveouts, exception clauses, right-to-regulate provisions, valuation provisions, and interpretative statements may have overlapping content or similar phrasing. The key distinction lies in their form: for instance, a carveout is directly integrated into the treaty text, identifying specific measures or investments excluded from the treaty’s scope. In contrast, an interpretative statement is an independent document that complements, adds clarity, and reinforces the implementation and enforcement of the existing treaty text. In this context, interpretative statements can provide additional elucidation concerning carveouts, exception clauses, right-to-regulate provisions, valuation provisions, or references to the application of other international legal sources and obligations, such as those present in international climate change, environmental, and human rights agreements.

To be as effective as possible in the context of climate change, interpretative statements should be as comprehensive as possible and ideally mention specific examples of measures that would not breach IIA obligations. Moreover, when addressing climate change measures and responsibilities, it is essential to note that global climate agreements, such as the UNFCCC or the Paris Agreement, do not comprehensively or exclusively outline States’ obligations regarding climate change. Solely referencing measures aligned with these agreements, therefore, may not cover all necessary actions. Concurrent duties under other legal instruments and bodies of law, such as human rights law, may require measures above and beyond those taken pursuant to the UNFCCC or the Paris Agreement. Furthermore, arbitrators often lack the specialized expertise necessary to assess whether a climate change measure meets the criteria of being bona fide, posing a challenge in justifying a State’s actions and finding a balance between investment obligations and climate change considerations. In light of these challenges, States can explore additional mechanisms to ensure or increase the effectiveness of interpretative statements. For example, States can include in their interpretative statements an obligation for the home States to intervene in ISDS proceedings to clarify the rightful interpretation of the IIA (see 3.2).
2.3 Crafting Climate Measures to Minimize Vulnerability to ISDS Claims

IIAs typically impose similar sets of obligations upon host States. Examples include:

(i.) The prohibition against direct expropriation of foreign investors’ assets (i.e., by seizing the investments) or indirect expropriation (i.e., by a substantive deprivation of the value of an investment through one or a series of actions or inactions);

(ii.) The obligation to provide investors fair and equitable treatment (FET), which is understood as an obligation to provide due process, to adopt proportionate measures, and to avoid actions that frustrate the legitimate expectations of investors; and

(iii.) The obligation to avoid discrimination against foreign investors on the basis of their nationality, both against investors from third countries and from the host States’ nationals.

While States investigate medium- and long-term solutions, they can concurrently work on an additional layer of protection to prevent or alleviate claims. Trade and environmental ministries within a State can work together, sometimes with the support of external experts, to carefully structure measures aimed at reducing dependence on fossil fuels — such as those phasing out or retiring existing facilities earlier than their designed operating lifespan, prohibiting future exploration, production, development, or export of fossil fuels, and/or raising the costs associated with fossil fuel production and utilization — in a manner that explicitly addresses and underscores their alignment with IIA obligations. This recommendation is grounded in instances where environmental ministries, operating independently from trade ministries, designed measures that, although legitimate, justified, and proportionate in principle, were susceptible to legal challenges by foreign investments due to coordination failures within governments.

Additionally, while frictions between international investment law obligations and other competing climate-related obligations of States exist, unambiguously and structurally addressing investment treaty obligations within climate measures can discourage investors from bringing ISDS claims in the first place and/or reduce those claims’ likelihood of success. Ensuring the transparency of any climate measures, referring to the human rights and environmental obligations to take such action, and demonstrating their equal application to all fossil fuel activities — domestic and foreign — decreases the likelihood, interest, or viability of investor claims. However, the latter can be proven to be imperfect because (i) clashes between investment law and climate action may be unavoidable, and (ii) it is impossible to predict future ISDS outcomes well, as tribunals are not bound by precedent and enjoy discretionary powers to decide on the merits.

Key elements involve recognizing the interconnection between the urgent need to reduce reliance on fossil fuels in response to the climate crisis and the varied threats posed by fossil fuels to climate change, human rights, health, and the environment and demonstrating the proportionality of these measures in relation to climate change mitigation and human rights protection. These are key to showcasing that the measures or decisions adopted are well reasoned, respond to public interest, and are essential to serving a public purpose. Below is a noncomprehensive list of elements that could be emphasized within measures or decisions that reduce reliance on fossil fuels:

- The uniform or consistent application or effect of measures that reduce reliance on fossil fuels among foreign investors and between foreign and domestic investments in the same economic sector or type of activity.
• The adoption of those measures in a transparent manner, respectful of due process and procedural guarantees, including through open consultations.\(^{131}\)

• The fact that such measures are required to comply with other international obligations such as climate change treaties, international environmental agreements, and human rights obligations.

• Scientific and international political support or consensus behind the measures, including the reports of the IPCC, International Energy Agency, or UN that substantiate the urgency, timeline, obligatory character, and proportionality of measures such as those undertaken by the State.\(^{132}\)

• References to fossil fuel companies’ knowledge that these or similar measures to reduce reliance on fossil fuels would be taken or would need to be taken.\(^{133}\)

In the event of arbitration claims, these considerations can be brought up in State defenses, even if not explicitly stated in the fossil fuel measures. They may also be used to bolster the argument that foreign investors in the fossil fuel sector were aware or should have been aware that measures to reduce reliance on fossil fuels would happen and that States had a legal duty to take such measures.

### Part III

**Responding to the Risk: Options to Challenge ISDS Claims**

If measures proposed in Part I and II are not enough to prevent or discourage foreign investors from bringing ISDS claims under IIAs, States still have options to respond to those claims on the merits or even challenge the jurisdiction of the tribunal (3.1). Non-disputing parties can also appear in those disputes to clarify the interpretation of IIA obligations and commitments and potentially shape the dispute’s outcome (3.2). Additionally, non-State actors have multiple tools at hand that have shown to be useful or even necessary to address and confront ISDS-related risks, including within disputes (3.3).

#### 3.1 State Responses to Investors’ Claims

Investment arbitration tribunals are not obliged to follow the decisions of other tribunals and retain the ability to provide distinct interpretations of investment agreements. As a result, ISDS tribunals may deliver divergent decisions in cases involving similar measures. This underscores the rationale for the most protective course of action for States when implementing measures to reduce reliance on fossil fuels — namely, to preclude ISDS claims by foreign investors entirely, which can be achieved through structural changes discussed in Part I.

States can also discourage foreign investors from making ISDS threats or bringing ISDS claims through insulation mechanisms discussed in Part II. Nevertheless, if investors bring a claim, States can still respond to those claims and defend themselves or even challenge the jurisdiction of the arbitration tribunal.

This section presents a non-exhaustive compilation of arguments that may be available to States in the event of claims. These options encompass challenges to the jurisdiction of investment tribunals and arguments related to the merits of potential cases.

**Challenge the jurisdiction of the tribunal**

Jurisdiction is an essential precondition to an arbitration tribunal’s ability to resolve an investment dispute between an investor and a host State.\(^{134}\) Determining jurisdiction relies primarily on the relevant legal instrument conferring authority upon the tribunal, such as an investment treaty, domestic foreign investment law, or an investment contract.

Challenging an investment tribunal’s jurisdiction involves practical steps taken by States to contest the tribunal’s authority over a particular dispute. States may present jurisdictional challenges by raising
arguments that question the tribunal’s competence to hear the case, often based on the wording and interpretation of the relevant investment treaty. These challenges can focus on issues such as the existence of an actual (legal) investment; the parties’ consent to arbitration; or whether the dispute falls within the treaty’s scope. In this context, States that may have withdrawn their consent, terminated or suspended the IIA, removed the ISDS provision, or implemented a carveout may challenge the jurisdiction of the tribunal if applicable.

Additionally, the tribunal must assess whether the party instituting the claim is a covered investor. Some IIAs impose criteria for investor eligibility, and disputes can emerge if the host State argues that the investor does not meet these qualifications. Finally, the investment tribunal must also assess whether the transactions that give rise to the claim qualify as a covered investment in the territory of the host State and whether the impugned State conduct is excluded from the agreement’s coverage (see e.g., 1.2).

The legal effects of challenging jurisdiction are substantial, as the tribunal’s final determination regarding jurisdiction can have far-reaching consequences, affecting the course of the proceedings and potentially the outcome of the case. If a party successfully challenges the tribunal’s jurisdiction, it can lead to the dismissal of the case or the inadmissibility of certain claims. Conversely, if the tribunal rejects the jurisdictional challenge, it reaffirms its authority to proceed with the dispute. Therefore, jurisdictional challenges serve as a critical means of safeguarding the integrity and fairness of international arbitration.

Assert the State duty to regulate and harmonious interpretation on the merits

State parties to IIAs are bound by concurrent legal obligations under various international legal frameworks, and they can assert these obligations as part of their defenses in arbitral tribunals. The act of entering into an IIA does not imply that a State has relinquished, annulled, or silently waived its existing international commitments under human rights or environmental law. Some obligations are, in fact, non-derogable. Consequently, when adjudicating investor-State disputes, it is appropriate for investment tribunals to take into account a State’s simultaneous and concurrent obligations under international law. This includes recognizing the duty to safeguard human rights and the environment, including from climate change, through effective regulation of investors’ conduct and encouraging a harmonious interpretation of these obligations.

International investment law permits arbitration tribunals to draw on other legal principles. IIAs typically provide that disputes shall be resolved in accordance with the domestic law of the host State and/or international law. Some tribunals have even concluded that international law still applies if the relevant IIA is silent on the law governing the dispute. Furthermore, Article 42 of the ICSID Convention instructs tribunals to decide disputes in accordance with “rules of international law as may be applicable” in the absence of parties’ agreement on the applicable law.

In practice, international environmental, climate change, and/or human rights law and obligations are likely relevant to many ISDS disputes, particularly in the context of fossil fuel measures.

Numerous international treaties play a crucial role in directly or indirectly addressing the complex issue of fossil fuel pollution, particularly in the marine environment. The International Convention for the Prevention of Pollution from Ships (MARPOL) focuses on minimizing pollution from ships, encompassing substances like oil. The United Nations Convention on the Law of the Sea (UNCLOS) establishes a comprehensive legal framework for the oceans that obliges States to prevent, reduce, and control marine pollution, which arguably includes emissions resulting from activities related to fossil fuels. The London Convention and Protocol regulate the dumping of wastes at sea, including hazardous substances originating from fossil fuel-related operations. The Oslo-Paris Convention (OSPAR) specifically addresses marine pollution in the Northeast Atlantic, encompassing pollutants arising from offshore oil and gas activities.
Additionally, the Convention on Biological Diversity (CBD)\textsuperscript{145} emphasizes biodiversity conservation, indirectly contributing to mitigating the impact of fossil fuel pollution on ecosystems. Other treaties, such as the International Convention on Oil Pollution Preparedness, Response and Co-operation (OPRC)\textsuperscript{146} and the International Convention on Civil Liability for Bunker Oil Pollution Damage (Bunker Convention),\textsuperscript{147} offer measures to deal with and compensate for oil spills, further reinforcing the global commitment to addressing fossil fuel-related marine pollution.

In the context of climate change, the UNFCCC and the Paris Agreement, taken together, oblige States, inter alia, to curb greenhouse gas emissions and take action to keep warming below 1.5°C.\textsuperscript{148} Beyond the international climate regime, human rights law also requires States to mitigate climate change. It constitutes an independent source of State obligation to take measures to curb the production and use of fossil fuels, and the known driver of planet-warming emissions and resultant harm. The foreseeable and potentially catastrophic adverse effects of climate change on a wide range of human rights give rise to States’ duties to take immediate actions to prevent those harms.\textsuperscript{149} The UN Human Rights Committee (HRC) has recognized that “[e]nvironmental degradation, climate change and unsustainable development constitute some of the most pressing and serious threats to the ability of present and future generations to enjoy the right to life.”\textsuperscript{150} The duty to protect the right to life requires States to take measures to prevent such foreseeable threats,\textsuperscript{151} including by adequately regulating the conduct of corporate entities subject to their jurisdiction or control that causes or contributes to climate change and its foreseeable impacts on human rights.\textsuperscript{152}

As the UN Committee on Economic, Social and Cultural Rights warned in 2018, in the face of such foreseeable impacts, the failure of States to prevent foreseeable human rights harm caused by climate change could constitute a breach of their obligations.\textsuperscript{153} UN Special Rapporteurs\textsuperscript{154} and a number of UN Treaty Bodies\textsuperscript{155} have also repeatedly addressed this issue and called on States to limit fossil fuel use and eliminate financial support for fossil fuel projects to mitigate the negative impacts of climate change on the full range of human rights guaranteed under international law, including the rights to life, health, food, water and sanitation, healthy environment, an adequate standard of living, housing, property, self-determination, development, and culture, among others.\textsuperscript{156} More recently, UN human rights experts urged States to accelerate the just and equitable phaseout of fossil fuels, warning about the immense magnitude of their negative human rights impacts. They also provided the following statement:

“To address the planetary crisis and tackle the wide range of fossil fuels negative human rights impacts, States must urgently decarbonise and detoxify. Wealthy States and high emitters should lead the phase out of fossil fuels, beginning with avoiding new investments and terminating fossil fuel subsidies. They should also provide financial and other technical support to developing countries to ensure a just transition to a zero-carbon economy. To successfully phase out fossil fuels will require strong international cooperation. States must fulfil their obligations to regulate the private sector and State-owned enterprises, to monitor compliance and enforce rules. This requires addressing barriers to climate action, including greenwashing, undue political influence, strategic lawsuits against public participation (SLAPPs), tax evasion and avoidance, business models not fit for the 21st century, and investor-State Dispute Settlement mechanisms that empower foreign investors to block or raise the cost of climate action.”\textsuperscript{157}

States can assert their prerogative to regulate and adopt other measures to reduce reliance on fossil fuels, not as an exception to investors’ treaty-based rights, but rather as a pre-existing right and obligation that shall not be limited by IIAs.
Clarify legitimate expectations of investors in the context of climate change

Foreign investors affected by measures that reduce reliance on fossil fuels may argue that at the time the investment was made, the host State expressed support for the investment, that they expected some stability in the regulatory framework of the host State, or that they could not foresee such a change in the regulatory framework of the host State.158 Such arguments are likely to rely on the notion of “legitimate expectations” of foreign investors and the “regulatory stability” of the host State. These concepts fall under the umbrella of FET obligations, which have been understood as obligations to avoid actions that frustrate the “legitimate expectations” of investors. This has translated into a requirement to maintain a certain level of stability and predictability in the regulatory framework upon which investors rely when making investments.159 The notion of “regulatory stability” or “stabilization provisions” (the latter, usually included in contracts) suggests that an investor has the right to expect that a host State will not significantly alter the regulatory framework existing at the time of the investment or if changes occur, the investor will be compensated for any resulting loss of profits. While these provisions have sparked substantial debate due to their potential to limit a host country’s regulatory authority in the public interest or compromise the protection of human rights, they nevertheless have been invoked successfully by investors in numerous ISDS cases under the FET standard.160

In light of the scientific consensus attributing climate change to fossil fuels and the impact of fossil fuels on human rights and the environment, and given the numerous political commitments made by States to address this global crisis, arguments asserting that regulations aimed at curbing the production or use of fossil fuels thwart an investor’s legitimate expectations are increasingly indefensible. Regulatory measures targeting fossil fuels as the root cause of climate change have been foreseeable for years, with investors having both actual and constructive knowledge of imminent regulatory changes.163 Major fossil fuel companies, cognizant of their role in contributing to climate change for decades, notwithstanding industry endeavors to obfuscate the impact of their products on global warming,164 cannot assert ignorance. Policymakers have demonstrated a long-standing commitment to addressing the drivers of climate change, making it implausible for these companies to feign unawareness of the foreseeable regulatory responses to mitigate the adverse effects of fossil fuel activities.

Moreover, fossil fuel investments are exposed to a range of climate-related risks, encompassing physical risks, regulatory risks associated with the transition to a low-carbon economy, and the increasing liability risk stemming from the surge in climate litigation.165 Indeed, known fossil fuel reserves and related infrastructure, such as pipelines and power plants, are increasingly at risk of becoming “stranded” assets166 due to government regulation (e.g., emissions reduction limits, carbon prices, coal phaseout, removal of fossil fuel subsidies), technological innovation (e.g., increasingly available and competitive alternative sources of energy), changes in societal norms and consumer behavior (e.g., increased use of electric vehicles), increased scrutiny and pressure from investors, as well as litigation (e.g., legal challenges resulting in court orders preventing pipeline construction in Indigenous territories). Investors have had actual or constructive notice of the inevitability of these measures.

Importantly, the guarantee of stability is not absolute as “[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged.”161 In fact, “except where specific promises or representations are made by the State to the investor,” the latter may not rely on an IIA “as a kind of insurance policy against the risk of any changes in the host State’s legal and economic framework.”162
Like the assertion of a fundamental change in circumstances (see above), arguments and defenses related to investors’ legitimate expectations are highly fact-specific and context-dependent. The success of any such claim or defenses against it will vary based on the specific timing of the investment and the impugned State action, as well as the conclusion of the IIA.

**Review the valuation of fossil fuel assets and compensation owed**

While reforms to valuation provisions in IIAs can alter how compensation will be determined and mitigate the risks of excessive compensation awards and inconsistent treatment of claims (see 2.1), States can also challenge the calculation of compensation owed in individual cases when a judgment is issued in favor of the claimant. Specifically, States can question how valuation and damages have been approached in light of climate change considerations and the value of fossil fuel resources.\(^{167}\)

IIAs are largely silent on valuation. If not, they usually refer to the fair market value of expropriated assets without determining any applicable methodology.\(^{168}\) To fill this silence, tribunals often interpret compensation in light of the principle that “reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.”\(^{169}\) They also often include future lost profits,\(^{170}\) which can open the door to controversial, contested, and arguably speculative projections about future earnings.

A myriad of factors influence the present value and anticipated future returns of fossil fuel investments. State actions aimed at diminishing dependence on fossil fuels are not likely to be the sole determinant of a fossil fuel project’s or company’s performance. Growing physical risks from climate impacts, transition risks from regulations and market shifts to other forms of energy, and climate litigation-related risks are reducing the profitability of fossil fuel investments.\(^{171}\) Changes in profitability include the deployment and growth of renewable energy offers and demand or structural decline in demand for fossil fuels.\(^{172}\) Banks and investors are also moving away from fossil fuel-related investments, increasing the cost of capital for fossil fuel investors. There is a strong case to be made not only that losses stem from a variety of causes, but also that fossil fuel assets, far from being a source of profit in the future, risk becoming liabilities.

States could also argue that from any claimed compensation owed or asserted future earnings, the tribunal should deduct the myriad of often ignored or unpriced costs that fossil fuel production and use impose on the public in terms of environmental, health, and climate impacts, as well as future closure and cleanup liabilities and remediation costs. By putting a present value on those externalized costs and accelerating those future liabilities, States can right-size estimates of the value of fossil fuel investments and earnings. When responding to asserted damages claims from investors, States can and should mention those structural, societal, financial, and economic changes that impact fossil fuel companies.

Furthermore, when addressing claims regarding loss of projected future profits, particularly by investors in the oil, gas, or coal industry, future economic scenarios and demand projections must not assume business-as-usual fossil fuel production and use. At the bare minimum, estimations of future earnings cannot assume constant or growing demand for fossil fuel products or fossil fuel-based energy/feeds-tocks.\(^{173}\) States may question investors’ assumptions or estimates to push back against inflated claims by investors or minimize the “cost” of climate action to the State through ISDS.\(^{174}\)

**Argue the necessity defense**

States may also assert the necessity defense to respond to arguments alleging that measures that reduce reliance on fossil fuels breach IIA obligations. The necessity defense is part of international customary law and is codified under Article 25 of the International Law Commission draft articles on the Responsibility of States for Internationally Wrongful Acts (ILC Articles on State Responsibility).
Multiple States have invoked the state of necessity in ISDS cases, especially in the wake of Argentina’s socioeconomic and political crisis in the late 1990s. The crisis led Argentina to take emergency measures that affected foreign investors. During this period, Argentina faced multiple ISDS claims.

According to Article 25 of the ILC Articles on State Responsibility, States must prove that the measure (i) “is the only way for the State to safeguard an essential interest against a grave and imminent peril;” and (ii) “does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.” The interest of the State acting out of necessity must also outweigh all other considerations upon reasonable assessment of all competing interests. To prove that a particular action was the only way to protect an essential interest against a grave and immediate peril, the first step is to determine what constitutes an essential interest, which needs to be interpreted on a case-by-case basis and in light of specific circumstances and situations. Importantly, States can invoke the ecological state of necessity as the environment is an “essential interest of the State.”

Fossil-fueled climate change has major impacts on human health, livelihoods, and life, as well as biodiversity and ecosystem integrity, which are essential interests of States. Those interests are in grave and immediate peril. In 2018, when the IPCC published its special report Global Warming of 1.5°C, temperature rise had reached 1°C above pre-industrial levels, and the world was already experiencing flooding from sea level rise, as well as heatwaves, droughts, hurricanes, and other forms of extreme weather that claim lives and destroy property and homes. In 2022, when the IPCC published its latest report on the impacts of climate change, it warned that climate change was already causing “widespread adverse impacts and related losses and damages to nature and people” and severe loss and damage to human and natural systems including “irreversible impacts as natural and human systems are pushed beyond their ability to adapt.” Beyond their health impacts due to their contribution to climate change, fossil fuels are responsible for an estimated one in five premature deaths annually due to air pollution, chiefly the release of particulate matter (PM2.5). The World Health Organization (WHO) estimated that this form of pollution was linked to approximately 4.2 million deaths in 2019.

The imminent danger posed by climate change is escalating, with heightened warming intensifying threats to fundamental rights. Each incremental rise in temperature exacerbates the damage and hampers adaptive measures. Warming of 1.5°C is not considered ‘safe’ for most nations, communities, ecosystems and sectors and poses significant risks to natural and human systems. Surpassing this threshold, even temporarily, would result in additional catastrophic and irreversible consequences. The cumulative effects of surpassing 1.5°C, coupled with diminishing resilience, pose a significant threat to human rights. Consequently, climate change is increasingly recognized as a pressing and imminent danger. Scholars additionally characterize climate change as a menace to national security and State sovereignty, further underscoring its immediate and perilous nature.

It is not possible to protect such interests without reducing States’ reliance on fossil fuels. To prevent further climate change and further irreversible damage to both people and ecosystems, it is clear that reliance on fossil fuels needs to be ended promptly. Measures that rapidly reduce the dependence on fossil fuels are essential for the State to protect its population, security, and sovereignty.

ISDS tribunals tend to adopt a stringent interpretation of the necessity defense. Tribunals may conclude that there are always alternative strategies to address different crises based on expert reports or comparative studies. However, as noted by Argentina in the Enron case, there will most likely always be an alternative, but this should not limit the possibility of proving a state of necessity. Moreover, the wording of Article 25 of the ILC Articles on State Responsibility requires that the measure “does not seriously impair an essential interest of the
State or States towards which the obligation exists, or of the international community as a whole.” While some parties would defend its importance, foreign investment protection for a fossil fuel project does not hold the same level of indispensability as the protection of fundamental rights, such as the right to life, health, and a healthy environment, which are prerequisites for the enjoyment of other rights and interests. Furthermore, the absence of concrete evidence demonstrating that the foreign investment protection regime consistently delivers its claimed benefits weakens any assertion that safeguarding this system is an essential State interest. Consequently, and depending on States’ circumstances, any argument asserting that regulating fossil fuels impairs the State’s essential interest in foreign investment protection may be difficult to substantiate.

**3.2 Potential Actions by Non-Disputing State Parties**

States that are a party to an IIA but are not a party to a specific dispute may want to participate as a non-disputing State Party (NDSP) in a given arbitration case to clarify the interpretation of IIA obligations and commitments and potentially shape the dispute’s outcome. In recent years, tribunals have seen an increased number of States participating as NDSP in ISDS. By doing so, States participate in the protection of their interests and future actions and contribute to the development of a more robust body of tribunal treaty interpretation.

NDSPs can contribute their insights on interpreting the applicable IIA with the tribunal overseeing the dispute, primarily through NDSP Submissions. NDSP Submissions are useful tools that clarify IIAs’ text and ensure that tribunals interpret IIAs in accordance with the intention and consent to which States Parties agreed. Those submissions can address IIA obligations and any provision discussed above, such as exception clauses, right-to-regulate or valuation provisions, or carveouts.

Such participation is allowed under numerous international treaties, including IIAs and arbitration rules. As an example, according to Article 5(1) of the 2014 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (UNCITRAL Transparency Rules), “[t]he arbitral tribunal shall, subject to paragraph 4, allow, or, after consultation with the disputing parties, may invite, submissions on issues of treaty interpretation from a non-disputing Party to the treaty.” Similarly, pursuant to Rule 68(1) of the 2022 ICSID Arbitration Rules (previously Rule 37(2) of the 2006 ICSID Arbitration Rules), “[t]he Tribunal shall permit a Party to a treaty that is not a party to the dispute (“non-disputing Treaty Party”) to make a submission on the interpretation of the treaty at issue in the dispute and upon which consent to arbitration is based. The Tribunal may, after consulting with the parties, invite a non-disputing Treaty Party to make such a submission.” NDSP Submissions can also be conditioned. As an example, according to Rule 68(2) of the 2022 ICSID Arbitration Rules, “[t]he tribunal shall ensure that non-disputing Treaty Party participation does not disrupt the proceeding or unduly burden or unfairly prejudice either party.”

To ensure this, the tribunal may impose conditions on the format, length, scope, or publication of the submission and set a deadline for the submission.

States also possess the opportunity to strengthen collaboration on climate-related issues through alternative avenues, such as using interpretive statements (see above in 2.2) or by jointly agreeing to participate as NDSPs in investment treaty arbitration cases. This collaborative engagement may ensure that climate objectives and related obligations outlined in international climate agreements, human rights instruments, and environmental treaties are duly considered and respected within the proceedings of ISDS. It provides a platform for States to articulate their perspectives, offer expert insights on climate policies, and highlight environmental and public welfare implications. This proactive approach aligns with the broader global initiative to combat climate change and safeguard the environment and human rights. It emphasizes the significance of harmonizing investment protection with climate action, striving to strike a balance between environmental sustainability and the resolution of ISDS. To be sure, such collaborative efforts, while valuable, come with
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associated costs in terms of both financial resources and time commitments. Participating as an NDSP and engaging in investment treaty arbitration cases demands financial investments and resource allocations to effectively present perspectives, provide insights, and contribute to integrating climate objectives within the proceedings.

3.3 Potential Actions by Non–Parties

Beyond the aforementioned arguments and tools, the active involvement and advocacy of non-State actors, including civil society organizations, think tanks, and other pertinent stakeholders, have emerged as central and effective in confronting the legitimacy challenges within the ISDS system. This engagement has played a crucial role in propelling ongoing international investment reforms and shaping contemporary practices, including by (i) raising concerning developments in the system, whether related to disputes or investment reforms; (ii) providing legal and technical analyses; (iii) increasing the visibility and accessibility of disputes to the public; or (iv) by submitting non-disputing parties (NDP) submissions. They also have raised attention to increasing incompatibilities between the investment law system and climate change action. This sentiment resonates with insights from an OECD working paper, underscoring that public opinion rejects the notion of private actors making decisions that impact the destiny of nations behind closed doors.

ICSID Rules of Arbitration and certain provisions within investment treaties stipulate the authority of investment tribunals to consider NDP submissions in ISDS cases. NDP application conditions usually require that: (i) the submission assist the arbitration tribunal in the determination of a factual or legal issue related to the proceedings by bringing a perspective, particular knowledge, or insight that is different from that of the disputing parties; (ii) the submission address matters within the scope of the dispute (i.e., they are not able to introduce new issues); (iii) there is a public interest in the subject matter of the dispute; and (iv) the NDP can demonstrate a significant interest in the ISDS dispute.

The majority of past ISDS cases where NDP have been involved touched upon some type of public interests, such as public health, environmental concerns, sustainable development, or the protection of cultural heritage, and have even involved communities that have been directly impacted by the investment project, or parties to parallel litigation proceedings. However, notwithstanding the clear public stake in the proceedings, tribunals are increasingly narrowing the interpretation of NDP admissibility conditions, making it very difficult for NDP submissions to be accepted.

In the face of these increasingly strict standards for NDP participation, it is essential to recognize that NDPs often bring invaluable specialized knowledge and a distinctive public interest perspective to the proceedings. Their submissions can provide tribunals with a more profound understanding of complex issues, especially in cases involving affected communities, Indigenous rights, environmental, human rights, or public health considerations. This contribution elucidates the relevance and impact of investment disputes beyond the narrow confines of the applicable agreement and the investor’s economic interests. In so doing, NDPs play a pivotal role in fostering a balanced consideration of arguments, introducing a broader range of viewpoints that may not be presented by the disputing parties alone. Ultimately, the involvement of NDPs in investment arbitration cases contributes to the transparency, accountability, and inclusiveness of the process, aligning it with broader societal values and expectations.

Conclusion

This toolkit is a living document that will be updated as legal precedent develops and facts evolve. The strategies and tools available above are neither exhaustive nor prescriptive. States and advocates navigating this space may find some arguments and avenues more appropriate or useful than others in certain cases or circumstances. Equipped with an understanding of available options to overcome ISDS barriers to climate action, readers can help accelerate the needed transition to a climate-safe, fossil-free future.


11. ISA, Net Zero by 2050: A Roadmap for the Global Energy Sector, May 2021, pp. 21–51: “There is no need for investment in new fossil fuel supply in our net zero pathway. Beyond projects already committed as of 2021, there are no new oil and gas fields approved for development in our pathway, and no new coal mines or mine extensions are required. [...] [N]o fossil fuel exploration is required and no new oil and natural gas fields are required beyond those that have already been approved for development. No new coal mines or mine extensions are required either.


15. The impact of arbitration on regulatory change has been explicitly mentioned in the latest IPCC report: “Moreover, there are cases where international cooperation may be hindering mitigation efforts, namely evidence that trade and investment agreements, as well as agreements within the energy sector, impede national mitigation efforts (medium confidence).” IPCC, Climate Change 2022: Mitigation of Climate Change, Full Report, Working Group III Contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 2022, p. 133, available at https://www.ipcc.ch/report/wg3/downloads/report/IPCC_AR6_WGIII_Fullreport.pdf. In the same report, it is mentioned that: “Investment agreements, which are often integrated in FTAs, seek to encourage the flow of foreign investment through investment protection. While international investment agreements hold potential to increase low-carbon investment in host countries (PAGE 2018), these agreements have tended to protect investor rights, constraining the latitude of host countries in adopting environmental policies (Miles 2019). Moreover, international investment agreements may lead to ‘regulatory chill’, which may lead to countries refraining from or delaying the adoption of mitigation policies, such as phasing out fossil fuels (Tienhaara 2018). More contemporary investment agreements seek to better balance the rights and obligations of investors and host countries, and in theory offer greater regulatory space to host countries (UNCTAD 2019), although it is unclear to what extent this will hold true in practice.” IPCC, Climate Change 2022: Mitigation of Climate Change, Full Report, Working Group III Contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 2022, p. 1499, available at https://www.ipcc.ch/report/wg3/downloads/report/IPCC_AR6_WGIII_Fullreport.pdf. Moreover, it has been acknowledged by arbitrators themselves. For example, Professor Philippe Sands stated recently in a Dissenting Opinion on the application for amicus curiae submission in Odyssey v. Mexico: “It is now well recognised that investment treaty arbitration can have a significant impact on domestic regulatory regimes, even where compensation is the only remedy awarded. It is therefore entirely possible that a finding that the Respondent has breached the treaty could lead to regulatory changes which directly affect the interests of the Cooperativa, either immediately or in the future. The Majority’s decision fails to recognise or take account of the broader impacts of investment treaty arbitration”, Odyssey Marine Exploration, Inc. v. The United Mexican States, ICSID Case No. UNCT/2011, Procedural Order No. 6, 20 December 2021, Professor Sands’ Dissenting Opinion, para. 2, available at http://iciisdfiles.worldbank.org/csdc/ICSIDBLOGS/Onin-edwards/CS57/857216_En.pdf.


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24. At the time of this publication, efforts to reform aspects of investment policy and law are underway under the auspices of the United Nations Conference on Trade and Development (UNCTAD) (reform of IIA), United Nations Commission on International Trade Law (UNCITRAL) Working Group III (ISDS reforms), the World Trade Organization (Joint Statement Initiative on investment facilitation), and the Organisation for Economic Co-operation and Development (OECD).


28. Ibid., p. 1602.


32. VCLT, Article 70(1).

33. VCLT, Article 70(2).

34. This prior notification period for the termination of a IIA can serve as a warning sign allowing the other Contracting Party to take the necessary steps to inform its investors about the upcoming termination of the IIA, who in turn can prepare for the consequences of the termination for their investments in the other Contracting Party. As an example, the Indian Model BIT 2015 provides for a unilateral termination of the treaty at any time with 12 months’ notice: “This Treaty shall remain in force for a period of ten years and shall lapse thereafter unless the Parties expressly agree in writing that it shall be renewed. This Treaty may be terminated anytime after its entry into force if either Party gives to the other Party a prior notice in writing twelve (12) months in advance stating its intention to terminate the Treaty. The Treaty shall stand terminated immediately after the expiry of the twelve (12) month notice period”. Indian Model BIT, 2015, Article 38.2. The Canadian Model BIT 2004 provides for a flexible approach, without fixed terms and with the possibility of unilateral termination at any time: “This Agreement shall remain in force unless either Party notifies the other Party in writing of its intention to terminate it. The termination of this Agreement shall become effective one year after notice of termination has been received by the other Party. […]”. Canadian Model BIT, 2004, Article 52.3.


37. ICCSD Convention, Article I.


39. ICCSD Convention, Article 71.


66. Ibid, para. 19.


68. VCLT Article 62 (c).


70. Fisheries Jurisdiction case (United Kingdom of Great Britain and Northern Ireland v. Iceland), Judgment I.C.J. Reports 1973, 2 February 1973, paras. 35–37. Based on this characterization, the circumstances could be considered as fundamental if they threaten the existence or vital development of a State party to the contested treaty. See also Árnadóttir, S., Fundamental Change of Circumstances, Chapter in Climate Change and Maritime Boundaries: Legal Consequences of Sea Level Rise, Cambridge University Press, 2021, pp. 168–219, available at https://doi.org/10.1017/978110847906.004.


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92. Annex A of the Treaty provides a list of BITs that will be terminated once the Treaty enters into force as provided by its Article 2. Sunset clauses of BITs of Annex A will also be terminated and thereafter will “not produce legal effects”. Annex B provides a list of BITs that have already been terminated. Article 3, on its turn, establishes that sunset clauses contained in those BITs will “be left without effect”. Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union, SN/4656/2019, 29 May 2020, Annex A and B.


94. VCLT, Article 42.4.


97. See Revised ECT, Annex II.


104. South Africa has taken steps to terminate many of its BITs with various countries. In 2012, it announced its intention to terminate a number of BITs, and it has been gradually taking measures to do so. One of the reasons cited for this move was concerns over the ISDS system and its perceived limitations on the ability of the government to regulate in the public interest. See UNCTAD, Speaking notes for Minister at the Discussion of UNCTAD’s Investment Policy Framework for Sustainable Development (IPFSO), Geneva – Switzerland, 24 September 2012, pp. 4–5, available at https://unctad.org/system/files/official-document/red55sta/daves_en.pdf.


111. Ibid.


114. See e.g., EU–Vietnam Investment Protection Agreement, 2019, Article 2.2. Comprehensive Economic and Trade Agreement (CETA), Article 8.9.


116. Ibid.


119. The WTO general exceptions provide that the relevant agreements “shall not prevent the adoption or enforcement” of measures for a specified range of public purposes, including measures necessary for the protection of human, plant, or animal life or health and measures relating to the conservation of exhaustible natural resources, subject to an anti–abuse requirement known as the “chapeau,” which requires that the exceptional measures not “constitute a means of arbitrary or unjustifiable discrimination” or act as a “disguised restriction” on international trade. Those clauses also usually share three elements: (i) an exhaustive list of permissible policy objectives; for example, the protection of human, animal, or plant life or health, or the conservation of natural resources; (ii) a nexus requirement, denoting that the required link between a state measure and a permissible objective: frequently used nexus requirements include “necessary for,” “related to,” and “designed and applied for”; and (iii) a prohibition of discriminatory or arbitrary application.
122. Usually, investor protection treaties allow State parties to expropriate for a public purpose. It is generally accepted that the test of a State’s good faith exercise of regulatory powers in the general interest does not qualify as expropriation. This is the so-called “police powers doctrine”. The police powers doctrine provides that a state possesses an inherent right to regulate in protection of the public interest and does not act wrongfully, when, pursuant to this power, it enacts bona fide, non-discriminatory, and proportionate regulations in accordance with due process. See e.g., United States Model BIT, 2012, Article 6. Surprisingly, states often fail to explain why a regulatory measure is important, how it is proportionate to the result sought, and whether it is required under existing legal obligations binding on the state. There is also no doubt that fossil fuels are the main drivers of the climate crisis, and an environmental, health, and human rights problem. See e.g., ClientEarth, Fossil fuels and climate change: the facts, 18 February 2022, available at https://www.clientearth.org/latest/latest-updates/stories/fossil-fuels-and-climate-change-the-facts/; generally United Nations General Assembly. Report of the Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable development. A/74/161, 15 July 2019. IIA protects investors from discriminatory measures. This means that States shall take measures that “treat equally what is equal but it does not require a State to treat equally that which is different”. RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain, ICSID Case No. ARB/13/30, Decision on Responsibility and on the Principles of Quantum, 30 November 2018, para. 431. As an example, in the context of the coal phase-out in the Netherlands, the government is designed to apply to all coal-fired power plants, and to all national and foreign investors, see Netherlands, Prohibition of Coal in Electricity Production Act, 2019.

123. The obligation to provide investors FET is also often understood as obligation to provide due process. In this context, arbitrariness is generally referred as “a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety”, or as “a lack of due process which offends a sense of juridical propriety” see Vsevolod, M., Unreasonable and/or Arbitrary Measures in Fair and Equitable Treatment, Jus Mundi, 24 October 2023, available at https://jusmundi.com/en/document/publication/en-unreasonable-and-arbitrary-measures-fair-equitable-treatment; Loewen, Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3, Award, 26 June 2003, para. 132. Aceris Law LLC, Denial of Justice in International Investment Law, Aceris Law, 10 October 2018, available at https://www.acerislaw.com/denial-of-justice-in-international-investment-law/.

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135. Non-derogable human rights refers to rights that are absolute and may not be subject to any derogation, even in time of war or emergency. As an example, Article 15(2) of the European Convention on Human Rights (ECHR) provides a list of rights that may not be suspended under any circumstances.

136. Noting that systemic integration has rarely been invoked in investment arbitration.


138. See e.g., MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile, ICCISD Case No. ARB/01/7, Award, 25 May 2004, para. 204; CMS Gas Transmission Company v. The Republic of Argentina, ICCISD Case No. ARB/01/8, Award, 12 May 2005, paras. 115–122.


140. See e.g., MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile, ICCISD Case No. ARB/01/7, Award, 25 May 2004, para. 204; CMS Gas Transmission Company v. The Republic of Argentina, ICCISD Case No. ARB/01/8, Award, 12 May 2005, para. 115.


153. See e.g., According to Uniper’s advisor, Mr. Schoenmakers, the company agreed to build the plant in 2007, after several meetings and discussions with the Government. Mr. Schoenmakers mentioned “the receptiveness of the Dutch government for such an investment that led to the construction of this power plant”. In a statement concerning its acquisition of Uniper, it was also reported that “Uniper’s investment decision was made in 2007 with cooperation from the Netherlands government at the time”, see ClientEarth, Annex: Legal opinion on Uniper’s legally misconceived ISDS threat to Dutch Coal Phase-Out, 21 November 2019, p. 16, available at https://www.clientearth.org/dsdb/3276/clientearth-legal-analysis-regarding-the-uniper-isd-threat-ce-en.pdf; Hyvärinen, E., 7 things to know about Fortum’s Uniper acquisition, ForTheDoers Blog, 16 October 2019, available at https://www.forum.com/about-us/blog/forenergy-7-things-to-know-about-fortums-uniper-acquisition/.


156. “No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor’s expectations was justified and reasonable, the host State’s legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the S.D. M. tribunals have stated, the determination of a breach of the obligation of ‘fair and equitable treatment’ by the host State must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders”, Saluka Investments B.V. v. The Czech Republic, UNCITRAL, Partial Award, 17 March 2006, para. 305.
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196. “The trends observable in recent IASs indicate that states wish to strengthen their ability to participate in disputes, especially on matters of treaty interpretation, and to further ensure that tribunals take due account of such interpretations [...]”, Magraw, K., Trends and ISDS Backlash Related to Non-Disputing Treaty Party Submissions, Public Actors in International Investment Law, 2021, p. 94, available at https://link.springer.com/chap- ter/10.1007/978-3-030-59916-5_6


198. See e.g., North American Free Trade Agreement (NAFTA), Article 1128 stating that: “[o]n written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agree- ment.”

199. 2002 ICSID Arbitration Rules, Rule 68(2).

200. 2002 ICSID Arbitration Rules, Rule 68(2).

201. OECD, Transparency and Third Party Participation in Investor State Dispute Settlement Procedures, OECD Working Papers on International Investment 2005/01, June 2005, p. 2, “The traditional manner in which governmental measures are reviewed for compliance with international law in a private setting, i.e. confidential in camera proceedings has come under increased scrutiny and criticism”, available at http://dx.doi. org/10.1787/624613550768


205. 2002 ICSID Arbitration Rules, Rule 67(2); 2006 ICSID Arbitration Rules, Rule 37(2).

206. As an example, in the case Odyssey Marine Exploration, Inc. v. United Mexican States, the tribunal does not consider that Cooperativa has a signifi- cant interest in the dispute, as “the Claimant is not seeking the restitution of the project at issue but a compensation arising out of the alleged breaches of NAFTA”, Odyssey Marine Exploration, Inc. v. United Mexican States, ICSID Case No. UNCIT/20/1, Procedural Order No. 6, 20 December 2021, para. 18.
Overcoming International Investment Agreements as a Barrier to Climate Action: A Toolkit to Safeguard Fossil Fuel Measures from Investment Treaty Claims

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