Obstacles for the Current IIAs in Addressing Climate Change

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Global climate change has become a major concern today, and it has been described by the G20 as “one of our greatest challenges”. Climate change is characterized by externality and has a global, long-term, and intergenerational impact. To prevent climate change deterioration, the 21st United Nations Climate Change Conference adopted the Paris Agreement, which promotes climate finance and mitigates climate change worldwide. At the international law level, since Germany and Pakistan signed the first bilateral investment treaty (BIT) in 1959, international investment agreements (IIAs) have emerged as one of the most significant sources of international legal protection and promotion of foreign investments.

climate change | international investment agreements | investor–state dispute settlement

1. Risks Posed by Investment Arbitration in Challenging Climate Measures

According to the statistics of the UNCTAD, there is a total of 3300 IIAs all over the world, with a majority of them concluded between the 1980s and the 2010s [1]. These “old-generation” IIAs were concluded before the widespread climate action and they are “climate neutral or climate blind” [2]. Investors may challenge the host states’ climate policy by invoking investment protection provisions, particularly the non-discrimination provisions, FET provisions, and indirect expropriation provisions, as these substantive protection provisions are formulated in broad and vague ways.

First, the principle of non-discrimination provisions prohibits the discriminatory treatment of foreign investors in like circumstances without a justifiable reason [3]. In contrast to the UNFCCC and the Paris Agreement, the requirement of non-discriminatory treatment clearly contravenes the principle of “common but differentiated responsibilities”. As far as the interpretation of “in like circumstances” is concerned, the arbitral tribunals tend to only consider investment projects that are competing in the same market and do not distinguish between high- and low-emission investors. In light of this, foreign investors may question whether the host state’s measures are discriminatory when it gives incentives to low-emission investments or removes subsidies for high-emission investments. For instance, in the same power and energy industry, enterprises with low carbon emissions such as photovoltaic and wind power will enjoy more preferential treatment than those with coal power generation, which may conflict with the requirements of non-discriminatory treatment. Additionally, distinguishing investors from different economic or business sectors may also violate the non-discrimination requirement. A tribunal ruled in the case of the Occidental Exploration and Production Company v. Ecuador that the term “in like situations” cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of NT cannot be done by addressing exclusively the sector in which that particular activity is undertaken [4]. As part of implementing the climate objectives, states have integrated high-emission industries such as power, steel, and building materials into the emission trading system and imposed restrictions on these industries. It is possible that, compared with investors in other types of business, foreign investors in the high-emission industries may claim that the climate regulatory measures of the host country are discriminatory.

Second, most voices on international investment reform and/or promotion of sustainable development in international economic law consider the FET as the most illustrative example that international investment law impedes climate change mitigation and transition to a less carbon-intense economy [5][6]. The FET standard serves the primary purpose of ensuring the stability of the investment environment in the host country [7]. Nevertheless, the implementation of climate measures by a host country may affect legitimate expectations of foreign investors, who will take it as a breach of FET standard [8]. A brief examination of the cases shows significant divergence in the legal standard of FET. For example, in the approximately 20 awards published to date concerning Spain's modification and ultimate cancellation of a feed-in-tariff renewable energy incentive scheme, the tribunal adopted contradictory approaches in interpreting the legitimate expectation. On one hand, some tribunals ruled in favor of investors and emphasized that the legal system and commercial environment in which investors conduct their investment cannot be fundamentally modified by the host states. On the other hand, a few tribunals sided with the host state and maintain that only when the host state deliberately promises and induces investors to invest and the measures it takes after investment fundamentally contradict the expectations of investors can it be regarded as violating the legitimate expectations of investors. Therefore, this has shown that the standard of FET is fuzzy and circumstances in which the host states make efforts to implement the emission reduction obligations under the climate change agreements, either through legislation or administration, may cause the investors of high-emission enterprises to file claims that these measures constitute a violation of the FET standard in IIAs. As a consequence, host states may be forced to forego the system improvement necessary to safeguard the public interest and to implement climate-related measures, owing to the threat of arbitration and damage compensation [9].

Finally, the indirect expropriation provision can also be invoked by the investors to challenge host states' climate measures. In practice, however, the tribunals have adopted three different and incompatible criteria for determining whether the host state's environmental measures constitute indirect expropriation: the "sole effects doctrine", "a proportionality test", and the "police powers doctrine" [10]. It is unclear to what extent the climate measures will be considered indirect expropriation based on the aforementioned different and somewhat inconsistent approaches. Consequently, whether from the text of IIAs or from the practice of investment arbitration, the indirect expropriation provisions may have negative impacts on the host state's ability to implement climate change policies. The interests of foreign investors will be affected if the host country adopts strict climate protection measures to reduce greenhouse gas emissions to accomplish climate goals, such as formulating and implementing strict emission standards, enforcing a carbon tax on high-emission releases, banning the use of fossil fuels, or refusing to issue business licenses to high-emission enterprises. When foreign investors believe these measures will deprive them of their investment or affect their profitability, they may resort to international investment arbitration by claiming indirect expropriation.

2. The Unresolved Conflict between IIAs and Other Areas of International Law

The Paris Agreement imposes binding obligations to reduce greenhouse gas emissions on its parties. As a result, the government needs to change the legal framework to reduce high-emission investment. However, this may expose the host state to the liability risk under the investor protection clauses of IIAs.

Both cases of S.D. Myers. v. Canada and Santa Elena v. Costa Rica raise the conflict of different treaty obligations. However, the tribunals in both cases ultimately ruled that international obligations did not alter the legal nature of the full compensation for expropriation. In S. D. Myers v. Canada, the claimant argues that Canada's PCB regulations contravene the national treatment, international minimum standard of treatment, performance requirements, and expropriation provisions of NAFTA [11]. On the contrary, Canada noted that it was acting in accordance with the convention on the Control of Transboundary Movements of Hazardous Waste and Their Disposal (Basel Convention), which prohibits hazardous wastes, including PCB regulations, to non-Basel Convention parties (such as the United States) [11]. It was finally found by the tribunal that the ban was not justified by any legitimate environmental reason [11]. It can be seen in this dispute that there are overlapping treaty obligations between NAFTA and the Basel Convention. There was also a conflict between international obligations between the IIAs and the Convention Concerning the Protection of World Cultural and Natural Heritage in Santa Elena v. Costa Rica. In this dispute, Costa Rica expropriated foreign investor property in order to preserve a unique ecological site according to the Convention Concerning the Protection of the World Cultural and Natural Heritage. Costa Rica claimed it had an international obligation to protect the environment. However, the tribunal refused to consider the environmental obligations of nature reserves and ruled that even if a governmental action was laudable and beneficial to society as a whole, it would still constitute expropriation and must be compensated [12].

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