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Past the Tipping Point? The Diminishing Value of Investment Treaties and Arbitration in the Green Transition Era

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On 24 April 2024, the European Parliament voted for the EU to withdraw from the Energy Charter Treaty ("ECT"). Three days earlier, Ecuador had voted to keep the country's constitutional ban on investor-state arbitration. These events mark the last chapters in the increasingly turbulent tale of investment treaties and investor-state arbitration.

Over the past few years, that tale has progressed toward a tipping point. Efforts to modernize the ECT surfaced vigorous public opposition against the treaty, and cases like *Rockhopper v. Italy* and *Eco Oro v. Colombia* fueled fears that investment arbitration is incompatible with states' efforts to tackle climate change. In late 2023, a UN report warned that investor-state arbitration has "catastrophic consequences for the environment and human rights."

Reading the writing on the wall, former president of the ICC Court of Arbitration Alexis Mourre recently said that "there is virtually no longer anyone, across the European political spectrum, defending [investor-state arbitration]." Mourre suggested that foreign investors and their advisors should now contemplate risk mitigation tools other than investment arbitration—such as contractual protection.

International investment law may now have reached, or already passed, the tipping point. In this era of green transition, do investment treaties and investor-state arbitration have any remaining value?

The Role and Risks of Private Investors in Climate Change Mitigation and Adaptation

First, some necessary background: Private investors play a pivotal role in the climate transition. In a frequently cited 2021 report, the International Energy Agency estimated that in order to reach net zero emissions by 2050, annual clean energy investment worldwide would need to triple by 2030—to around US$4 trillion annually. Recent studies indicate that the world will need US$10 trillion annually between 2030 and 2050 to avoid the worst impacts of climate change. While some of these funds will come from the public coffers, most of it will come from private investors.

The central role of private investors in the climate transition was recognized already in the 2015 Paris Agreement, which emphasizes the importance of finance and investment in operationalizing the goal of limiting global warming to 1.5°C above pre-industrial levels. Article 2.1(c) of the

Agreement calls on governments to "make financial flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." To achieve this, states will need to engineer new policy frameworks, make significant legislative changes, and regulate like never before. Not exactly a recipe for a stable investment climate.

Risk is inherent to all investments; in fact, the assumption of risk is often included in the definition of "investment" in investment treaties. The risk profile is more complex, however, for investments in renewable energy and other forms of climate change mitigation and adaptation. These investments typically happen in the context of regulatory instability and often require substantial upfront capital expenditures, sometimes in technology that is still in its infancy. Understandably, investors seek to mitigate these risks, including by assurances that their investments are shielded from certain government regulatory actions or policy shifts that could jeopardize their returns.

Investment Treaties and Arbitration as Risk Mitigation for Foreign Investors

Investment treaties have long been considered to mitigate the risks faced by foreign investors, including risks related to regulatory instability. Enforceable through investor-state arbitration, the generous protections provided by these treaties have, in effect, served as a free insurance policy for foreign investors. This is why some law firms today advise "companies exposed to certain climate-related government measures to vindicate their rights" by restructuring their investments to ensure coverage by one of the 2,000+ bilateral investment treaties ("BITs") currently in force. Regardless of whether this is ethical, is it still solid advice?

There are signs that investment treaties and investor-state arbitration are falling out of favor; going forward, they may not be reliable as an insurance policy for foreign investors. Relatively few countries sign new treaties that include investor-state arbitration. According to UNCTAD, in 2022, 60 investment treaties were terminated, while fewer than 20 new ones were signed. Several countries, including India, have terminated all their existing BITs. Add to this the European exodus from the ECT and a decline in the number of new investor-state arbitrations filed. Is this perhaps the writing on the wall?

Of course, even if investment treaties are on their way out, treaty-based arbitration will not disappear overnight. Famously, the ECT's sunset clause keeps the treaty's protections alive for 20 years after a country's withdrawal. Some investors may be tempted to conclude that investment arbitration will remain a viable risk mitigation tool for the foreseeable future. I would not be so confident in that conclusion. Because even where there is an applicable investment treaty, tribunals may be increasingly hesitant to use it to shield investors from regulatory instability resulting from states' efforts to tackle the climate crisis.

The Shrinking Scope of Treaty Protection in the Context of Climate Crisis

The scope of treaty-based investor protections has expanded over time. Over the past couple of decades of arbitral caselaw, certain key treaty provisions have come to be interpreted very broadly. For example, many tribunals have read the common treaty promise of Fair and Equitable Treatment ("FET") to guarantee the same level of protection as a contractual stabilization clause. In doing so, many have cited language originating in the 2004 *Occidental v. Ecuador* award:

"[T]here is certainly an obligation not to alter the legal and business environment in which the investment has been made." That statement may have flown in the past—but for how much longer? In the context of climate crisis and energy transition, it may appear a bit tone deaf.

Many observers have criticized the expansive interpretations of FET, and some (myself included) have called for a narrower reading of the provision in light of the global climate goals and states' obligations under the Paris Agreement. So far, nobody has stated the issue more eloquently than Zachary Douglas in his dissenting opinion in a renewable energy case against Spain: "[I]n an era where radical reforms in the energy sector are not only desirable but necessary for the sustainability of human life on Earth, it seems incongruous now to be interpreting the FET standard as requiring States to buy back their right to implement those reforms at the highest price." I would venture a guess that many arbitrators, in the privacy of their chambers, probably agree with him.

Treaties Do Not Protect Investors Against Foreseeable Regulatory Changes

In analyzing an FET claim, most tribunals will consider whether the regulatory changes that allegedly impacted the foreign investor were *foreseeable* at the time when the investment was made. If the changes were foreseeable, the investor assumed the associated risks. Today, in the midst of the biggest economic transformation since industrialization, it is not hard to spot regulatory change on the horizon.

Given the urgency of the climate crisis and the pressure on states to meet their obligations under the Paris Agreement, reasonable foreign investors should expect regulatory changes to be rolled out in all sectors and industries. Moreover, considering the speed with which these changes must be made, and the uncharted territory involved, investors should also expect that states may not get it right on the first try—meaning they will need to make adjustments to recently passed regulations. Climate-related regulatory change is not only foreseeable, but arguably also falls within states' largely undisputed right to regulate in the public interest (or, some would say, their *duty* to regulate).

In the context of climate crisis, urgent economic and societal transformation, and vigorous political and public criticism of investor-state arbitration, tribunals may be unwilling to continue interpreting the FET standard as a *de facto* stabilization clause. Arbitrators are well aware that states have obligations under climate and human rights law to reduce emissions and to protect citizens against catastrophic climate change, and that significant regulatory space is needed to meet those obligations. Those who fail to take this into consideration when interpreting and applying treaty language will risk appearing out of touch with reality.

Is There a Place for International Investment Law in the Green Transition?

It is easy to assume that investment treaties and investor-state arbitration, by providing protection and mitigating risk, help mobilize foreign investments—including the trillions necessary for the green transition. I used to make that assumption myself. But times change and new evidence comes to light, and now even Alexis Mourre admits that the common belief that investor-state arbitration increases the flow of foreign investment has never been proved scientifically.

True, there is scant evidence to support the claim that investment treaties and arbitration help a country attract investment. An OECD Working Paper has shown that investment protection treaties have little to no effect on foreign direct investment flows, and a meta-analysis of 74 separate studies, published in the Journal of Economic Surveys, found "robust evidence that the effect of international investment agreements is so small as to be considered zero."

In 2022, the Columbia Center for Sustainable Investment conducted a survey of renewable energy experts, in a quest to understand the factors that shape investment decisions. The survey results "confirm[ed] decades of research that have failed to establish that . . . investment treaties have a discernable impact on promoting foreign investment flows, including in the renewable energy sectors." Further to this point, investment treaties and arbitration are not among the 167 criteria used by Bloomberg New Energy Finance to assess countries' attractiveness for renewable energy investments. In fact, countries that have not signed or have recently terminated such treaties are ranked by Bloomberg as providing the best opportunities for renewable energy investors.

Conclusion

Foreign investors play a central role in the green transition; investment treaties and investor-state arbitration, it would appear, do not. In the green transition, these traditional forms of investment protection may have limited relevance as a risk mitigation tool and thus no value as an investment incentive. Investors may prefer to rely on other risk mitigation strategies, including carefully drafted contracts, political risk insurance, and—perhaps most importantly—comprehensive due diligence. Taking care to understand the investment climate and setting reasonable expectations can go a long way in avoiding disputes altogether. On their part, governments that want to attract green investment should engage with investors and do whatever they can to provide regulatory stability, procedural transparency, and good old basic fairness.

The author is the co-editor of Investment Arbitration and Climate Change (Wolters Kluwer 2024)

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