The International Investment Regime and Climate Change Goals: Clash of the Existing Systems and Available Balancing Tools

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Abstract

International commitments of states require them to adopt regulatory measures aimed at reducing CO2 emissions to combat climate change. This is likely to trigger a wave of investor-state claims by affected foreign investors, mostly from the fossil fuel industry. As no precedent currently exists, this article seeks to analyse how investment tribunals might approach such claims and balance substantive protections under international investment agreements with host states' obligations under the international climate change regime. After a brief overview of international climate change law, the article considers whether investor-state dispute settlement may serve as an enforcement mechanism for states' international climate change commitments, or rather investors' claims cause a regulatory chill. The article further analyses how international climate change law might be applied in investment treaty disputes and concludes that it is likely to be invoked to interpret standards of investment protection. Finally, the view is adopted that the police powers doctrine defence and invocation of general public policy exceptions, contained in new generation investment treaties, might excuse host states from compensation for regulatory measures adopted in furtherance of climate goals.

Keywords: Climate Change, Compensation, Expropriation, Fossil Fuels Phase-out, General Exceptions Clauses, International Environmental Law, Investor-State Dispute Settlement, Police Powers Doctrine, Principle of Systemic Integration, Regulatory Chill

A. Introduction

It is not new for the investor-state dispute settlement (ISDS) mechanism being used to challenge environmental and climate-related measures taken by states.[1] Until recently, however, broader concepts of climate change have only appeared, if at all, as

1 *UNCTAD*, Treaty-based Investor-State Dispute Settlement Cases and Climate Action, IIA Issues Note, Issue No. 4 (September 2022), p. 1, available at: https://unctad.org/system/files/official-document/diaepcbinf2022d7_en.pdf (15/6/2023); *Paine/Sheargold*, JIEL 2023/2, p. 288. See e.g. ICSID, case No. ARB/17/14, *Rockhopper Exploration Plc, Rockhopper Italia S.p.A. and Rockhopper Mediterranean Ltd v. Italian Republic*; ICSID, case No. UNCT/15/2, *Lone Pine Resources Inc. v. The Government of Canada*; ICSID, case No.

part of the background.[2] For the first time, regulatory changes adopted pursuant to state's international commitments to combat climate change resulted in ICSID arbitrations against the Netherlands in 2021, when investors challenged a Dutch law to phase-out coal power by 2030, or to convert coal power plants to produce biomass energy.[3] As a part of its defence, the Netherlands has heavily referred to its international obligations under climate change law.[4] Thus, *RWE v. the Netherlands* could be the first dispute in which a tribunal may have to weigh a treaty's investment protection provisions against state's obligations under climate-related treaties.

In turn, experts predict global action on climate change to trigger a wave of investment claims from fossil fuel investors similar to those brought against the Netherlands, totaling around $340 billion.[5] Against this backdrop, there are calls for reform of the current regime to ensure investment treaties, and the risk of facing ISDS claims, do not hinder states from achieving a transition to low-carbon economies.[6] Clearly, such reform could take years and until then investment tribunals will have no choice but to resolve anticipated disputes under the existing investment regime, which lacks provisions that effectively support climate action. Accordingly, this contribution seeks to assess compatibility of the existing investment regime with climate change goals and to deliberate how, in current circumstances, tribunals might approach claims challenging states' measures that implement their international climate change commitments. With this purpose in mind, the interplay of the existing international legal framework for climate change and the existing in-

ARB/21/63, *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*; *Alberta Petroleum Marketing Commission v. United States of America*, Notice to submit a claim to arbitration 9 February 2022.

2 *Ipp/Magnusson/Kjellgren*, The Energy Charter Treaty, Climate Change and Clean Energy Transition. A Study of the Jurisprudence, 2022, p. 6, available at: https://www.climatechangecounsel.com/_files/ugd/f1e6f3_d184e02bff3d49ee8144328e6c45215f.pdf (15/6/2023). See e.g. ICSID, case No. ARB/12/12, *Vattenfall AB and others v. Federal Republic of Germany*; ICSID, case No. UNCT/20/3, *Westmoreland Coal Company v. Government of Canada*; ICSID, case No. ARB/20/52, *Koch Industries, Inc. and Koch Supply & Trading, LP v. Canada*.

3 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands* (suspended, see: *Bohmer*, RWE Netherlands arbitration is suspended, pending appeal against German anti-arbitration declaration, available at: https://www.iarepporter.com/articles/rwe-v-netherlands-arbitration-is-suspended-pending-appeal-against-german-anti-arbitration-declaration/ (15/6/2023)); ICSID, case No. ARB/21/22, *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands* (concluded, on 17 March 2023 the tribunal issued an order taking note of the discontinuance of the proceeding, following the request made by claimants as a condition of Germany's bailout of Uniper SE).

4 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, Respondent's Counter-Memorial 5 September 2022.

5 *Di Salvatore*, Investor-State Disputes in the Fossil Fuel Industry, IISD Report, International Institute for Sustainable Development, 2021, p. 40, available at: https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf (15/6/2023); *Tienhaara, et al*., Science 2022, pp. 702–703; *Dooley*, JWIT 2022/5–6, p. 855.

6 *UNCTAD*, The International Investment Treaty Regime and Climate Action, IIA Issues Note, Issue No. 3 (September 2022), p. 2, available at: https://unctad.org/system/files/official-document/diaepcbinf2022d6_en.pdf (15/6/2023).

vestment regime is first reviewed (section B). Afterwards, the applicability of climate change law within ISDS proceedings is scrutinised (section C). Subsequently, the tools available under the existing investment regime to balance substantive protection standards with host states' measures to combat climate change are discussed (section D). Finally, concluding remarks are provided (section E).

B. Climate Change Goals and respective Obligations of States: Is the International Investment Regime of any Assistance to Enforce them?

To examine the role of climate change law as an area of international environmental law in relation to the existing investment regime, one should look at the basics of the climate change regime, including its treaty instruments and principles. It is important to understand the possible interaction between the two regimes, especially considering the fragmentation of international law and absence of enforcement mechanisms in climate change law, as opposed to the investment regime with ISDS. Accordingly, the issue is whether, in general, ISDS can complement action on climate change or, conversely, cause a regulatory chill effect.

I. Overview of Climate Change Law

1. Obligations of States under Climate Law: the UNFCCC, the Paris Agreement and its Aftermath

The United Nations Framework Convention on Climate Change (UNFCCC) entered into force on 21 March 1994,[7] has near-universal membership and is recognised as "the primary international, intergovernmental forum for negotiating the global response to climate change".[8]

Art. 2 UNFCCC sets the ultimate objective for the climate change regime, which is the "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system". This objective is a broader declaratory goal; it does not create specific obligations, but rather sets up a framework that needs to be developed in future agreements.[9] Obligations of all Contracting Parties are found in Art. 4(1) UNFCCC, and include, *inter alia*, the undertaking to implement and make available national programmes containing measures to mitigate climate change and measures to facilitate adaptation to climate change and to cooperate in this regard. In accordance with Art. 4(2) UNFCCC, these obligations are followed by more specific obligations of developed countries, as listed in Annex I. They include, *inter alia*, commitments to

7 United Nations Framework Convention on Climate Change, 9 May 1992, Treaty Doc No. 102-38, 1771 U.N.T.S. 107.

8 *UNGA*, Res.70/1 Transforming our world: 2030 Agenda for Sustainable Development, 21 October 2015, UN Doc. A/RES/70/1, p. 8, para. 31.

9 *Frosch/Giemza*, TDM 2023/1, p. 8.

support climate change activities and take measures to mitigate climate change by limiting the anthropogenic greenhouse gas emissions with the aim to reduce their CO2 emissions minimum to the level they had in 1990, and to report periodically. Thus, the UNFCCC did not set specific targets for greenhouse gas emissions, but it laid the basis for future discussions and obligations on climate change. Furthermore, the UNFCCC established regular Conferences of the Parties (COPs), which became relevant for the further development of global climate policy.

In 1997 at the COP3, the UNFCCC was reinforced by the Kyoto Protocol. The document assigned the individual emission reductions targets for the developed states. Correspondently, under the Kyoto Protocol, countries took an obligation to implement measures to limit their greenhouse gas emissions to a certain degree.[10]

In 2015, the COP21 resulted in the conclusion of the Paris Agreement, which was adopted by 196 parties and entered into force on 4 November 2016. The Paris Agreement specifies the broad goal of the UNFCCC and, as opposed to the Kyoto Protocol, sets goals for all states, not only for developed ones.[11] According to Art. 2(1), the goals of the Paris Agreement are to limit the global temperature rise to well below 2, preferably to 1.5 degrees Celsius compared to pre-industrial levels; and to make "finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development". In terms of commitments, the Paris Agreement requires states to create targets, policies and measures for reducing of their greenhouse gas emissions. In particular, according to Art. 4(2) thereto, each state obliges to "prepare, communicate and maintain successive nationally determined contributions [NDCs] that it intends to achieve" and pursues domestic mitigation measures to achieve these NDCs. Under the Paris Agreement Art. 4(3) and 4(9), NDCs shall represent a progression over time and reflect the highest possible ambitions in the light of different national circumstances and shall be reported every five years. Furthermore, states are entitled to regularly update or enhance their NDCs, according to Art. 14(3). Thus, as opposed to the UNFCCC, the Paris Agreement has imposed precise obligations to combat climate change on all states.

The aims of the Paris Agreement were further reaffirmed in 2021 at the COP26, resulting in the adoption of the Glasgow Climate Pact where the states, for the first time in history, pledged to phase down unabated coal power and phase-out inefficient fossil fuel subsidies.[12]

Furthermore, the European Union (EU) aims at being a global leader in combating climate change. In 2020, the European Green Deal was approved – a program under which the EU Member States committed to turn the EU into the first cli-

10 Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 10, 1997, 2303 U.N.T.S. 162, Annex B.

11 *Frosch/Giemza*, TDM 2023/1, p. 10.

12 *UNFCCC*, Report of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement on its third session, held in Glasgow from 31 October to 13 November 2021, 8 March 2022, UN Doc FCCC/PA/CMA/2021/10/Add.1, Decision 1/CMA.3 Glasgow Climate Pact, para. 36.

mate-neutral continent by 2050.[13] This ambition aligns with EU obligations under the climate change regime, namely the UNFCCC and the Paris Agreement.[14] Accordingly, the EU submitted its updated NDCs under the Paris Agreement stating the target to reduce emissions by at least 55% by 2030 from 1990 levels, to attain its 2050 net zero goal.[15] To achieve these objectives, in 2021 the EU adopted the European Climate Law, which enshrines in legislation these commitments.[16]

2. Principles of Climate Law

Although much of the law developed at the international level in response to climate change is mainly treaty based, some rules and principles of general international and environmental law are relevant to the topic.[17] In particular, these include the principles of prevention and precaution, as well as the "polluter pays" principle.

The prevention principle is formulated in Principle 2 of the Rio Declaration, which provides that states have "the responsibility to ensure that activities within their jurisdiction […] do not cause damage to the environment" beyond their jurisdiction.[18] The prevention principle is linked to the due diligence obligation.[19] This obligation is satisfied when states take appropriate measures to address private conduct which may cause environmental harm, including implementing and enforcing regulatory measures in accordance with international environmental obligations.[20] At the same time, whilst the application of the harm prevention rule and due diligence to transboundary pollution is widely recognised as reflecting a rule of customary international law[21] or a general principle of law enshrined in environmental

13 *European Commission*, European Green Deal, available at: https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en (15/6/2023).

14 *European Commission*, Communication from the Commission to the European Parliament, the European Council, The Council, the European Economic and Social Committee and the Committee of the Regions of 11 December 2019, The European Green Deal, COM/2019/640 final.

15 *European Commission*, Paris Agreement, available at: https://climate.ec.europa.eu/eu-action/international-action-climate-change/climate-negotiations/paris-agreement_en (15/6/2023).

16 Regulation (EU) No 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999, OJ L 243, 9/7/2021, pp. 1–17.

17 *Bodansky/Brunnée/Rajamani*, p. 10.

18 Rio Declaration on Environment and Development of 14 June 1992, UN Doc A/CONF.151/26.

19 *Dooley*, JWIT 2022/5–6, p. 869; ICJ, *Pulp Mills on the River Uruguay (Argentina v Uruguay)*, Judgement, [2010] ICJ Rep 14, para. 101.

20 ICJ, *Pulp Mills on the River Uruguay (Argentina v Uruguay)*, Judgement, [2010] ICJ Rep 14, para. 187.

21 *International Law Commission*, Draft Articles on Prevention of Transboundary Harm from Hazardous Activities, 2001, para. 3; ICJ, *Pulp Mills on the River Uruguay (Argentina v Uruguay)*, Judgement, [2010] ICJ Rep 14, para. 187; ICJ, *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)*, Judgment, [1997] ICJ Rep 7, para. 140.

laws at national levels,[22] the existence of such obligations in customary international law with regard to climate change is still unsettled.[23]

Whereas the prevention principle deals with responding to a certain risk of environmental harm when scientific proof exists, the precautionary principle, in contrast, deals with scientific uncertainty when a risk is suspected, but there is no definitive proof of either a causal link between the activity and the harm, or that the suspected damage will materialise.[24] The precautionary principle is reflected in Principle 15 of the Rio Declaration under which "to protect the environment, the precautionary approach shall be widely applied by States", including that "where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation". The precautionary principle is also a guiding principle in Art. 3(3) UNFCCC. Unlike the prevention principle, the status of the precautionary principle in international law is less settled.[25] Although it is sometimes recognised as an existing or emerging customary rule,[26] it is often perceived as the guiding approach in international environmental law.[27] At the same time, the precautionary principle is widely incorporated into domestic legal systems, which may allow its application as a general principle of law.[28]

Finally, Principle 16 of the Rio Declaration provides that "the polluter should, in principle, bear the cost of pollution", although it is not stated in binding terms.[29] The rationale behind the principle is that the polluter should bear the costs of the pollution prevention, control and reduction measures introduced by public authorities and should be liable for the environmental damage caused.[30] The principle is recognised by some international environmental agreements as "a general principle

22 *Arslan*, TDM, 2023/1, p. 4.
23 *International Law Commission*, Draft guidelines on the protection of the atmosphere, with commentaries, p. 28; *Dooley*, JWIT 2022/5–6, p. 870.
24 *De Sadeleer*, in: Fitzmaurice et al. (eds.), p. 151; *Arslan*, TDM 1/2023, p. 3.
25 *De Sadeleer*, in: Fitzmaurice et al. (eds.), pp. 168–169.
26 *Sands* et al., p. 147; *Ansari/Wartini*, JITLP 2014/1, p. 24; WTO AB, *EC Measures Concerning Meat and Meat Products,* Report of the Appellate Body, WT/DS26/AB/R and WT/DS48/AB/R, para. 120.
27 *Dooley*, JWIT 2022/5–6, p. 875; ICJ, *Pulp Mills on the River Uruguay (Argentina v Uruguay)*, Judgement, [2010] ICJ Rep 14, para. 164.
28 *Dang*, TDM 1/2023, p. 11.
29 *Tomoko*, The Role of the Precautionary and Polluter Pays Principles in Assessing Compensation (September 2015), p. 16, available at: https://www.rieti.go.jp/jp/publications/dp/15e107.pdf (15/6/2023); *Birnie/Boyle/Redgwell*, p. 322.
30 *European Court of Auditors*, Special Report: The Polluter Pays Principle: Inconsistent Application across EU Environmental Policies and Actions, p. 6, available at: https://www.eca.europa.eu/Lists/ECADocuments/SR21_12/SR_polluter_pays_principle_EN.pdf (15/6/2023); Convention for the Protection of the Marine Environment of the North-East Atlantic Art. 2(2)(b), 1992, UN Treaty Series, Vol. 2354, p. 67; Convention on the Protection and Use of Transboundary Watercourses and International Lakes Art. 2(5)(b), 1992, UN Treaty Series, Vol. 1936, p. 269.

of international environmental law".[31] However, it is not recognised as a customary international norm.[32] The principle is included in the Treaty on the Functioning of the European Union Art. 191(2) and, hence, forms part of EU primary law.

Some clarity on the status of the discussed principles in relation to climate change may emerge soon, once the International Court of Justice issues an advisory opinion on states' obligations with respect to climate change, as recently requested by the United Nations General Assembly.[33]

II. Interaction between and the Effect of the Investment Regime on States' global Action on Climate Change and their respective International Commitments

1. ISDS as a Tool to Enforce States' International Commitments on Climate Action

While international environmental agreements contain commitments of states to combat climate change, these agreements do not provide for an internal legal mechanism to enforce states' substantive obligations to achieve targets set therein.[34] It is argued that ISDS is a viable legal framework to enforce states' respective commitments.[35]

It is suggested that changes in state's domestic regulatory framework that are inconsistent with state's international climate change obligations, when such measures also negatively affect the value of the investment, could amount to an investment treaty violation.[36] Arguably, the perspective of an investment claim and potential payment of a large sum of damages should drive states to meet their climate change commitments.[37] Claims brought against Italy, Spain and the Czech Republic after they changed the incentives regime for investments in renewable energy are referred to as ISDS claims encouraging enforcement of states' international commitments.[38]

Consequently, the opinion has been formed that investors and investment tribunals within ISDS can contribute to making states comply with their climate change commitments. However, this opinion does not seem to be sound. First, investors' decisions, including whether to initiate ISDS proceedings, are dictated by their own economic interests. As a rule, investors only pursue investment treaty

31 International Convention on oil pollution preparedness, response and cooperation, 1990, UN Treaty Series, Vol. 1891, p. 51; Convention on the Transboundary Effects of Industrial Accidents, 1992, UN Treaty Series, vol. 2105, p. 457.
32 *Heine/Faure/Dominioni*, CL 2020/1, p. 99; *Birnie/Boyle/Redgwell*, p. 323.
33 *United Nations*, General Assembly Adopts Resolution Requesting International Court of Justice Provide Advisory Opinion on States' Obligations Concerning Climate Change (29 March 2023), available at: https://press.un.org/en/2023/ga12497.doc.htm (15/6/2023).
34 *Altchiler*, PLR 2021/2, pp. 257, 274.
35 Ibid., pp. 258, 273; *Farnelli*, JWIT 2022/5–6, pp. 890, 913.
36 *Altchiler*, PLR 2021/2, pp. 258, 275–276; *Farnelli*, JWIT 2022/5–6, p. 889.
37 *Altchiler*, PLR 2021/2, p. 276.
38 Ibid., p. 275; *Farnelli*, JWIT 2022/5–6, p. 889.

claims if they consider that there are viable chances of obtaining monetary compensation for the damage caused to their investments. Clearly, the intention to enforce state's international climate change obligations, as opposed to business considerations, is far from the primary motivation. Second, when investors' expectations are allegedly violated by host states, those expectations as a rule are based on states' domestic policies, rather than on international treaties. No investment case was found in which investors relied exclusively on a host state's international commitments as a policy from which the state subsequently deviated, and which caused a detriment to the investment. In the Spanish, Italian and Czech sagas investors brought their claims based on changes made to domestic subsidy regulatory regimes.[39]

Thus, ISDS might, by chance, as a side effect contribute to compliance by states with their international climate change obligations, however, it is hardly suitable as an enforcement mechanism.

2. Chilling Effect of ISDS on States' International Commitments on Climate Action

With states paying out billions to compensate investors (a trend sometimes referred to as "crippling compensation")[40] and difficulty to predict outcomes,[41] it is argued that ISDS and states' fear of the risk of compensation create regulatory chill, defined comprehensively as "delaying, compromising, or abandoning the formulation or implementation of bona fide regulatory measures in the interest of the public good as a result of a real or perceived threat of investor-state arbitration".[42] In other words, when there is compliance with an international obligation on one side and an opportunity for the state to avoid paying huge compensation on the other, the chances of the latter outweighing the former are high.

With regard to the chilling effect on climate change regulation, concerns are raised that fossil-fuel companies may use ISDS to block effective changes to national legislation.[43] This problem was recognised by the Intergovernmental Panel on Climate Change (IPCC) in its 2022 report: "there are still examples of international cooperation having a chilling effect on climate mitigation, particularly through […] investment practices, including legal norms designed to protect the interests of owners of fossil assets".[44] Furthermore, findings that the fossil fuel industry is by far the most litigious industry in ISDS (investors succeeded in 72% of cases decided on the

39 *Schmidl*, The Renewable Energy Saga from Charanne v. Spain to The PV Investors v. Spain: Trying to See the Wood for the Trees (1 February 2021), available at: https://arbitrationblog.kluwerarbitration.com/2021/02/01/the-renewable-energy-saga-from-charanne-v-spain-to-the-pv-investors-v-spain-trying-to-see-the-wood-for-the-trees/ (15/6/2023).

40 *Paparinskis*, ICSID Review 2022/1–2, pp. 290–291.

41 *Tienhaara et al.*, Science 2022, p. 701.

42 *Schram et al.*, GP 2018/2, p. 195.

43 *Di Salvatore*, Investor-State Disputes in the Fossil Fuel Industry, (fn. 5), pp. 18–20; *Tienhaara et al.*, Science 2022, p. 703.

44 *IPCC*, Climate Change 2022: Mitigation of Climate Change, Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate

merits, with the average amount awarded being nearly 5 times higher than in non-fossil fuel cases)[45] and that achieving the Paris Agreement goals will require decommissioning a significant number of existing fossil fuel operations earlier than planned,[46] may speak to the concerns raised. Arguably, the Energy Charter Treaty (ECT), if not reformed, also contributes to the fear of potential ISDS claims.[47] Relevant evidence is offered in this regard. First, in 2017, after Canadian oil and gas company Vermilion threatened France with a potential ECT claim over a draft law aimed at phasing-out fossil fuel extraction by 2040, a softened version of the law was adopted.[48] Second, Denmark, being the largest pool of ECT-protected assets in the EU, set a deadline for phasing-out fossil fuels by 2050 because an earlier deadline would allegedly entail higher risks of potential compensation under the ECT.[49] Finally, although not within the ECT framework, it is discussed that fears of ISDS claims prevented New Zealand from becoming a full member of the Beyond Oil and Gas Alliance,[50] which was launched by some governments committing to stop issuing new oil and gas exploration concessions and to set a Paris-aligned date for ending of the existing ones.[51]

However, the above examples are circumstantial evidence that does not allow to conclude whether effects of regulatory chill are widespread or isolated events only. As far as academic research on the existence and measurements of the chilling effect is concerned, the findings are mixed.[52] Most scholarly works lack direct and comprehensive empirical evidence on the presence of the chilling effect and its scope,[53] mainly because such analysis means identifying and measuring non-events that would otherwise occur in the absence of external factors.[54] In addition, it is hardly possible to link specific regulatory actions (or lack thereof) by states to the real rea-

Change, p. 1506 available at: https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf (15/6/2023).

45 *Di Salvatore*, Investor-State Disputes in the Fossil Fuel Industry, (fn. 5), pp. 9-10, 15, 17–18.

46 *Tienhaara/Cotula*, Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuel assets, 2020, p. 23, available at: https://www.iied.org/sites/default/files/pdfs/migrate/17660IIED.pdf (15/6/2023); *Tienhaara et al.*, Science 2022, p. 701.

47 *Meager*, Cop26 targets pushed back under threat of being sued (14 January 2022), available at: https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/# (15/6/2023): ECT protects around 345 billion Euro of fossil fuel assets in the EU; *Tienhaara et al.*, Science, 2022, p. 703.

48 *Red Carpet Courts*, Blocking climate change laws with ISDS threats: Vermilion vs France, available at: https://10isdsstories.org/cases/case5/ (15/6/2023).

49 *Meager*, Cop26 targets pushed back under threat of being sued, (fn. 47). For comparison, the Netherlands' deadline was set by 2030, which ultimately resulted in two investment claims by RWE and Uniper.

50 Ibid.

51 https://beyondoilandgasalliance.org/who-we-are/ (15/6/2023). New Zealand joint the alliance as an associate member.

52 *Schram et al.*, GP 2018/2, pp. 193, 194; *Moehlecke/Wellhausen*, ARPS 2022, p. 496; *Berge/Berger*, JIDS 2021/1, pp. 1–2, 6.

53 *Moehlecke*, ISQ 2020/1, pp. 1–2; *Schram et al.*, GP 2018/2, pp. 195, 200.

54 *Berge/Berger*, JIDS 2021/1, p. 23; *Schram et al.*, GP 2018/2, pp. 193, 195.

sons behind them, as state authorities may be hesitant to make such information public.

First attempts to empirically demonstrate the chilling effect from ISDS were made by collecting data through interviews and surveys among officials in Canada and led to divergent conclusions.[55] While two more systematic and cross-county studies provided certain empirical confirmation of regulatory chill created by ISDS and affected third countries, a limited scope of the chilling effect was shown.[56] Ultimately, this evidence still does not allow for generalizable conclusions regarding its effect across states with different levels of development and involvement in ISDS. Arguably, a combination of political and economic factors determines the regulatory activity of states.[57] Accordingly, sufficient financial resources, strong political will and public support may increase the likelihood of a government adopting a policy and reduce the chances of regulatory chill from ISDS. In contrast, the concentration of economic power within the sector potentially affected, the political priority of investment liberalization and corruption are factors that may make the same governments less inclined to pursue the disputed policy.[58]

Thus, given the influence of the fossil fuel sector and large sums of money at stake, it cannot be ruled out that ISDS proceedings recently initiated by fossil fuels investors against the Netherlands may create a chilling effect on third states' policies to phase out fossil fuels. Nevertheless, the power of the fossil fuel industry to resist the adoption of climate-related measures needed to meet the Paris Agreement goals should not be exaggerated. The scenario may differ among countries due to their different political and economic conditions. Time is needed to gather comprehensive evidence, which is not available now, to answer the question of whether the current investment regime and its ISDS mechanism can turn ambitious climate action by some states into greater inaction by others.

C. Is the Door to the current Investment Regime open for Climate Change Law?

As evidenced by the Netherlands' arguments in *RWE v. the Netherlands*,[59] the host state's defence in climate change-related investor-state disputes will likely be centred around extensive and detailed references to its obligations under international climate change law as justification for the regulatory measures challenged by the investor. This context raises the question of how climate change law might fit into ISDS proceedings.

55 See *Côté*, pp. 153, 187 (finding no consistent evidence to support the possibility of regulatory chill). On the contrary, *Van Harten/Scott*, JIDS 2016/1, pp. 92–116 (finding that regulators changed their decision-making on regulatory measures because of ISDS risks).
56 For more details: *Moehlecke*, ISQ 2020/1, pp. 1–12; *Berge/Berger*, JIDS 2021/1, pp. 1–41.
57 *Schram et al.*, GP 2018/2, p. 199.
58 Ibid.
59 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, Respondent's Counter-Memorial 5 September 2022.

I. Application of Climate Change Law under IIAs

Consideration of the application of climate change law to an investment dispute primarily depends on the text of the IIA. Some of the new-generation IIAs that are currently in force, contain in their preambles references to environmental and climate change concerns;[60] reaffirm states' right to regulate in the environmental area;[61] confirm commitment to avoid lowering of environmental standards to attract foreign investment;[62] recall multilateral environmental treaties and reaffirm commitments to their implementation;[63] and introduce environmental protection as a carve-out from standards of investment protection[64] or as general exceptions.[65]

However, the ECT example shows that broadly formulated provisions on environmental issues, *inter alia*, the preamble recalling the UNFCCC and other international environmental agreements, and recognising "the increasingly urgent need for measures to protect the environment", have so far not played any significant role in investment jurisprudence.[66] Such provisions contained in most IIAs that are currently in force, do not provide for direct application of climate change law to investment disputes (this is consistent with the general concept that environmental obliga-

60 Hungary – United Arab Emirates BIT, Preamble: "Recognizing that these objectives should be achieved in a manner consistent with the promotion and protection of public health, environment […]"; UK – Turkey FTA, Preamble: "Recognising the importance of sustainable development, including urgent action to protect the environment and combat climate change and its impacts, […], consistent with rules and principles under multilateral environmental agreements to which they are party, including the UNFCCC".

61 Myanmar – Singapore BIT, Preamble: "Reaffirming the Parties' right to regulate and to introduce new measures, such as […] environmental measures relating to investments in their territories in order to meet legitimate public policy objectives"; Rwanda – United Arab Emirates BIT, Art. 9.

62 Colombia – Japan BIT, Preamble: "Recognizing that these objectives and the promotion of sustainable development can be achieved without relaxing […] environmental measures of general application".

63 Switzerland – China FTA, Art. 12.1(1): "The Parties recall the Stockholm Declaration on the Human Environment of 1972, the Rio Declaration on Environment and Development of 1992, Agenda 21 on Environment and Development of 1992, the Johannesburg Plan of Implementation on Sustainable Development of 2002 and the Rio+20 Outcome Document "The Future We Want" of 2012" and Art. 12.2(1): "The Parties reaffirm their commitment to the effective implementation in their laws and practices of multilateral environmental agreements to which they are a party […]. They shall strive to further improve the level of environmental protection by all means, including by effective implementation of their environmental laws and regulations".

64 Hungary – Islamic Republic of Iran BIT, Art. 5(4): "Non-discriminatory measures of the Contracting Party that are designed and applied to protect legitimate public welfare objectives, such as […] the environment, which are taken in good faith, which are not arbitrary, and which are not disproportionate in light of their purpose, do not constitute measures having equivalent effect to expropriation or nationalization".

65 China – Turkey BIT, Art. 4(1)(a): "Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining, or enforcing any non-discriminatory and necessary measures: (a) designed and applied for the protection of […] the environment".

66 *Ipp/Magnusson/Kjellgren*, The Energy Charter Treaty, Climate Change and Clean Energy Transition, (fn. 2), p. 37.

tions are established to regulate interstate relations),[67] neither do they preclude investors from challenging states' environmental and climate change-related measures in ISDS proceedings. At the same time, environmental provisions in IIAs constitute the context for treaty interpretation and some of them (carve-outs from specific protections and general exceptions) may be helpful for investment tribunals as tools to balance investment protections with climate change law obligations of host states, as will be addressed below.

Conversely, the Morocco-Nigeria bilateral investment treaty (BIT), signed in 2016 and awaiting ratification, is a rare example of an IIA that provides a legal basis for the direct application of climate change law to the merits of an investment dispute. Art. 18 BIT imposes post-establishment obligations on investors, *inter alia*, to uphold human rights in the host state and not to circumvent international environmental and human rights obligations to which Morocco or Nigeria are parties. In this regard, it should be recalled that the right to a clean, healthy and sustainable environment has recently been recognised as a human right, with reference to obligations of states under multilateral environmental instruments, and it was acknowledged that climate change interferes with the enjoyment of such rights.[68] Accordingly, explicit reference contained in the mentioned BIT allows for direct application of relevant human rights and climate change law provisions to ISDS proceedings.[69]

II. The Principle of Systemic Integration

The issue of interaction between investment law and other international legal regimes is not new to ISDS proceedings. For example, the *SPP* tribunal considered whether the United Nations Educational, Scientific and Cultural Organization (UNESCO) Convention governed Egypt's conduct to cancel the project and justify measures taken. The tribunal found that the UNESCO Convention was relevant to the dispute because both parties acknowledged its application but held that the Convention did not exclude the investor's right to compensation.[70] At the same time, the most known and discussed normative interaction so far has been between the EU and investment regimes. The majority of investment tribunals which were engaged in such analysis resolved the issue in favour of the prevalence of investment law,[71] stating that "the question of whether [respondent] was […] obliged under EC

67 *Sands et al.*, pp. 153–167.

68 *United Nations General Assembly*, UNGA Res.76/300 (28 July 2022) The human right to a clean, healthy and sustainable environment, UN Doc. A/RES/76/300.

69 *Santacroce*, ICSID Review 2019/1, pp. 145–146.

70 ICSID, case No. ARB/84/3, *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, Award 20 May 1992, paras. 78, 154.

71 *Ipp*, Regime Interaction in Investment Arbitration: Climate Law, International Investment Law and Arbitration (12 January 2022), available at: https://arbitrationblog.kluwerarbitration.com/2022/01/12/regime-interaction-in-investment-arbitration-climate-law-international-investment-law-and-arbitration/ (15/6/2023).

law to act as it did, is only an element to be considered by this Tribunal when determining the "rationality", "reasonableness", "arbitrariness" […] of the [measure]".[72]

Be that as it may, the investment law regime should not be viewed as a self-contained regime, as it is influenced by external sources of international law.[73] In this context, the use of interpretative techniques allows tribunals to avoid making controversial statements on the relative hierarchy of investment and external regimes.[74]

One of the techniques is expressed by the Vienna Convention on the Law of Treaties (VCLT) at Art. 31(3)(c) and known as the principle of systemic integration. It requires tribunals, when interpreting IIAs, to take into account "any relevant rules of international law applicable in the relations between the parties".[75] Those are customary international law, general principles of law, other treaties, which should assist the tribunal in determining the proper meaning of the IIA provisions and ensure its consistency with the more general framework.[76] This also includes environmental treaties, *inter alia*, the UNFCCC, Paris Agreement and EU climate law.[77]

The principle of systemic integration is especially important in reinterpreting the provisions of existing IIAs, both old and new generation, which contain little bridges to international climate change goals. It allows the integration of climate change law into ISDS proceedings and requires investment tribunals to construe relevant investment protections in a manner consistent with climate change commitments of states.

In this regard, a few considerations are important. First, the principle of systemic integration does not imply the displacement of treaty provisions by sources external to the IIA, but rather it brings external interpretative materials to guide the IIA's interpretation with a view to avoid conflicts between the IIA and external legal regime.[78] The *Allard* tribunal clarified with regard to the host state's participation in environmental treaties that this "does not change the standard under the BIT, although consideration of a host State's international obligations may well be relevant in the application of the standard to particular circumstances".[79]

Second, "relevant" rules of international law that are "applicable" to the disputing parties should not be limited to general principles of law, customary interna-

72 ICSID, case No. ARB/07/22, *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*, Award 23 September 2010, para. 7.6.9.
73 *Miles/Lawry-White*, ICSID Review 2019/34, p. 15; ICSID, case No. ARB/07/26, *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, Award 8 October 2016, para. 1200.
74 *Viñuales*, p. 148.
75 *International Law Commission*, Report of a Study Group on Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, UN Doc A/CN.4/L.682, 13 April 2006, para. 413.
76 Ibid., paras. 461-462.
77 *Ipp*, Regime Interaction in Investment Arbitration: Climate Law, International Investment Law and Arbitration, (fn. 71).
78 *Santacroce*, ICSID Review 2019/1, p. 150.
79 PCA, case No. 2012-06, *Peter A. Allard v. The Government of Barbados*, Award 27 June 2016, para. 244.

tional law, or international treaties binding between the IIA parties. Arguably, a flexible approach should be adopted, whereby in interpreting IIAs, tribunals may consider international law rules as they have evolved and exist at the time of the interpretation, not only when the IIA was concluded; they may also include international obligations binding only on one party, as well as *erga omnes* obligations.[80] Consequently, the principle of systemic integration should allow investment tribunals, when interpreting IIA provisions, to take into account external climate change law as it stands, in particular the rules of the Paris Agreement or EU climate law, even if these were adopted after the conclusion of the IIA.

Finally, the principle of systemic integration can be limited by the language of a specific IIA.[81] The ECT provides such an example. Art. 16 ECT explicitly limits the applicability of other treaties in ECT disputes by stating that in case of a conflict between an ECT provision and a provision of another treaty, the treaty provision more favourable to the investor prevails. Another example of such a limitation is the language of a choice-of-law provision in a given IIA. If the wording is limited to "principles of international law", human rights and, by analogy, climate change law provisions can only apply to the extent that they fall within this narrower category.[82]

Ultimately, the application of the principle of systemic integration contributes to a coherent international legal system. It allows the interpretation of IIA substantive obligations in harmony with international climate change law. However, the successful integration of investment law and climate change law obligations will depend on arbitral tribunals tasked to solve investment disputes with climate change dimension.[83]

III. Climate Change Law as an Interpretative Tool

Tribunals generally consider commitments of host states under international law as relevant to the interpretation of protection standards and assessment of a breach of the particular IIA. Consequently, tribunals in ISDS proceedings challenging climate change mitigation measures are expected to follow this path.

Whether an investor is entitled to legitimate expectations of regulatory stability is expected to be one of the central issues in the analysis of fair and equitable treatment (FET)/ minimum standard of treatment (MST) claims in such investment cases.[84] In this regard, findings of tribunals in ECT renewable energy disputes, where investors referred to host state's commitments under the UNFCCC and the Paris

80 *Simma*, ICLQ 2011/3, pp. 583, 586.
81 *Ipp/Magnusson/Kjellgren*, The Energy Charter Treaty, Climate Change and Clean Energy Transition, (fn. 2), p. 38.
82 *Santacroce*, ICSID Review 2019/1, p. 142.
83 *Ipp*, Regime Interaction in Investment Arbitration: Climate Law, International Investment Law and Arbitration, (fn. 71).
84 *Ipp/Magnusson/Kjellgren*, The Energy Charter Treaty, Climate Change and Clean Energy Transition, (fn. 2), p. 57.

Agreement to prove that they were entitled to legitimate expectations,[85] may be of assistance. Thus, the *Watkins Holding* tribunal found that investor's expectations were legitimate because Spain's renewable energy investment incentive scheme "was part of a wider international and domestic policy to develop RE power generation infrastructure and to specifically encourage and attract the necessary investments".[86]

Conversely, in similar cases other tribunals avoided reference to international climate law obligations of the host state when analysing legitimate expectations.[87] The *Sevilla Beheer* tribunal refused to recognize that state's international environmental obligations were sufficient for legitimate expectations that renewable energy regime would not be reformed. The tribunal pointed out that "the fact that a State is bound by international obligations in the field of environmental law and participates in the international debate concerning renewable energy sources does not as such give rise to a State representation".[88]

As part of the analysis of the investor's expectations of regulatory stability, some tribunals have also considered whether the investor conducted due diligence before making the investment.[89] Tribunals emphasized that the host state's international law obligations are included in the legal framework within which the investment was made.[90] Additionally, investors may be expected to assess risks associated with the broader background of a host state[91] in light of reasonably anticipated changes in its economic and social conditions.[92] Accordingly, when an investor invests in vulnerable areas, it cannot be unaware of regulatory risks or reasonably expect that the investment will not be affected. In words of the *Phillip Morris* tribunal, investors in harmful products "such as cigarettes can have no expectation that new and more onerous regulations will not be imposed […]. On the contrary, in light of

85 ICSID, case No. ARB/15/44, *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, Award 21 January 2020, para. 71; ICSID, case No. ARB/13/30, *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.àr.l. v. Kingdom of Spain*, Decision on Responsibility and on the Principles of Quantum 30 November 2018, para. 87; PCA, case No. 2012-14, *AES Solar and others (PV Investors) v. The Kingdom of Spain*, Final Award 28 February 2020, para. 591.

86 ICSID, case No. ARB/15/44, *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, Award 21 January 2020, paras. 71, 527.

87 *Farnelli*, JWIT 2022/5–6, p. 906.

88 ICSID, case No. ARB/16/27, *Sevilla Beheer B.V. and others v. Kingdom of Spain*, Decision on Jurisdiction, Liability and Principles of Quantum 11 February 2022, paras. 861–862.

89 *Levashova*, NILR 2020, p. 238; *Farnelli*, ICLR 2021/1, p. 48; ICSID, Case No. ARB/05/8, *Parkerings-Compagniet AS v. Republic of Lithuania*, Award 11 September 2007, para. 333.

90 ICSID, case No. ARB/16/5, E*SPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, and InfraClass Energie 5 GmbH & Co. KG v. Italian Republic*, Award 14 September 2020, para. 513.

91 *Levashova*, NILR 2020, pp. 237–238; ICSID, case No. ARB/04/19, *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador*, ICSID Award 18 August 2008, para. 340.

92 ICSID, case No. ARB/15/42, *Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB v. Kingdom of Spain*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2020, para. 600.

widely accepted articulations of international concern for the harmful effect of tobacco, the expectation could only have been of progressively more stringent regulation".[93]

Consequently, in analysis of FET/MST claims in fossil phase-out cases under existing IIAs, investment tribunals may be expected to assess whether fossil fuel investors are entitled to legitimate expectations that the field would not be subject to a changing regulatory environment, as well as whether investors conducted due diligence on the host states' energy transition policies and related international climate commitments. Under such analysis tribunals may consider the time of the establishment of the investment, whether by that time the host state had already joined the UNFCCC and announced its NDCs under the Paris Agreement. If the investment was established after joining the Paris Agreement by the host state and announcement of its NDCs, it might be reasonable to conclude that it should have been clear to any prudent investor that climate change regulation is likely to become stricter over time.[94] At the same time, given the ongoing development since 1992 of scientific awareness of the threat posed by climate change, it might be difficult to conclude that investors in the fields that are implicated by climate change could have reasonably expected the field to remain unregulated.

Moreover, environmental law principles may also play a role in tribunal's analysis of consistency of state's measures to mitigate climate change with protections under the IIA. For example, the precautionary principle may be used in a proportionality analysis in FET and expropriation claims.[95] The *Muszynianka* tribunal applied the principle in an FET analysis and concluded that the measure was enacted in good faith in pursuit of environmental and public health objectives.[96] The majority in the *Eco Oro* tribunal also found that the precautionary principle was "clearly relevant when considering the effect and proportionality of the measures" for the expropriation claim.[97] In contrast, according to the same tribunal, for the FET claim, the precautionary principle was of little relevance, while the tribunal referred to the lack of scientific certainty of the threat of environmental damage and concluded that Colombia's actions were arbitrary.[98]

Finally, as anticipated, in its recent defence the Netherlands rejects that investors had legitimate expectations or were offered any undertaking of immutability of the regulatory framework. Conversely, according to the Netherlands, there were repeated warnings that fossil fuels would be subject to a changing regulatory environ-

93 ICSID, case No. ARB/10/7, *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, Award 8 July 2016, paras. 429–430.
94 Paris Agreement Art. 4(11) encourages states to "at any time adjust its existing nationally determined contribution with a view of enhancing its level of ambition".
95 *Dooley*, JWIT 2022/5–6, p. 876; *Dang*, TDM 2023, p. 11.
96 UNCITRAL Rules, PCA case No. 2017-08, *Spoldzielnia Pracy Muszynianka v. Slovak Republic*, Award 7 October 2020, paras. 553, 556.
97 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, paras. 654–656.
98 Ibid., paras. 807, 811.

ment.[99] The Netherlands heavily relies on "continued international climate policy" starting with the adoption of the UNFCCC, and "climate ambitions of the EU". Arguably, in such context any reliance on immutability of the climate policy legal framework is unreasonable.[100] The Netherlands also invokes the application of the precautionary principle, and the "polluter pays" principle.[101] Ultimately, it remains to be seen how the tribunal will consider commitments of the Netherlands within the global climate change regime, the relevance of such commitments for interpretation of protection standards, as well as application of environmental principles in this case.

D. Where do we Stand now: Tools Available under the Current Investment Regime to Balance Standards of Investment Protection and Climate Change Goals

In view of the threat that the existing investment regime and ISDS may pose to the effective implementation of the Paris Agreement goals, various options within broader ISDS reform are being discussed to ensure that climate change action is not hindered.[102] Those options include, *inter alia*, withdrawal from all or some of IIAs, particularly the older treaties, including the ECT; modernisation of the existing IIAs to safeguard policy space for climate measures; and the development of new models of IIAs which legalize states' climate change regulatory measures and exclude fossil fuel investments from the scope of protection.

In the meanwhile, most of the 3289 IIAs[103] were concluded before the Paris Agreement and, as a rule, do not have references to the climate change agenda. However, there are tools available for investment tribunals under the existing framework which could balance IIAs protection standards and the regulatory responses of host states towards climate change. The suitability and effectiveness of the police powers doctrine and general exceptions provisions included in some new generation IIAs to safeguard climate change regulatory action without payment of compensation for breach of IIA provisions will be discussed below.

99 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, Respondent's Counter-Memorial 5 September 2022, paras. 887–906.

100 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, Respondent's Counter-Memorial 5 September 2022, paras. 895–901, 949–950, 954, 956.

101 Ibid., paras. 731–735; 736–741.

102 *Brauch* et al., JIA 2019/1, pp. 7 ff.; *Tienhaara/Cotula*, Raising the cost of climate action? (fn. 46), pp. 33 ff.; *OECD*, Investment Treaties and Climate Change, OECD Public Consultation, Compilation of Submissions (January – March 2022), available at: https://www.oecd.org/investment/investment-policy/OECD-investment-treaties-climate-change-consultation-responses.pdf (15/6/2023).

103 https://investmentpolicy.unctad.org/international-investment-agreements (15/6/2023).

I. Police Powers Doctrine as Justification of Climate Change Regulatory Measures' Consistency with IIAs

1. Recognition of the Police Powers Doctrine in International Investment Law

The police powers doctrine along with its direct antithesis – the sole effect doctrine – and the proportionality principle, separately or combined are used by investment tribunals to analyse expropriation claims.[104] While there is debate on which doctrine should prevail,[105] arguably the police powers doctrine is more likely to be applied to identify instances of indirect expropriation.[106] In this context, the doctrine covers bona fide non-discriminatory measures falling under state's sovereign right to regulate that result in loss of property by an investor, but do not amount to indirect expropriation and, accordingly, do not give rise to compensation.[107] Environmental measures, being one of the most serious public welfare objectives, including measures necessary to mitigate climate change, fall within the scope of this doctrine.

It is widely recognised that the police powers doctrine forms part of customary international law.[108] Furthermore, around 90 new generation IIAs have codified the doctrine by either specifically naming the police powers, or describing it.[109]

The application of the police powers doctrine by investment tribunals to old generation IIAs, which do not codify it but mandate compensation for expropriation in all circumstances, raised a discussion in academic literature. It is argued that the police powers doctrine, as a customary norm, cannot displace the ordinary meaning of the treaty provision on expropriation.[110] However, since the doctrine is an autonomous customary concept, it does not require direct incorporation into IIAs to have a legal effect, nor does it replace the treaty obligation to compensate, but coexists with expropriation provisions in IIAs.[111]

104 *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), pp. 329, 333; *Riffel*, ICLQ 2022/4, p. 953.
105 *Mostafa*, AILJ 2008, p. 294; *Ranjan*, AJIL 2019/1, p. 123.
106 *Pellet*, in: Kinnear et al. (eds.), p. 448; *Dooley*, JWIT 2022/5–6, p. 858.
107 *OECD*, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law, Working Papers on International Investment, 2004, p. 5, footnote 10, available at: https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf (15/6/2023); *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), pp. 323–325; *Newcombe/Paradell*, p. 358; *Pellet*, in: Kinnear et al. (eds.), pp. 448–449; *Dooley*, JWIT 2022/5–6, p. 856.
108 *Viñuales*, in Douglas et al. (eds), pp. 329, 344; *Newcombe/Paradell*, p. 358; *Ranjan*, AJIL 2019/1, p. 117; ICSID, case No. ARB/10/7, *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, Award 8 July 2016, paras 290–301. For a different opinion see, *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), pp. 339, 341.
109 COMESA Common Investment Area Agreement, Art. 20(8); CETA Annex 8-A; *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), pp. 325, 338–339; *UNCTAD*, Expropriation, UNCTAD Series on Issues in International Investment Agreements II, 2012, p. 83, available at: https://unctad.org/system/files/official-document/unctaddiaeia2011d7_en.pdf (15/6/2023); *Dooley*, JWIT 2022/5–6, p. 856.
110 *Ranjan*, AJIL 2019/1, pp. 119 ff.
111 *Viñuales*, in: Douglas et al. (eds), pp. 329–330; *Dooley*, JWIT 2022/5–6, pp. 863–864.

2. Police Powers Doctrine and Indirect Expropriation

There is obviously tension between the compensable expropriation and the non-compensable state's regulatory measure under the police powers doctrine. On the one hand, if all legitimate measures (for a public purpose, non-discriminatory and adopted in due process) fell within the police power of the state, it would contradict IIAs non-expropriation provisions under which even fully legitimate measures must be accompanied by compensation.[112] On the other hand, if all legitimate regulations adopted, *inter alia*, in the environmental field as an exercise of the state's police powers caused compensation, it would limit states sovereignty.[113]

Accordingly, only certain legitimate measures should qualify as exercise of the state's police powers. However, neither investment treaty jurisprudence, nor doctrine, have yet developed a comprehensive test to distinguish non-compensable regulations under the police powers doctrine from measures of expropriation.[114] Hence, "international law has yet […] to draw a bright and easily distinguishable line" between two concepts.[115]

An attempt to fill this gap is made in new generation IIAs. Generally, they establish a presumption of the police powers doctrine. Mainly, "non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives […], do not constitute indirect expropriations". Only the presence of "rare circumstances" allows derogation from the doctrine, i.e. when "the impact of a measure […] is so severe in light of its purpose that it appears manifestly excessive".[116] However, such provisions still do not make it easy to draw a line between legitimate environmental, *inter alia*, climate change regulation and "rare circumstances" which would constitute compensable indirect expropriation. Under the similarly worded treaty, the *Eco Oro* tribunal opined that in such case to establish the existence of the latter, there "must be a very significant aggravating element or factor in the conduct of the State".[117] Ultimately, both in new and old generation IIAs, it is the tribunal who will apply particular requirements to qualify a measure.

Among the criteria usually analysed to qualify a measure as non-compensable exercise of police powers, the most widespread are that the measure taken must be bona fide, for a valid public purpose, adopted in due process and does not constitute

112 *Khachvani*, ICSID Review 2020/1–2, pp. 155, 157; *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), p. 332; UNCITRAL Rules, *Pope & Talbot Inc. v. The Government of Canada*, Interim Award 26 June 2000, para. 96.

113 *Khachvani*, ICSID Review 2020/1–2, p. 155; ICSID, case No. ARB(AF)/99/1, *Marvin Roy Feldman Karpa v. United Mexican States*, Award 16 December 2002, para. 103.

114 *Khachvani*, ICSID Review 2020/1–2, p. 157; *Melville*, TDM 2023, pp. 12–13.

115 UNCITRAL Rules, *Saluka Investments B.V. v. The Czech Republic*, Partial Award 17 March 2006, paras. 263–264.

116 *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), p. 339; CETA Annex 8-A.

117 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 643.

an intentionally discriminatory regulation against a foreign investor.[118] Some tribunals further regarded proportionality of the measure in relation to its purpose.[119] In this context, the *Philip Morris* tribunal took into account national and international obligations of Uruguay when assessing whether the measures were proportionate to the objective they meant to achieve.[120] One more criterion to consider is whether the primary intent underlying the regulatory measure is not to deprive the investor of its property for political reasons, but to take it in the name of public benefits.[121]

Furthermore, a few tribunals considered investor's expectations in light of indirect expropriation and the police powers doctrine.[122] In addition to aspects discussed above in the context of the FET standard, one further point could be made. It might be the case that the host state was encouraging foreign investors to invest in a particular field, and reasonable expectations were created by the state's representations. As a result, the investor could have reasonably interpreted the absence of regulations as a conscious choice by the state to refrain from adopting such regulations.[123] Based on the existing investment jurisprudence, such a situation would potentially amount to an indirect expropriation.

Nevertheless, the criteria mentioned mirror, to a certain degree, the legality requirements of expropriation. Accordingly, an alternative "changed circumstances" test was developed in the doctrine.[124] Under the test, if the regulation is aimed to improve public welfare and negatively affects the property rights of the investor, compensation is due because society cannot improve its welfare at the expense of a few individuals and should bear the economic burden of improvement itself. In contrast, if the regulation is not intended to enhance public welfare, but is necessary to maintain the existing one in light of objectively changed factual circumstances or

118 UNCITRAL Rules, *Saluka Investments B.V. v. The Czech Republic*, Partial Award 17 March 2006, paras. 254–255; ICSID, case No. ARB/10/7, *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, Award 8 July 2016, para. 305; *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), p. 326; *Melville*, TDM 2023, pp. 6-7.

119 ICSID, case No. ARB(AF)/00/2, *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, Award 29 May 2003, paras. 122, 133; PCA, case No. 2012-07, *Mohamed Abdel Raouf Bahgat v. Egypt*, Final Award 23 December 2019, para. 232; PCA, case No. 2019-18, *Olympic Entertainment Group AS v. Ukraine*, Award 15 April 2021, paras. 89–90.

120 ICSID, case No. ARB/10/7, *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, Award 8 July 2016, para. 306.

121 *Zhu*, HILJ 2019/2, p. 411; *Kryvoi/Trakhalina*, Can Regulatory Freedom Justify Indirect Exprpriation in Invetsment Arbitration? (10 August 2019), available at: https://arbitrationblog.kluwerarbitration.com/2019/08/10/can-regulatory-freedom-justify-indirect-expropriation-in-investment-arbitration/ (9/4/2023).

122 ICSID, case No. ARB(AF)/97/1, *Metalclad Corporation v. The United Mexican States*, Award 30 August 2000, para.107; ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 694.

123 *Riffel*, ICLQ 2022/4, p. 968; *Khachvani*, ICSID Review 2020/1–2, pp. 168–169.

124 *Khachvani*, ICSID Review 2020/1–2, pp. 159, 164–165.

new knowledge, compensation for depriving a private investor of its property is not required except in cases of abuse. An example here is the *Chemtura* tribunal's finding that Canada's banning of the agrochemical lindane was a valid exercise of the state's police powers and did not constitute an indirect expropriation because it was "motivated by the increasing awareness [including at the international level] of the dangers presented by lindane for human health and the environment".[125] Consequently, the risk of new regulatory restrictions on an investor's activity arising from increased scientific awareness can be seen as a business risk (same as epidemics, natural disasters), whilst the risk that a state decides to increase public welfare by restricting investor's rights is a sovereign risk, against which IIAs protect investors.[126]

Accordingly, ongoing climate action implemented through regulatory restrictions that limit investor's property rights or render its activity economically unviable may be recognised by investment tribunals as a non-compensable exercise of the state's police powers.[127] Such a finding requires case-by-case examination, in which it must be shown that the adoption of measures was not accompanied by abuse, discrimination or violation of due process. Global climate change goals, respective international commitments of host states, domestic policies and states behaviour are the criteria important for such analysis. In addition, tribunals may pay special attention to the fact that such measures are taken because of a recent scientific awareness of the imminent threat posed by climate change.

3. Police Powers Doctrine and other Standards of Investment Protection

It is suggested that the police powers doctrine only applies to breaches of the expropriation standard.[128] In this regard, reference is made to new generation IIAs, where the doctrine is generally codified in the context of provisions on indirect expropriation.[129] However, if the police powers doctrine does not apply to standards beyond expropriation, it can easily be neutralised by investors' claims for violation of other standards, such as FET.[130] Yet, assuming that the police powers doctrine is an autonomous customary concept, its operation should not be different in such case. Ultimately, the doctrine implies an assessment of the overall reasonableness of the state measure by focusing on a variety of issues, which may vary depending on the

125 UNCITRAL Rules, *Chemtura Corporation v. Government of Canada*, Award 2 August 2010, paras. 266, 135.
126 *Khachvani*, ICSID Review 2020/1–2, pp. 166–168.
127 ICSID, case No. ARB/21/4, *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands*, Respondent's Counter-Memorial 5 September 2022: the Netherlands argues that adoption of the law to phase-out coal power by 2030 was a valid exercise of the Netherlands' police powers and therefore no expropriation took place.
128 ICSID, case No. ARB/03/17, *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic,* Decision on Liability 30 July 2010, para. 148.
129 *Titi*, in: Gattini/Tanzi/Fontanelli (eds.), p. 342.
130 *Viñuales*, in: Douglas et al. (eds), p. 332.

particular facts of the case and the standards of protection invoked by an investor.[131]

However, in practice difficulties arise. The *Eco Oro* tribunal had to decide upon both expropriation and MST/FET claims. With regard to the expropriation claim, despite a number of "significant failings" on the part of Colombian state organs, the tribunal concluded by a majority that "the measures were adopted as a part of Colombia's valid and legitimate exercise of its police powers" and denied the claim.[132] While recognising that "the factual matrix and many of the legal arguments" are the same for both expropriation and MST/FET claims, a different majority, however, found that the same actions of Colombia's organs were arbitrary, frustrated legitimate expectations of the claimant and failed to provide a stable and predictable legal environment.[133] As part of its MST/FET analysis the tribunal mentioned the exercise of police powers by Colombia, contending, however, that "deference to the State's powers cannot require the Tribunal to condone actions that would otherwise comprise a breach of [FET standard]".[134] Accordingly, the tribunal followed the text of the treaty, which codified the police powers doctrine among the expropriation provisions and did not discuss whether the police powers doctrine as an autonomous customary concept could apply to the MST/FET claim, but rather focused on an assessment of the measures' consistency with the standard and found its violation.

Thus, although legal arguments and factual evidence may overlap within expropriation and FET claims, it should not be assumed that arguments made with regard to the police powers defence against expropriation would suffice for a successful defence against an FET claim.[135] Hence, while arguments for applying the police powers doctrine to standards other than expropriation seem compelling, it is difficult to conclude that tribunals will apply it in this way.

II. General Exceptions in new Generation IIAs and an Obligation to Pay Compensation

1. WTO-style General Exceptions in IIAs

One of the reasons for criticism of the investment regime has originally been that foreign investors have used IIAs to challenge a wide range of host states' regulatory policies, including those related to the environment, and arbitrators have increasing-

131 Ibid., pp. 339, 344.
132 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia, Decision on Jurisdiction*, Liability and Directions on Quantum 9 September 2021, para. 698.
133 Ibid., paras. 804–805.
134 Ibid., para. 751.
135 *Dooley*, JWIT 2022/5–6, pp. 865–866.

ly decided on policies rationales for states' measures.[136] In an attempt to ensure that afforded investment protection does not restrict state's regulatory action in the public interest, general public policy exceptions clauses began to appear in the new generation IIAs.[137] Recently general exceptions have become very popular and were included in half of all new IIAs signed in the last five years.[138]

These new provisions as a rule are closely modelled on, or incorporate, mutatis mutandis, general exception provisions of the General Agreement on Tariffs and Trade (GATT) Art. XX and/or the General Agreement on Trade in Services (GATS) Art. XIV.[139] General public policy exceptions clauses provide that the relevant IIAs "shall not prevent the adoption or enforcement" of measures aimed at protecting public policy objectives, such as the environment, human, animal, plant life or health.[140] Several latest IIAs explicitly clarified that such exceptions include "measures necessary to mitigate climate change".[141] These exception clauses as a rule have a similar structure which contains three elements. They provide for an exhaustive list of permissible policy objectives, set a link between a state measure and permissible objective (e.g. "necessary for", "designed and applied for"), and require that a measure does not constitute "a means of arbitrary or unjustifiable discrimination".[142] The essence of general public policy exceptions was succinctly laid out by Canada in its non-disputing party submission in *Eco Oro*, stating that they act as a "final 'safety net' to protect the State's exercise of regulatory powers in pursuit of the specific legitimate objectives identified in the exceptions".[143]

136 *Sabanogullari*, The Merits and Limitations of General Exception Clauses in Contemporary Investment Treaty Practice (21 May 2015), available at: https://www.iisd.org/itn/en/2015/05/21/the-merits-and-limitations-of-general-exception-clauses-in-contemporary-investment-treaty-practice/ (15/6/2023).

137 *Heath*, Eco Oro and the twilight of policy exceptionalism (20 December 2021), available at: https://www.iisd.org/itn/en/2021/12/20/eco-oro-and-the-twilight-of-policy-exceptionalism/ (15/6/2023).

138 *Alschner*, Why omitting general public policy exceptions from investment treaties is a setback for the right to regulate, available at: https://ccsi.columbia.edu/sites/default/files/content/docs/fdi%20perspectives/No%20342%20-%20Alschner%20-%20FINAL.pdf (15/6/2023).

139 *Newcombe*, General Exceptions in International Investment Agreements, Draft Discussion Paper Prepared for BIICL Eighth Annual WTO Conference (13–14 May 2008), available at: https://www.biicl.org/files/3866_andrew_newcombe.pdf (15/6/2023). For example, Australia – Hong Kong Investment Agreement (2019), Art. 18; Japan-Colombia BIT, Article 15; UK–New Zealand FTA, Article 32.1(1)–(2).

140 *Paine/Sheargold*, JIEL 2023/2, p. 290.

141 UK–New Zealand FTA, Art. 32.1.3; UK-Norway, Iceland, and Liechtenstein FTA, Article 14.1(3)(a)–(c).

142 *Sabanogullari*, The Merits and Limitations of General Exception Clauses in Contemporary Investment Treaty Practice, (fn. 136).

143 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Non-Disputing Party Submission of Canada 27 February 2020, para. 20.

2. New Provisions, old Findings?

The main question with regard to GATT/GATS-like general exceptions in IIAs is whether such provisions operate to exclude the requirement to pay compensation. The answer would appear to be simple – if the general exception applies, there is no violation of the IIA and no state obligation to pay compensation. This stems from interpretation of similarly worded exceptions in the law of the World Trade Organization (WTO). In particular, if an exception is applicable, it exempts measures from the substantive commitments in the treaty without legal consequences.[144]

This also appeared to be the mutual understanding between Canada and Colombia on the interpretation of the relevant provision in Canada-Colombia Free Trade Agreement (FTA).[145] However, the view of the *Eco Oro* tribunal appeared to be different. While the tribunal accepted that Colombia's measures fell within the scope of the exception, the majority found that the WTO-like general exception did not excuse payment of compensation for a breach of the MST that had already been established.[146] The majority compared the general exception provision (which was silent on the payment of compensation) with FTA Annex 811(2)(b), reflecting the police powers doctrine.[147] According to the tribunal, had the Contracting Parties intended that a measure could be taken under the general exception without the payment of compensation, the general exception "would have been drafted in similar terms as Annex 811(2)(b), namely making explicit that the taking of such a measure would not give rise to any right to seek compensation".[148] Hence, the tribunal interpreted the general exception provision of the FTA "such that whilst a State may adopt or enforce a measure pursuant to the stated objectives in [general exception] without finding itself in breach of the FTA, this does not prevent an investor claiming […] that such a measure entitles it to the payment of compensation".[149]

144 *WTO AB*, WT/DS135/AB/R, *European Communities: Measures Affecting Asbestos and Asbestos Containing Products,* Report of the Appellate Body, para. 115; *Alschner,* Why omitting general public policy exceptions from investment treaties is a setback for the right to regulate, (fn. 138); *Riffel*, ICLQ 2022/4, p. 973.

145 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Non-Disputing Party Submission of Canada 27 February 2020, para. 16; Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 378.

146 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 837.

147 Canada-Colombia FTA Annex 811(2)(b): "Except in rare circumstances, such as when a measure or series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted in good faith, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, for example health, safety and the protection of the environment, do not constitute indirect expropriation".

148 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 829.

149 Ibid., para. 830.

This finding of the *Eco Oro* tribunal attracted a number of criticisms.[150] The problem is that the *Eco Oro* tribunal's conclusion contradicts the rule that, apart from expropriation (will be discussed in the following section), the state is obliged to compensate an investor if a violation of an international obligation is established. Accordingly, since the application of the general exception clause results in no breach of the IIA, it should follow that no compensation is due.

The *Eco Oro* tribunal justified its finding by reference to the Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA) Art. 27(b),[151] according to which the invocation by a state of a circumstance precluding wrongfulness (i.e. consent, self-defence, countermeasures, force majeure, distress and necessity, as listed in Chapter V ARSIWA), is without prejudice to the question of compensation for any material loss caused by the state's act. However, Colombia did not invoke any circumstance precluding wrongfulness, as listed in ARSIWA, but a general exception provision stipulated in the FTA.[152] In such case, according to the investment treaty jurisprudence, express treaty exceptions should not be mixed with customary international law circumstances precluding wrongfulness.[153] Accordingly, reference to Art. 27(b) ARSIWA does not support the finding that the compensation is due when the general WTO-like exception applies.

The *Eco Oro* tribunal was not the first one dealing with the exception clause in the IIA. However, 4 previous investment tribunals – *Bear Creek* (which will be separately addressed in the following section), *Copper Mesa*, *Al Tamimi* and *Infinito Gold*[154] – also touched upon the exception clauses but did not provide a balanced position. The *Copper Mesa*, *Al Tamimi* and *Infinito Gold* tribunals were addressing the exception provisions which had slightly different wording from WTO-like clauses. Exception provisions in those cases allowed a state to adopt any measure, unless in an arbitrary or unjustified manner, to address environmental concerns but

150 *Garden*, ICSID Review 2023/1, p. 19; *Heath*, Eco Oro and the twilight of policy exceptionalism, (fn. 137); *Batifort/Larkin*, ICSID Review 2022, pp. 17–18; *Mathews/Devitre*, New Generation Investment Treaties and Environmental Exceptions: A Case Study of Treaty Interpretation in Eco Oro Minerals Corp. v. Colombia (11 April 2022), available at: https://arbitrationblog.kluwerarbitration.com/2022/04/11/new-generation-investment-treaties-and-environmental-exceptions-a-case-study-of-treaty-interpretation-in-eco-oro-minerals-corp-v-colombia/ (15/6/2023); *Alschner*, Why omitting general public policy exceptions from investment treaties is a setback for the right to regulate, (fn. 138).

151 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 835.

152 *Batifort/Larkin*, ICSID Review 2022, p. 18, footnote 122.

153 ICSID, case No ARB/02/16, *Sempra Energy International v. Argentine Republic*, Decision on the Argentine Republic's Application for Annulment of the Award 29 June 2010, para. 208.

154 ICSID, case No. ARB/14/21, *Bear Creek Mining Corporation v. Republic of Peru*, Award 30 November 2017; PCA, case No. 2012-2, *Copper Mesa Mining Corporation v. Republic of Ecuador*, Award 15 March 2016; ICSID, case No. ARB/11/33, *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, Award 3 November 2015; ICSID, case No. ARB/14/5, *Infinito Gold Ltd. v. Costa Rica*, Award 3 June 2021.

which had to be "otherwise consistent with this Agreement".[155] Due to the different factual contexts and slightly different wordings of the clauses in each case, three tribunals came to different findings.

The *Copper Mesa* tribunal found that measures were arbitrary and, accordingly, the exception was not applicable in the case.[156] The *Al Tamimi* tribunal did not even consider the exception clause as the respondent's defence, but only addressed it as the context for interpreting the MST. The tribunal found no MST violation because fines adopted by the Oman authorities in response to the claimant's activities in an environmentally sensitive area were not in bad faith, or procedurally unfair, but rather they were "environmental regulatory enforcement", and "forceful protection" of Oman's environmental laws.[157] According to the tribunal, the purpose of the exception clause was to reaffirm a state's "margin of discretion" in the application and enforcement of environmental laws.[158] The *Infinito Gold* tribunal echoed this view on the exception clause, but the difference between the two cases was that in the latter the tribunal found the FET breach.[159] Thereto, the tribunal concluded that the "otherwise consistent with this Agreement" requirement of the exception was decisive and it did not exempt the state's environmental measures from liability for substantive breaches of the BIT.[160]

Therefore, no investment tribunal so far has interpreted the general public policy exceptions as operating to exclude the requirement of compensation for violation of the substantive breaches. The *Eco Oro* tribunal's finding that a GATT-inspired exception allows a state to adopt environmental measures without breaching the IIA, but does not preclude payment of compensation, seems at odds with the interpretation of similar clauses by WTO bodies and customary provisions on state's responsibility. It also contradicts the intention of Contracting Parties to the new generation IIAs to protect state's discretion in environmental matters and exclude the duty to pay compensation in the exercise of such discretion. Accordingly, if subsequent investment tribunals analyse the gaps in the *Eco Oro* tribunal's findings, there will be a chance that similar WTO-like general exceptions in IIAs could be interpreted as not requiring compensation for measures taken to combat climate change. However, as regards to the exceptions which contain "otherwise consistent with this Agreement" wording, there are little chances that future tribunals will interpret them as operating to exclude liability to pay compensation due to their restrictive wording.

155 U.S.-Oman Free Trade Agreement, Art. 10.10; Canada-Costa Rica BIT, Annex I (General and Specific Exceptions) Section III(1) (General Exceptions and Exemptions).
156 PCA, case No. 2012-2, *Copper Mesa Mining Corporation v. Republic of Ecuador*, Award 15 March 2016, paras. 6.66, 6.67.
157 ICSID, case No. ARB/11/33, *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, Award 3 November 2015, paras. 340, 387, 445.
158 Ibid., paras. 440, 446.
159 ICSID, case No. ARB/14/5, *Infinito Gold Ltd. v. Costa Rica*, Award 3 June 2021, para. 777.
160 Ibid., paras. 780, 781.

3. General Exceptions and Expropriation

Notwithstanding the analysis above, the interpretation of general exceptions provisions in IIAs with respect to compensation takes a different turn in cases of expropriation claims.

The *Bear Creek* tribunal was the only one so far dealing with this issue. After the tribunal found there to be unlawful indirect expropriation,[161] it considered GATT-like exception in the Canada – Peru FTA. The Tribunal opined that the exception "does not offer any waiver from the obligation […] to compensate for the expropriation"[162] and ordered compensation to be paid to claimant. This finding was cited by the *Eco Oro* tribunal in support of its position that the WTO-like exception did not preclude compensation for the MST breach.[163]

However, the findings of the two tribunals are not comparable. In the context of expropriation, the duty to compensate an investor does not flow from the establishment of a breach. Compensation is one of the conditions for the legality of the expropriation, hence, even lawful taking is accompanied by compensation under customary international law.[164] In turn, unlawful expropriation is an international wrongdoing and requires reparation,[165] which should be at least as much as the compensation for a lawful expropriation.[166] Accordingly, when the expropriation takes place, even if the measure is necessary to protect a legitimate public welfare objective, such as climate change goals, a state still must pay compensation. Exactly this idea was pursued by the *Santa Elena* tribunal, in the context of direct expropriation, it was determined that "where property is expropriated, even for environmental purposes, […] the state's obligation to pay compensation remains".[167]

Commentators support that general public policy exceptions in IIAs would seem to have no impact on the expropriation provisions. The latter demands compensation in any case, because the exception clauses are not meant to provide less investor protection than that accorded under customary international law.[168] Accordingly, the *Bear Creek* tribunal's finding that a general public policy exception does not exempt from the obligation to compensate for the expropriation, would not necessar-

161 ICSID, case No. ARB/14/21, *Bear Creek Mining Corporation v. Republic of Peru*, Award 30 November 2017, para. 449.
162 Ibid., para. 477.
163 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, para. 834.
164 *UNCTAD*, Expropriation, (fn. 109), pp. 40, 111.
165 Ibid.
166 ICSID, case No. ARB/14/21, *Bear Creek Mining Corporation v. Republic of Peru*, Award 30 November 2017, para. 596.
167 ICSID, case No. ARB/96/1, *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, Award 17 February 2000, para. 72.
168 *Newcombe*, General Exceptions in International Investment Agreements, (fn. 139), pp. 11-12; *Nikièma*, Best Practices Indirect Expropriation (12 March 2012), pp. 8-9, available at: https://www.iisd.org/publications/guide/best-practices-indirect-expropriation (15/6/2023).

ily be applicable outside the context of expropriation to other breaches of substantive obligations.[169]

Finally, contrary to the finding of the *Eco Oro* tribunal, there is no inconsistency in the co-existence of the police powers doctrine, general public policy exceptions and the effects they have.[170] When the police powers doctrine is successfully invoked, the measure does not qualify as an expropriation, hence no compensation is due. If, nevertheless, the expropriation is established, the general exception comes into play. It justifies otherwise illegal expropriation, making it lawful. But the crucial point here, again, is that for lawful expropriation compensation remains payable.

Thus, despite some criticism of the general WTO-like exceptions in IIAs,[171] these provisions have potential to counterbalance the impact of investment protections on states' efforts to combat climate change through domestic regulatory measures. If future investment tribunals consider the shortcomings of the *Eco Oro* award, they will have a tool in the form of the WTO-like general exceptions to excuse host states from liability for violation of investor rights by imposing climate change regulatory measures, after a comprehensive analysis of all facts and the language of the IIA. However, cases of expropriation should be distinguished from other standards. If it is established that a climate change measure constitutes an expropriation, it is unlikely that an investment tribunal will interpret an IIA general exception as offering a waiver from compensation.

E. Conclusion

Under the climate change regime, with the UNFCCC and the Paris Agreement at its core, states committed to significantly limit global warming. Meeting this ambitious goal requires the introduction of unprecedented regulatory measures. This will adversely affect the economic activities of foreign investors, especially in the fossil fuels industry, who may decide to sue states under the existing investment regime. In turn, this framework in its current shape gives protection to all investors in all sectors and, accordingly, is not compatible with climate change goals. It is unlikely to be suitable as an enforcement mechanism for international climate change commitments of states. At the same time, the widely discussed phenomenon of regulatory chill is just one possible scenario, which may differ from country to country due to their different economic and political conditions. Currently there is no evidence to prove the power of fossil fuel industry to resist further climate-related measures necessary to achieve the Paris Agreement goals, since no investment tribunal has yet ruled on such a case. The development of the climate change-related investor-state dispute against the Netherlands and regulatory behaviour of third

169 *Garden*, ICSID Review 2023/1, p. 23.

170 ICSID, case No. ARB/16/41, *Eco Oro Minerals Corp. v. Republic of Colombia*, Decision on Jurisdiction, Liability and Directions on Quantum 9 September 2021, paras. 829–830.

171 *Morfopoulos*, TDM 2023, pp. 1–12.

countries against this backdrop will provide data for a subsequent analysis of this phenomenon.

Whereas broadly formulated provisions on environmental issues in existing IIAs have not yet played, and are unlikely to play, any significant role in ISDS in the future, invocation of climate change law by respondents may ensure the balanced coexistence of investment protections and states' policy space to mitigate the effects of climate change. First, states may argue that their climate change commitments are the relevant rules of international law applicable to the investment dispute with the purpose to interpret substantive obligations under IIAs and to determine whether the breach took place. Accordingly, states can submit that international climate change law is a part of the regulatory environment in which the investment was made and shapes states' behaviour. This can work as a defence to the legitimate expectations of investors under the FET standard and influence the assessment of the duty of an investor to undertake due diligence regarding host state's anticipated climate policies. Second, states' climate-related regulatory measures which negatively affect investor rights can be recognised by investment tribunals as a non-compensable exercise of the state's police powers. International climate change commitments of host states can justify implementation of bona fide regulatory measures, the primary intent of which is not to deprive the investor of its property but to respond to the recent scientific awareness of the imminent threat posed by climate change. Third, WTO-inspired general public policy exceptions included in recent new generation IIAs could excuse host states from liability for breaches of investment protection standards. Tribunals should interpret such clauses in a manner consistent with the intention of Contracting Parties to protect the exercise of a state's regulatory powers to achieve legitimate objectives set out in the exceptions, which cover climate change-related regulatory measures. However, since such disputes and arguments are yet to occur in investment arbitration, a change of mindset of arbitrators is important to recognise a global responsibility for the effects of climate change. Investment tribunals should be more flexible to find that, subject to meeting a set of requirements developed under investment law, host states should not be punished for measures they adopt in response to this global threat, especially when they have not gained anything from changing the regulatory framework but only aimed to mitigate effect of climate change.

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