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Climate Change and International Investment Law: What Are the Challenges and Uncertainties? Arbitration practitioners' reflections at the 8th EFILA Annual Conference

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The defining challenge of the 21st century is undoubtedly climate change. There is consensus that we need to reduce the level of carbon emissions and abide by the scientific community's directions to preserve our environment; we are beyond preventing harm – our current urgency is mitigation. We seem united in our common goal to meet the decarbonization targets of the Paris Agreement, the most significant regulatory realization to date with more than 190 signatories. In Europe, the Green Deal, along with the next generation of green policy Directives and the EU Recovery plan's largest stimulus package to date, aim to steer massive sustainable investments within the EU. Similarly in the United States, the unprecedented Inflation Reduction Act 2022 projects over USD 350 billion in clean investments over the next years – albeit that the Federal Government recently greenlighting the Willow Project has steered great controversy. This post provides a recap of discussions of these themes at the recent EFILA Annual Conference which took place on 16 March 2023 in Madrid. Keeping with the theme of the Conference, the post focusses on the discussions from panels (**1**) emphasizing the message that our current investment protection system needs to re-focus on social justice and (**2**) discussing what the challenges and uncertainties of our international investment law are in implementing climate change action.

1. The Current Investment Protection System Needs to Re-Focus on Social Justice

Wendy Miles KC set the tone of the Conference through her keynote entitled *The Role of Law in Promoting, Facilitating and Protecting Investment in Net Zero*, highlighting that our harsh socio-economic reality can be visualised as follows:

We are all on the same boat. While it is not sinking, giving a false sense of safety on the upper board, the waters in which it floats are slowly boiling – and it is the lower decks that feel it most. There is no rescue boat in sight, and we do not have enough lifeboats. To save everyone on board, we must first ensure the upper decks feel this urgency as well before it is too late to act.

We seem to know "what" it takes to solve the problem – transitioning to net-zero carbon systems. In other words, we know how to build more lifeboats. It remains to be seen how investment protection features in this story.

International investment law was simply not designed for facilitating a global energy transition. Nevertheless, we should be united in deploying every single legal mechanism we can to implement the goals of the Paris Agreement. Instead on debating if the current system somehow hinders regulatory change, we should reflect on its impact on social justice and securing intergenerational equity. Our investment laws should support those actors at the forefront of the energy transition, the real backbones of most economies (e.g., small and medium companies, especially in less developed and emerging countries). They are the ones that need investment most.

2. Challenges and Uncertainties of International Investment Law in Implementing Climate Change Action

So what are the main challenges that our community faces in the climate transition? In two words, "econobility" (**A**) and *Rockhopper* (**B**).

A. Econobility and Accounting for the Energy Transition

In the economic dynamics of the energy transition, there is an inherent tension between the interests of States – which (should) prioritize green initiatives to implement the Paris Agreement – and those of private polluters – which are pressed to satisfy employment requirements, guarantee energy supplies, and secure those supplies in the face of war and other crises. Yet these interests are not necessarily antagonistic, so how can we alleviate this tension?

A panel chaired by Dr. José Ángel Rueda García discussed this tension when States simultaneously act as both regulators and shareholders in state-owned companies. Cecilia Carrara pointed to this dichotomy as highlighting the important role of State-Owned Enterprises (SOEs), which must be particularly astute and proactive in their climate change action. In turn, Dr. Paschalis Paschalidis emphasized that investors should equally be more responsible in fulfilling their part in the energy transition. He also suggested that state aid regulations be revisited to ensure they do not obstruct necessary governmental funding.

The second panel, chaired by Dr. Moritz Keller, focused on the various challenges and uncertainties. As Marieke Faber noted, the trend is to widen companies' responsibilities by increasing their due diligence and reporting obligations, to speed up their transition and prevent greenwashing. For example, the EU's new Corporate Sustainability Reporting Directive makes companies report and reflect on their value chains, anticipating and adapting their goals to the Paris Agreement.

Laura Cózar pointed out that this heightened corporate social responsibility also brings new ingredients to valuations. Companies' Environmental, Social, and Governance (ESG) initiatives and green financing investments shall be projected to better adapt to the net-zero future, lowering their risk factor and translating into a lower discount rate. Of course, the cost of these initiatives will also factor in the cost of capital.

B. Rockhopper and the Role of ECT arbitration in Supporting Climate action

In the context of our common goal, the current investment state dispute resolution system and the controversial Energy Charter Treaty (ECT) are not forces of evil.

In the words of Timothy Foden, "the narrative against the ECT lacks a rudimentary fact check." The idea that the ECT is a hinderance on climate transition because it protects fossil fuel investment and prohibits States from freely regulating is misleading. There is no empirical evidence of this alleged regulatory chill. As Samantha Rowe emphasized, the ECT is a neutral convention which applies to fossil fuel and renewable energy investments equally. Indeed, statistics indicate that ECT-based investor-state arbitration is in fact predominantly used by renewable energy investors and arbitrators awarded significantly more damages to them than any others. Its modernized version does its part in carving out protection of fossil fuel investments, but also carves out other protections, such as access to investor-state arbitration for intra-EU investors.

A subsequent Oxford-style lively debate in the room on the motion "*A (modernized) ECT is necessary to speed up the energy transition in accordance with the Paris Agreement goals*", involving on the side for the motion: Prof. Dr. Yannick Radi, Prof. Rafael Gil Nievas, Risteard de Paor and against the motion Anja Ipp, Prof. Belen Olmos Giupponi, Lourdes Martínez de Victoria Gómez, resulted in only a slight majority for the motion.

Some opine that a lack of investment protection only discourages the foreign direct investment needed to fund the energy transition. This is particularly the case for developing countries which are reliant on fossil fuels and struggle to align to net-zero targets. Is then suddenly abolishing the protection of all former fossil fuel investors the justiciable approach? Or is it true that investment in mitigation needs to be supplemented with investment for adaptation? Irrespectively, tribunals need to be wary of the balance between facilitating an equitable transition and green washing, or grandfathering unsustainable investments.

Then, of course, we have decisions like *Rockhopper*, a prime example of why the role of ISDS in the net-zero future remains questionable. The award has become the leading reference for the argument that the ECT is not compatible with our current goals gives States a dangerous "regulatory chill", David Sandberg explained. Rockhopper seems to have conjoined the state's right to regulate and investor's right to fair compensation, instead of treating them like separate concepts.

Alexander Leventhal pointed out that one of the main challenges and uncertainties of the future role of ISDS in the current regulatory context concerns the legal standard by which we assess State actions. For example, phase out cases (usually in mining or oil and gas sectors) usually include expropriation claims by fossil fuel investors, inviting consideration of whether the States' actions had a "legitimate public purpose" – such as fulfilling the goals of the Paris Agreement. However, tribunals in these cases must often also determine whether the State accorded investors fair and equitable treatment, by assessing their legitimate expectations on a case-by-case basis; this is a less predictable exercise.

Despite these uncertainties, we have seen examples of the positive role that investment arbitration can play in tackling climate change. For instance, we have seen successful environmental counterclaims by States against polluters (*see, e.g. Burlington. v. Ecuador*), and tribunals rejecting expropriation claims based on good faith environmental preservation actions by the State, acting within their police powers (s*ee, e.g. Eco Oro v. Colombia*, decision which was however criticized for placing environmental and investment protection on equal footing); and we are seeing this trend codified in the new generation of International Investment Agreements (which *e.g.*, condition investment protection on sustainability (*See, e.g*. CPTPP Chapter 20; CETA, Chapter 22; USCMA; Netherlands Model BIT 2019; Morocco Model BIT 2019; BLEU Model BIT 2019).

Finally, a “fireside chat” with Sir Francis Jacobs, the former British Advocate General, who served 17 years at the Court of Justice of the EU (CJEU), highlighted the difficulties of the CJEU to accept any other international court or tribunal next to it.

3. Conclusion

In sum, the EFILA conference had productive discussions that reinforced the idea that even though the outcome of the ECT modernization process, ISDS reform, and the current regulatory system remains uncertain, there is a positive push towards steering of the international investment protection system towards social justice is gladly visible. In fact, there is a strong commitment from the arbitration community to build us lifeboats.

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