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The Practice of International Investment Agreements in the Context of Climate Change Conflicts and Solutions

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Abstract: Climate change is an issue of growing importance on a global scale. The traditional International Investment Agreements (IIAs) and the provisions made in response to climate change often conflict with one another. This has led to a need to find a way to reconcile these differences and establish a complementary and mutually reinforcing relationship between IIAs and climate change treaties. This paper aims to identify the focal points of conflict and explore potential solutions through case analysis and other methods. One potential solution is to make reasonable adjustments to the IIAs to align them with the specific provisions needed to address climate change. By doing so, it may be possible to bridge the gap between traditional IIAs and the requirements of climate change treaties. This approach is essential in ensuring that investment agreements do not hinder the progress of climate change initiatives. It is crucial to find a balance that allows for sustainable economic development while also addressing the pressing concerns of climate change. Finding a way to reconcile the conflicts between traditional IIAs and climate change treaties is of paramount importance. By making targeted adjustments and seeking common ground, it is possible to establish a framework that supports both economic growth and environmental sustainability.

Keywords: Climate change, international investment agreements, sustainable development

1. Introduction

At the end of 2015, two major international agreements related to climate change were established within the United Nations, once again highlighting the connection between global climate governance and international investment regulations. Firstly, the United Nations Summit in September 2015 approved the 2030 Agenda for Sustainable Development, which emphasizes that the SDGs encompass social, economic, and environmental dimensions. Secondly, the Paris Agreement, agreed upon by the UNFCCC Conference of the Parties in early December 2015, outlines targets for mitigating climate change and response measures for participating countries, as well as provisions for finance, technology, and transparency. The UN Secretary-General has also emphasized that addressing climate change is a means of advancing the 2030 Agenda for Sustainable Development [1]. These international climate change agreements have established a global legal framework for addressing climate change and have set national targets for reducing greenhouse gas emissions, including carbon dioxide. To meet the requirements of these international climate agreements, governments have implemented numerous measures to promote investment and development in low-carbon sectors, as well as measures to restrict or even prohibit investment in high-energy-consuming,

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high-emission, and high-pollution industries. These measures may put foreign investors who do not align with the characteristics of a low-carbon economy and cannot meet the criteria for reducing greenhouse gas emissions at a competitive disadvantage, potentially leading to investors initiating international investment arbitration and making economic claims against the host country under the substantive rules of the International Investment Agreements on the protection of investors and investments.

The current international investment agreement only clearly protects the investors and restricts or prohibits host countries from taking steps that are detrimental to or harmful to the interests of investors. However, these agreements do not cover climate change, so they fail to provide policy space for host countries to take measures to address climate change. This conflicts with the provisions of the climate change agreement requiring host countries to take measures such as reducing greenhouse gas emissions. In addition, the dispute settlement mechanism between investors and the host country tends to protect the private interests of investors and often ignores the public interests of the host country. Therefore, countries may bear legal responsibility for violating the obligations of international investment agreements to protect investors by taking measures to deal with climate change.

2. The Shortcomings of Existing Investment Agreements in Addressing Climate Change

2.1. Pre-entry

Pre-establishment rights are important rules in the field of international investment, which guarantee the national treatment and the most-favored-nation treatment that national investors should enjoy before setting up investment enterprises in the host country [2]. However, the "ownership" clause in some international investment treaties may limit the host country's regulatory power to implement clean energy and technical standards for foreign-funded enterprises, thus hindering the host country's efforts to promote climate-friendly investment. Although most investment clauses do not explicitly contain the "right to establish" clause, the "property status" clause has been continuously expanded in recent international investment agreements, making national treatment before access gradually become an increasingly important rule in the field of international investment. This provision is also included in the ongoing Sino-US bilateral investment agreement negotiations.

2.2. Preferential Treatment Provisions for Foreign Investment after Establishment

Commonly, international investment agreements specify the protective provisions for foreign investment made after establishment, primarily encompassing national treatment, most-favored-nation treatment, fair and equitable treatment, and expropriation provisions. These terms may potentially deter host countries from promoting environmentally and climate-friendly investments.

2.2.1. Citizen Treatment

The national treatment standard stipulates that the host country must treat foreign investors in a manner equivalent to domestic investors under similar conditions. A standard national treatment clause typically states that "each Contracting Party shall treat its investors in the other Party no less favorably than it treats its investors with regards to the management, maintenance, use, or treatment of the investments". The objective of the national treatment clause is to prevent the host country from providing more favorable terms to domestic investors [3].

The standard of national treatment prohibits granting preferential treatment to foreign investors or treatment higher than that of nationals. National treatment can also be regarded as non-discriminatory, meaning that the treatment given to foreign investors should be equivalent to that given to nationals.

In determining whether the host country discriminates against foreign capital and violates the national treatment clause, the arbitral tribunal must compare the treatment of the foreign capital with that of domestic investors in "like circumstances"[4].The national treatment clause is intended to prevent the host country from giving more favorable terms to domestic investors [3].

The determination by arbitral tribunals of the definition of "similar circumstances" is crucial in determining whether investors can successfully claim compensation. In previous instances of arbitration, certain tribunals have employed a narrow interpretation, while others have tended to interpret it broadly, thereby maximizing the protection of investors' interests. If the arbitral tribunal adopts a broad understanding of "similar circumstances," even grouping investors from different economic sectors and engaging in different types of activities for comparison, the likelihood of finding the host country in violation of its national treatment obligation is significantly increased.

The outcomes of trials vary greatly in different cases. In the case of SD Myers v. Canada, if different types of power plants are considered competitors in the electricity market, a ban on closing coal-fired power plants would constitute a violation of national treatment, despite its public interest in addressing climate change. Another example is the case of Claton-Bilcon v. Canada, in which the applicant sought to expand its quarry and marine terminal project on the Canadian coast, requiring local provincial, and federal permits. The environmental impact assessment experts recommended against continuing the project. Both the local and federal governments ruled against issuing the permits based on this advice. The applicant alleged that Canada violated the national treatment principle of NAFTA and sought compensation, which was supported by the arbitral tribunal. Therefore, the national treatment standard can be used to challenge any government action that may affect investors and prevent the implementation of stricter environmental standards [5].

2.2.2. The Most Favorable Nation Treatment (MFN treatment)

The usual practice about the most favored nation treatment clause is that one contracting party shall not offer to investors of the other contracting party treatment less favorable than that it offers to investors of any other contracting party or non-contracting party in similar situations. For example, in the case of Parkerings v. Lithuania, the applicant argued that the host country government allowed another company to be granted the concession to build a parking lot, thus discriminating against the applicant. The related parking lots are in the old town area protected by the UNESCO Convention, and several cultural institutions have raised objections. The arbitral tribunal took into consideration these issues and determined that the potential negative effects of the parking lot proposed by the applicant in the historical and environmentally protected area and the projects of the competitors were not "similar" [6].

Currently, almost all international investment agreements stipulate fair and equitable treatment for foreign investors and are considered the "king clause" and "golden rule" in international investment law. However, the content of fair and equitable treatment is not certain and needs to be determined by arbitral tribunals based on specific facts in individual cases. From recent arbitration cases on fair and equitable treatment, international investment arbitral tribunals tend to interpret the content of fair and equitable treatment broadly, based on the minimum standard of treatment under customary international law. Some tribunals believe that the minimum standard of treatment under modern customary international law has expanded to cover requirements for transparency and not violate investors' legitimate expectations. For example, in the "Arold v. Barbados" arbitration case concluded in 2016, the international permanent arbitral tribunal also held that the standard of fair and equitable treatment in international investment agreements includes legitimate expectations [7].

Expropriation: International investment agreements (IIAs) typically include provisions on expropriation. Currently, direct expropriation is infrequently utilized, with indirect expropriation being more common. Indirect expropriation refers to actions taken by the host State that do not result

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in the investor losing ownership of the property, but significantly impact the investor's investment interests, resembling expropriation. Many IIAs incorporate clauses prohibiting the host government from nationalizing or confiscating investments. Nationalization or confiscation may occur through direct or indirect means, such as government interference with the use or enjoyment of investments. Indirect expropriation may be deemed equivalent to direct expropriation. Measures implemented by the host country to address climate change may also affect foreign investment and be classified as expropriation under IIAs, necessitating compensation. The criteria for determining expropriation may vary among arbitral tribunals, with some focusing solely on the impact on investors and others balancing public welfare objectives with the investor's interests. Clear language in IIAs is essential to clarify whether such measures constitute expropriation. The impact of the measures on investors is a crucial consideration for all arbitral tribunals in determining expropriation. Therefore, it is important to consider the potential impact of climate change measures on foreign investment to prevent disputes and ensure the protection of foreign investment. China's foreign direct investment is primarily concentrated in energy, metals, and other resource industries, which can have a significant impact on the local environment. Additionally, energy and metal mining industries are prone to carbon emissions, potentially leading to hostile expropriation measures by local governments and communities [4].

One significant risk that foreign investors should be mindful of is the expropriation of their assets by the host country's government [8].

According to the principle of territorial sovereignty in international law, sovereign states have the right to nationalize or expropriate the property of foreign nationals within their territory. However, under customary international law and treaty provisions, the host country government must meet certain conditions when exercising lawful expropriation [9]. According to consensus, expropriation should meet the following criteria: it should be for a public purpose, non-discriminatory, under due process of law, and provide compensation to foreign investors [10].

Host countries' actions are often seen as indirect expropriation, impacting investors' rights without taking ownership. For example, if a government bans coal to reduce emissions, coal companies may seek compensation. International investment agreements have environmental exception rules, allowing countries to regulate for the public interest. However, these may not cover climate change measures, posing risks for developing countries. There's no consistent approach in arbitration on whether climate measures constitute expropriation. Factors like impact on investors and host countries' intent are considered. This uncertainty poses risks for host countries in implementing climate measures. International investment agreements allow countries to collect fees, usually indirectly, affecting investors' rights without ownership [11].

3. Breaking the Deadlock Methods

3.1. Exception Clause

Due to the uncertainty of whether goodwill regulatory measures implemented by the host country for public interest constitute indirect expropriation, this situation can be avoided through the exception clause method. The environmental exception rule is generally stated as: except in very few cases, the implementation of non-discriminatory management measures by the host country to safeguard legitimate public interests, such as public health, safety, and the environment, does not amount to indirect expropriation. The purpose of the rule is to protect goodwill regulatory measures aimed at legitimate public policy objectives (such as public health, safety, and the environment) from constituting indirect expropriation. It can also be specified, as in the BITs of Canada and the United States, that the "except in rare circumstances" clause, explicitly states that climate change investments are rare circumstances and do not apply to expropriation provisions. Examples include the 2012 US

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BIT template, the EU's "TTIP draft," bilateral investment agreements between China and Uzbekistan, and the free trade agreement between China and New Zealand, among others. The use of exception clauses can take necessary measures in emergency or urgent situations without bearing legal responsibility for violating treaty obligations.

The existence of discrimination in international investment agreements is an important factor in determining indirect expropriation. The measures taken by the host country to fulfill its international obligations to climate change, which discriminate against investors or investments, naturally constitute discrimination and are therefore considered indirect expropriation and require compensation for investors. Therefore, the expropriation clause should indicate that the host country's goodwill and legitimate measures taken to fulfill its international obligations to climate change do not constitute indirect expropriation for investors and investments.

3.2. Legal Interpretation

When the host country's energy-saving and emission-reduction measures result in increased costs for investors, investors often initiate arbitration on the grounds of expropriation of their property by the host country, seeking compensation. At this time, the arbitral tribunal, in interpreting the expropriation clause in international investment agreements, can use the polluter pays principle as an interpretive factor, requiring investors to internalize the costs of their pollution, demonstrating the legality of not compensating for measures taken to address climate change.

4. Conclusion

With the increasing global concern over climate change, there may be more and stricter international climate agreements in the future. This will further impact the development of international investment law, potentially leading to more provisions on environmental protection and sustainable development being incorporated into international investment agreements. At the same time, the dispute settlement mechanism between investors and states may also undergo changes to better reflect the goals of sustainable development. For investors, this will mean the need to pay more attention to and understand climate change, sustainable development, and related legal issues in order to make investment decisions in line with global trends.

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