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Reforming International Investment Law for Effective Climate Change Action

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Abstract. This study will explore how International Investment Agreements (IIAs) can be adapted to support efficient mitigation and adaptation to climate change. In other words, attempt to align investment policies with objectives of environmental protection. Our goal is to do this without hampering investment in environmental protection. A critical question that this study tries to answer is whether such changes in IIAs can be applied across the board to all different economic contexts and, in particular, their feasibility for less developed countries. Its major goal is to enhance investor confidence, especially in the environmentally green area. This will help us achieve the United Nations' Sustainable Development Goals (SDGs). Our findings have essential implications for policymakers and decision-makers to develop climate policy and international cooperation on climate issues. In addition, it is very relevant to increase economic resilience in various economic environments and to fight the negative impacts of climate change.

Keywords: international investment law; climate change; developing and developed countries

1. Introduction

The point at which international investment meets environmental policy has become pivotal to global sustainability due to the increasing effects of climate change. This study seeks to answer the key research question: How can IIAs be reformed or interpreted without acting as a barrier to environmentally friendly investments while effectively accommodating mitigation and adaptation to climate change? The question is indeed urgent, as there is growing awareness that the current investment frameworks may well obstruct the very actions required for the transition on climate change.

The question arises from the apparent contradiction between the objectives pursued by IIAs—setting investor protection and market access—and the imperative need for climate action. With international experience of the economic and environmental consequences of climate change, it is time to reconsider the role that IIAs may play. As currently framed, the regime has the dangerous potential to be an obstacle to policies designed to constrain emissions of greenhouse gases or, in any other way, to achieve consistency with sustainability considerations.

Answers to this question may substantially influence the direction of present policy debates and future text in various international agreements. We can spur a greener global economy by aligning

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investment policies with environmental objectives. It is not an abstract connotation; rather, it is an existing reality. To make it quite explicit, consider a case where a developing country wants to introduce a carbon tax purposed at cutting its emissions. If it means an IIA is standing in the way, with possible investor claims, it cuts across global climate goals directly. Such policies could be used as the founding basis on which a wave of climate-friendly investment and policy would launch to advance UN Sustainable Development Goals (SDGs). once IIAs have been reformed to allow it.

Today's decisions over IIAs would set the course of international climate actions and economic development, at least for the coming decades. The moot implications would range from a paradigm shift in international trade and investment flows to affecting the livelihood of billions of people in both industrialized and developing countries. The reader learns about ongoing complicated processes in international efforts toward combating climate change and ensuring sustainable development by engaging in this question.

2. Thesis and roadmap

The tentative thesis of this work is that while there is recognition at the preliminary level in IIAs that something has to be done to take care of the climate, the generality and inflexibility of their provisions make execution difficult both for policymakers and investors. It suggests that a multidimensional approach, sensitive to countries' capacity and needs, is necessary when devising solutions efficiently and equitably. It is hypothesized that by developing a more context-sensitive framework within IIAs, it is possible to harmonize the objectives of climate change mitigation with the principles of fair and non-discriminatory investment treatment, ensuring that sustainable development is attainable for all nations, irrespective of their level of economic development.

To study my thesis, this research will first show some key literature related to the research topic in which the author has identified a gap or inconsistency in the literature. Then, the author tried to design a research question to address that gap and made hypotheses. Next case studies are used to find an answer to the research question that tests the identified hypotheses. Finally, the conclusion will try to offer a clear answer to the research question, consistent with the thesis.

3. Literature review

Climate change is the top priority on the world schedule. The Paris Agreement, a pivotal accord adopted in December 2015 under the United Nations Framework Convention on Climate Change (UNFCC), is a call for "urgent action to combat climate change and its impacts," echoing the sentiments of Goal 13 within the Sustainable Development Goals (SDGs) set forth in September 2015. This global consensus underscores the imperative to address the pressing issue of climate change. Despite these strides, the integration of climate considerations into international investment agreements (IIAs) has been less than comprehensive. Policymaking in this arena has yet to fully embrace the urgency of climate action and environmental preservation as a critical and specific concern, highlighting a gap that must be bridged to ensure a sustainable future.

Daniel M. Firger and Michael B. Gerrard [1] argued that environmental concerns can be mentioned in the preamble and body part of IIAs. Preambular language is always used to determine the scope and object of the full treaty. This ensures the commitments to mitigate the climate change crisis are highlighted rather than undermined. UNCTAD’s 2010 World Investment Report was drafted to affirm that “IIAs and attendant FDI flows aim to help address the climate change challenge.” Likely, the Energy Charter Treaty (ECT) referred to the UNFCC for the benefit of

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present and future generations. Except for these simple mentions, countries may replicate the precise language of the UNFCCC's preamble to avoid any ambiguities.

Non-discriminatory treatment encompassing both national and most favored nation treatment promised that foreign investors and investments must be 'no less favorable' than that accorded to investors and investments of the host State itself and of third States who are 'in like circumstances'. Martin Dietrich Brauch [2] pointed out that when enacting policies aimed at mitigating climate change, host countries might inadvertently find themselves at odds with the non-discrimination provisions of International Investment Agreements (IIAs). Policies that favor environmentally friendly investments, such as those in renewable energy, and discourage those with high carbon footprints could be seen as discriminatory under these agreements. The crux of the issue lies in the fact that IIAs do not explicitly state that investments with varying levels of environmental impact are not to be treated as 'like circumstances.' This ambiguity leaves the door open to potential disputes.

There is a growing trend of refining the interpretation of key terms like "like circumstances". Markus Gehring and Marios Tokas [3] mentioned that the COMESA Investment Agreement's Article 17 explicitly acknowledges environmental impact as a criterion for establishing comparability between different investments. Similarly, numerous Bilateral Investment Treaties (BITs), such as the Canada–Guinea BIT in 2015, articulated that performance requirements regarding the use of technology to meet generally applicable environmental requirements are not inconsistent with the relevant prohibition of performance requirements. This clarification is instrumental in harmonizing environmental stewardship with the obligations of investment agreements.

Another ambiguous statement in IIAs is about expropriation. US model BIT Art 6 stated that neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization except for a public purpose; in a non-discriminatory manner; on payment of prompt, adequate, and effective compensation; and in accordance with due process of law and Minimum Standard of Treatment. Both indirect and direct expropriation may hinder climate change action. Martin Dietrich Brauch [2] further described that a nation might nationalize sectors heavily reliant on fossil fuels as part of a low-carbon economy initiative. However, this bold step could trigger a wave of legal challenges from affected investors under the support of IIAs. They may question whether the expropriation was genuinely for a public purpose, whether it adhered to the proper legal procedures, and whether it was executed in a manner free from discrimination. Additionally, they will assess whether the compensation offered was just and equitable.

Synthesizing the messages stemming from the existing literature on the nexus of action against climate change and IIAs, one specific insight emerges: even though much has been done in the elucidation of the challenges posed by certain principles in these agreements, the actual way toward solutions appears a bit muddled. What is more urgently needed is research that would give clear and actionable solutions to make the road to a sustainable future one that is paved by pragmatic and effective measures.

4. Statement of hypotheses

Hypothesis 1: Building upon the potential for non-discriminatory treatment provisions to conflict with environmental policies, this hypothesis explores the extent to which these provisions may inadvertently hinder or facilitate effective climate change governance. It is suggested that the current ambiguity in IIAs regarding the treatment of investments with different environmental impacts could

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lead to a situation where climate-friendly policies are perceived as discriminatory, thus potentially limiting the policy tools available to states for addressing climate change.

Hypothesis 2: Existing legal frameworks and policy initiatives have been explored to mitigate the adverse effects of expropriation on climate change governance. These include the development of international standards for fair and equitable treatment of foreign investments, the incorporation of environmental considerations into investment agreements, and the establishment of dispute resolution mechanisms that prioritize sustainable development and climate objectives.

Hypothesis 3: The third hypothesis suggests that by refining and adapting existing principles and measures within IIAs, it is possible to reduce the disparities in the impact of MFN and NT on climate change across different economic contexts, thereby aligning investment law with climate change objectives in an equitable and effective manner.

5. Case study analysis

The interface between international investment agreements (IIAs) and climate change governance is complex and in a state of evolution, and my hypotheses zero in on the role that nondiscrimination principles play, the investigation of legal frameworks that could contain negative expropriation consequences, and the articulation of principles to bring investment law into better consistency with the emergence of policies on climate change.

5.1. Kyoto protocol

The Kyoto Protocol, as an early example of international climate governance, introduced mechanisms like the Clean Development Mechanism (CDM). Article 12 of the Kyoto Protocol stipulates that CDM projects are restricted to collaborations between developing countries and entities from developed countries. However, such initiatives might inadvertently conflict with non-discrimination principles in IIAs, such as the National Treatment (NT) or Most-Favored-Nation (MFN) obligations. The restriction of CDM projects to only those involving entities from developed countries could be seen as discriminatory under NT principles, potentially setting the stage for challenges by affected investors.

5.2. Vattenfall v. Germany

The Vattenfall v. Germany (ICSID Case No. ARB/09/6) illustrates the tension between environmental protection measures and investor rights under the ECT. Under the framework of German legislation, the construction of a power plant requires 2 permits from the Authority for Urban Development and Environment in Hamburg (Behorde fur Stadtentwicklung und Umweit, BSU), one for the construction and operation of the plant and the other for the use of water. The water permit was extremely restrictive, imposing requirements for the temperature of the cooling water to be returned to the Elbc River and for the oxygen content of the river water to be well beyond what could reasonably be expected at Vattenfall.

During the construction of the power plant, the Respondent requested the Claimant expand the scale of production to ensure the supply of electricity and heating for the city of Hamburg. However, due to pressure from public opinion from environmental organizations, the Respondent was later forced to change its attitude and imposed a series of restrictions on the license for the power plant, which resulted in the halt.

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From the perspective of environmental protection, Germany's imposition of stringent environmental conditions on the construction of a power plant was deemed by the ICSID tribunal to constitute an indirect expropriation, thus infringing upon the investor's rights. The investors were seeking compensation from the government. This case highlights the need for a careful balance between environmental sustainability and the protection of investments, suggesting that the ECT's framework could be further refined to integrate environmental principles into investment arbitration better.

5.3. ECT

Kaj Hobér argued that the ECT constitutes a significant step forward in bridging the gap between international investment law and environmental issues insofar as it expressly envisages several key environmental and sustainable development principles.[4] The preamble of the treaty refers to the climate change regime, but most notably, the ECT provisions refer to sustainable development, the principle of precaution, and the polluter-pays principle.

However, the potential for these principles to be applied in cases like Vattenfall is limited by the current structure of the ECT. To better address environmental concerns within the framework of the Energy Charter Treaty (ECT) and international investment arbitration, several enhancements could be considered. The ECT could be amended to include explicit environmental provisions that prioritize sustainable development, the precautionary principle, and the polluter-pays principle.

Introducing a flexibility mechanism would allow contracting parties to implement necessary measures for environmental protection, even if these measures might conflict with certain investment protection obligations under the ECT. Strengthening the dispute settlement mechanism to explicitly permit counterclaims by host countries based on environmental protection arguments and ensuring these claims are thoroughly examined would also support the integration of environmental concerns.

If the existing provisions of the ECT are found incompatible with environmental protection goals, contracting parties might consider withdrawing from the treaty or renegotiating it to align with current environmental objectives. Learning from other international investment agreements that already incorporate environmental clauses, such as the sustainability chapters in EU trade agreements, could provide valuable insights for the modernization of the ECT.

5.4. TSI

The Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation (TSI), recognized as the winner of the Stockholm Treaty Lab prize, serves as an exemplary framework for nations to encourage global investment shifts from high-carbon to low-carbon energy paradigms. Its foundational structure comprises three key elements: 1. discouraging investments that are not sustainable; 2. encouraging investments aligned with sustainability principles; and 3. facilitating a transition towards economies and societies that are environmentally sound, socially inclusive, economically viable, and resilient to climate change.

Contrasting with conventional international investment agreements that prioritize the safeguarding and enhancement of all investment types, including those detrimental to environmental health, the TSI deviates from the contentious and broadly applied criteria such as FET, indirect expropriation, full protection and security, and legitimate expectations. Landmann and Niclas state that these criteria uphold the rights of investors and their investments against actions conflicting with globally recognized norms. [5] The treaty offers precise definitions to circumvent the expansive

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interpretations that have characterized past arbitral tribunal decisions. It explicitly excludes ambiguous criteria, along with procedural rights for unsustainable investments (Articles 3.3 and 3.4).

According to Bradly J. Condon, the TSI states that non-discrimination provisions are applicable solely to investments within the same category. [6] While the treaty prohibits discrimination among sustainable investments under similar conditions, it permits and indeed advocates for preferential treatment of sustainable investments over those that are unsustainable, which are to be phased out.

In essence, the TSI presents an optimistic outlook for the future of climate governance and international investment. However, several challenges may impede its adoption and influence.

Firstly, investors might seek the benefits of older, more favorable treaties. Consequently, nations must overhaul all existing BITs to allow the TSI to achieve its intended impact fully. Moreover, the effectiveness of the TSI could be diminished by pre-existing investment contracts that provide access to ISDS under the traditional investment arbitration framework. The most significant barrier to the TSI's success may thus be the prolonged period required to reform outdated treaties and to wait for the expiration of old contracts, enabling the treaty's full potential to be realized within the system.

Another potential impediment to the TSI's widespread acceptance is the disparity in bargaining power among prospective signatories. Nations with developing or smaller economies may struggle to enforce such a transformative approach on larger or more dominant treaty partners. The success of the TSI hinges on visionary and influential nations embracing and advocating for this model of investment protection.

Furthermore, certain states, particularly developing ones, may lack the expertise or financial resources to fulfill the TSI's institutional obligations. The treaty acknowledges this potential challenge by proposing alternative structures for its joint committee, contingent on the involvement of developing states (Article 10.1). Nonetheless, developing countries would still need to appoint representatives from government bodies overseeing sectors like energy, environment, and climate change and establish a national contact point. While the TSI addresses the issue of state capacity in other articles by offering technical assistance (e.g., Article 6.3(4) on the transparency requirement to make state party laws and regulations publicly accessible), no such provisions exist for the TSI's institutional obligations. Therefore, similar provisions should be incorporated to alleviate the burden on developing countries.

6. Conclusion

This study has delved into the intricate relationship between international investment law and climate change action, revealing the limitations of the current legal framework in facilitating climate initiatives. Through the analysis of case studies, the following conclusions and recommendations are presented:

The above research indicates that the existing legal framework of international investment law increases the cost for countries to address climate change. To mitigate the conflict between investment law and climate action, it is recommended that existing bilateral investment treaties be reformed to ensure they do not impede climate action. Specifically, more bilateral international investment treaties should incorporate explicit environmental provisions or carve-outs, allowing governments to undertake climate actions without the burden of compensation payments.

From the viewpoint of the role of arbitrators and legislators, when adjudicating investment disputes, they should pay greater attention to climate change considerations. They must directly

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account for climate concerns within their decisions and legislative processes to ensure that legal outcomes align with global climate objectives.

The study also highlights the insufficient support for developing countries. To better assist these nations, it may be beneficial to consider a tiered system, with one set of rules for developing countries and another for developed ones. Such a system could more effectively address the distinct needs and challenges faced by countries at different stages of development in their climate actions.

While this study provides a rough analysis of the current issues, there are areas that require further investigation. Particularly, how to design an international investment legal framework that promotes climate action while also protecting investor rights and how to achieve fair and effective climate governance among countries with varying levels of development are questions that merit the attention of future researchers.

In summary, this research underscores the critical role of international investment law in addressing climate change and proposes a series of reform recommendations. Through these reforms, we can envision a more equitable and sustainable global economic system that fosters both economic growth and environmental protection.

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