Biblioteca di diritto internazionale
International Law Series
Collana diretta da Alberto Malatesta

Foreign Direct Investment, Human Rights and Climate Change

A Multiperspective Approach

Edited by
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Ludovica Chiussi Curzi
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McGraw Hill

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Corso Vercelli, 40 – 20145 Milano
Tel. 02535718.1 – www.mheducation.it

Impaginazione: a cura dei Curatori
Grafica di copertina: Feel Italia, Milano

Stampa:

ISBN: 9788838622809

0 1 2 3 4 5 6 7 8 9 - 29 28 27 26 25

Biblioteca di diritto internazionale
International Law Series
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Già pubblicati in questa Collana:

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Questo volume è stato realizzato dall'Università di Bologna con il contributo dell'Unità di Analisi, Programmazione, Statistica e Documentazione Storica – Direzione Generale per la Diplomazia Pubblica e Culturale del Ministero degli Affari Esteri e della Cooperazione Internazionale (MAECI), ai sensi dell'art. 23 bis del Decreto del Presidente della Repubblica 5 gennaio 1967, n. 18. Le opinioni contenute nel presente volume sono espressione degli autori e non rappresentano necessariamente le posizioni del MAECI.

Preface

This edited book finds its roots in a workshop held by the Department of Legal Studies of the University of Bologna in June 2023, on 'Foreign Investments, Climate Change and Protection of Fundamental Rights', as part of a joint project with the Italian Ministry of Foreign Affairs and International Cooperation and the Italian branch of the International Law Association.

The book draws upon the core dimension of the workshop, namely to offer a forum for dialogue among different categories of stakeholders (public sector, intergovernmental organisations, law firms, and academia) with a view to examining the key challenges in the relationship between two potentially conflicting trends, namely the promotion and facilitation of foreign direct investment, on the one hand, and the demands of environmental and social sustainability, on the other hand.

This editorial project has been made possible thanks to the valuable contribution of Andrea Cerofolini, Alessia Preti and Grazia Eleonora Vita. We are also thankful to Professor Alberto Malatesta, for accepting the book as part of the '*Biblioteca di diritto internazionale* – International Law Series', as well as to Marta Colnago, from McGraw Hill, for her editorial assistance.

MA, LCC, AT

October 2025

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Introduction

by Marco Argentini, Ludovica Chiussi Curzi, Attila M. Tanzi

Foreign direct investment (FDI) plays a central role in promoting the development of host countries and ensuring the effective implementation of a considerable number of fundamental rights. At the same time, the challenges posed by the fight against climate change place investments within the contours of the framework of the objectives set forth in the main international instruments on the subject. In parallel, business activities, including FDI, often come into conflict with the protection of human rights and the environment.

These potential tensions have long been the subject of discussion and of regulation efforts, highlighting the complexity of fitting corporate actors into a legal framework that is primarily intergovernmental. This challenge, however, has long been a wake-up call for a branch of international law that was traditionally conceived to merely protect the rights of foreign investors.[1]

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[1] For some of the earlier reflections on the matter, see Pierre-Marie Dupuy, Francesco Francioni and Ernst-Ulrich Petersman (eds), *Human Rights in International Investment Law and Arbitration* (Oxford University Press 2009); Bruno Simma, 'Foreign Investment Arbitration: A Place for Human Rights?' (2011) 60 International & Comparative Law Quarterly 573; Attila M Tanzi, 'On Balancing Foreign Investment

As well known, the so-called ‘first-generation’ investment agreements focused largely on investor protection, leaving aside investors’ accountability concerning the protection of global interests, such as the environment and fundamental human rights that might be affected by business activities. This was occasionally at the cost of the state’s right to regulate specific sectors in the public interest.

In recent years, and amidst increasing criticism of international of foreign investment, there has been an apparent reversal of this trend. ‘New-generation’ investment treaties are gradually incorporating social and environmental sustainability clauses, albeit in a fragmented manner. As emphasised in a study by the Human Rights Council’s Expert Mechanism on the Right to Development published in 2023, ‘some [international investment agreements] and model bilateral investment treaties […] have expressly incorporated sustainable development, SDGs and human rights, both in their preambles and their operative provisions’.[2] It was highlighted that, following the adoption of the Sustainable Development Goals in 2015, 224 international investment agreements were adopted, of which 31 percent explicitly referred to these goals.[3] At the same time, investment arbitration tribunals have become increasingly sensitive to sustainability issues in the interpretation of older international investment agreements.[4]

Interests with Public Interests in Recent Arbitration Case Law in the Public Utilities Sector’ (2012) 11 The Law & Practice of International Courts and Tribunals 47.

[2] Human Rights Council, ‘Right to development in international investment law. Study by the Expert Mechanism on the Right to Development’ (3-5 April 2023) UN Doc A/HRC/EMRTD/7/CRP.2, para 10.

[3] ibid, para 11. The number of investment agreements is updated to December 2023.

[4] See, with special regard to social sustainability, the report of the Working Group on the issue of human rights and transnational corporations and other business enterprises, ‘Human rights-compatible international investment agreements’ (27 July 2021) UN Doc A/76/238, paras 48-49. In particular, it is highlighted that ‘arbitration tribunals – especially if they include human rights experts – could articulate human rights obligations of investors in three ways: (*a*) by using the “other applicable law” hook of such agreements to embed obligations in relation to international human rights law; (*b*) by interpreting certain provisions of the agreements to read human rights into

This illustrates how the prevention of human rights abuses and environmental damage in the context of international investment is being pursued through a combined action of international law-making and arbitral case law. The promotion of social and environmental sustainability in new-generation investment agreements has been pursued through several strategies, including (i) the explicit recognition of the state's right to regulate, (ii) the provision that arbitral tribunals take into account violations of human rights and environmental protection when determining the *quantum* of compensation, (iii) explicit mention of investors' obligation to comply with the domestic law of the host state in matters of human rights and environmental protection, and (iv) reference to international instruments on business and human rights.[5]

As the number of investment agreements incorporating social and environmental sustainability considerations grows, a large number of older-generation treaties are still in force. And states parties to them may face significant challenges from foreign investors when pursuing international environmental targets and obligations. As stressed in a paper produced by the Organisation for Economic Co-operation and Development (OECD), these states 'can be exposed to high-value claims and damages awards relating to important public policies involving the regulation of business in sensitive areas, including under older treaties between advanced economies such as the Energy Charter Treaty'.[6]

In 2011, the UN Human Rights Council adopted the Guiding Principles on Business and Human Rights,[7] whose relevance was explicitly emphasised

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them; and (*c*) by building on explicit human rights provisions in the agreements' (para 49).

[5] See, on the matter, UN Doc A/76/238 (n 4) paras 41-47; UN Doc A/HRC/EMRTD/7/CRP.2 (n 2) paras 31-38.

[6] David Gaukroger, 'Business Responsibilities and Investment Treaties', Consultation paper by the OECD Secretariat (15 January 2020) para 52 <https://www.oecd.org/daf/inv/inve stment-policy/Consultation-Paper-on-business-responsibilities-and-investment-treaties. pdf>.

[7] Office of the United Nations High Commissioner for Human Rights, 'Guiding Principles on Business and Human Rights' (2011) UN Doc HR/PUB/11/04.

by the Inter-American Court of Human Rights in its 2025 advisory opinion on the climate emergency and human rights.[8] One of the three ‘pillars’ of these Principles consists of the so-called ‘corporate responsibility to respect human rights’,[9] which implies a duty of due diligence on the part of business enterprises (‘human rights due diligence’[10]). Such statements, in combination with an increasing number of authoritative instruments, state and corporate practice, enhance the trend towards the creation of due diligence standards for corporations to avoid causing adverse human rights impacts through their activities, and to address such impacts when they occur. Companies would then be required to take the necessary steps to mitigate any such impacts directly related to their industrial or commercial activities, even if they have not contributed to causing them. The legal ground and nature of corporate due diligence and accountability in this area remains controversial. While the late John Ruggie, who served as the UN Secretary-General’s Special Representative on Business and Human Rights from 2005 to 2011 and was one of the proponents of the Principles, described this responsibility as a ‘social expectation’ rather than a ‘legal duty’,[11] the impact of these standards on investor behaviour seems to be increasingly crystalling.[12]

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[8] Inter-American Court of Human Rights, *Climate Emergency and Human Rights*, Advisory Opinion, 29 May 2025, para 348.

[9] UN Doc HR/PUB/11/04 (n 7) 13ff. The other two pillars are the obligation of states to protect human rights and the possibility for victims of human rights violations to have access to effective remedies.

[10] ibid 17ff.

[11] Human Rights Council, ‘Report of the Special Representative of the Secretary General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie’ (21 March 2011) UN Doc A/HRC/17/31, para 6.

[12] The Principles have been explicitly referred to by the *Urbaser SA and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v Argentina* Tribunal (ICSID Case No ARB/07/26), Award, 8 December 2016, para 1195, fn 434. The Tribunal maintained that ‘international law accepts corporate social responsibility as a standard of crucial importance for companies operating in the field of international commerce’, specifying that ‘[t]his standard includes commitments to comply with human rights in the framework of those entities’ operations conducted in countries other than the country of their seat or incorporation’ (ibid, para 1195). On the progressive recognition

Principle 9 of the Guiding Principles calls for the pursuit of harmonisation between potentially conflicting state obligations pertaining to foreign investment, particularly in the public utilities sector. In particular, it provides that 'States should maintain adequate domestic policy space to meet their human rights obligations when pursuing business-related policy objectives with other States or business enterprises, for instance through investment treaties or contracts'.[13] This highlights the importance of new bilateral investment treaties (BITs) that take into account the social and environmental sustainability of investments.[14] Notable examples include the Dutch[15] and Brazilian[16] BIT models, the Moroccan-Nigerian BIT[17] and the new Italian model.

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of investor obligations, see Barnali Choudhoury, 'Investors Obligations for Human Rights', 35(1-2) ICSID Review 82 (2020); Nicolas Bueno, Anil Yilmaz Vastardis, and Isidore Ngueuleu Djeuga, 'Investor Human Rights and Environmental Obligations: The Need to Redesign Corporate Social Responsibility Clauses', 24(2) The Journal of World Investment and Trade 179 (2023).

[13] UN Doc HR/PUB/11/04 (n 7), Principle No 9.

[14] See the Commentary to Principle 9, which highlights that 'the terms of international investment agreements may constrain States from fully implementing new human rights legislation, or put them at risk of binding international arbitration if they do so'. For a survey of good practices on the inclusion of social and environmental sustainability clauses in international investment agreements, see UN Doc A/HRC/EMRTD/7/CRP.2 (n 2) paras 13-17.

[15] Netherlands model Investment Agreement (2019) <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5832/download>, articles 6 (sustainable development) and 7 (corporate social responsibility).

[16] Model BIT Brazil (2015), <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4786/download>, arts 14 (corporate social responsibility) e 16 (provisions on investment and environment, labor affairs and health).

[17] Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Federal Republic of Nigeria (signed in Abuja on 3 December 2016, not yet ratified by Nigeria) <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5409/download>, arts 1(3) (definition of 'investment'), 13 (investment and

The UN Working Group on Business and Human Rights has recently produced a report which is particularly relevant in providing guidance for states on the point at issue.[18] The report encourages reference to best practices in the negotiation of new international investment agreements or reforming existing ones, so as to allow sufficient domestic regulatory space for states to fulfil their human rights obligations under both international law and domestic constitutional law, while at the same time encouraging responsible behaviour by investors. In particular, it recommends that states '[n]egotiate in future only such international investment agreements that are compatible with their international human rights obligations as well as national development needs and priorities',[19] and that investors '[t]ake their human rights responsibilities seriously throughout an investment cycle irrespective of the location or context of an investment'.[20]

This approach resonates with the recent report of the Special Rapporteur on human rights and climate change, on 'The Imperative of Defossilising Our Economies'.[21] The latter emphasises the importance that investment regimes should support the transition to renewable energy and align with states' human rights obligations to protect the environment and the climate system.[22]

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environment), 14 (impact assessment) and 15 (investment, labour and human rights protection).

[18] UN Doc A/76/238 (n 4).

[19] ibid, para 76(e).

[20] ibid, para 77(b).

[21] Human Rights Council, 'The imperative of defossilizing our economies. Report of the Special Rapporteur on the promotion and protection of human rights in the context of climate change, Elisa Morgera' (15 May 2025) UN Doc A/HRC/59/42.

[22] ibid, para 83. See also Astrid Puentes Riaño, Elisa Morgera and Surya Deva, Statement by UN experts on the 16th UN Conference on Trade and Development (UNCTAD), 'States must prioritise human rights and planetary health in trade, investment and business regulation' (21 October 2025) <https://www.ohchr.org/sites/default/files/documents/issues/environment/srenvironment/activities/2025-10-21-stm-sr-env.pdf>.

Within this context, Davide D'Urso's contribution focuses specifically on the new Italian model BIT published in 2021,[23] with special regard to its sustainable development clauses. It addresses, in particular, the section devoted to the obligations of contracting parties with regard to corporate social responsibility,[24] environmental protection,[25] climate change,[26] and the protection of workers' rights.[27] It is emphasised how the new Italian model also expressly refers to the obligations of state parties to promote the dissemination and use of international soft law instruments on sustainability, such as the Global Compact, the above-mentioned Guiding Principles on Business and Human Rights, the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy of the International Labour Organization, and the Guidelines for Multinational Enterprises of the OECD.

It is worth noting that, in the Italian panorama, the growing importance of sustainability, was confirmed by the adoption of Constitutional Law No. 1/2022. This reform amended Article 9 of the Constitution introducing the principle that the Republic 'shall safeguard the environment, biodiversity and ecosystems, also in the interest of future generations', providing that '[s]tate law shall regulate the methods and means of safeguarding animals'.[28]

The obligations outlined in the new Italian BIT model apply exclusively to the contracting states and not to private investors, with the result that any violations cannot be invoked in an arbitration dispute between the state and the investor.[29] Accordingly, arbitration clauses in international investment

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[23] Model BIT Italy (2022) <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6438/download>.

[24] ibid, art 19.

[25] ibid, art 20.

[26] ibid, art 21.

[27] ibid, art 22.

[28] Constitutional Law of 11 February 2022, No 1 (in Official Gazette No 44 of 22 February 2022). An English translation of the Italian Constitution is available at <https://www.quirinale.it/allegati_statici/costituzione/costituzione_inglese.pdf>.

[29] Model BIT Italy (n 23) art 24(1).

agreements (IIAs) are of paramount importance in ensuring the effectiveness of investment sustainability provisions.

This perspective is explored by Cecilia Carrara, whose chapter provides a practitioner's perspective. She highlights the still central role of IIAs in the entire investor-state dispute settlement (ISDS) system, and offers a comprehensive overview of new trends addressing climate change concerns within the international investment framework. The author also examines the increasing weight that the doctrine of contributory neglicence is gaining in the international investment law debate.

The growing relevance of international investment law and arbitration as a forum for climate change disputes has been recently aknowledged by the United Nations Environment Programme. In particular, the 2023 Global Climate Litigation Report has highlighted that investment arbitration – along with mediation – is becoming an important tool for resolving such disputes.[30]

Building on this framework, Agata Daszko examines the role of ISDS mechanisms in relation to energy transition policies. In particular, her chapter critically analyses how investment tribunals navigate the dichotomy between protecting investor rights and upholding state regulatory jurisdiction concerning environmental protection and climate change mitigation. Through a review of pertinent case law, including *Westmoreland Mining v Canada*, *Lone Pine v Canada*, and *Bilcon v Canada*, it assesses whether fears that ISDS may impede the energy transition are justified. Daszko's analysis focuses primarily on the arbitral interpretation and application of the fair and equitable treatment and indirect expropriation rules. While acknowledging the ISDS system's responsiveness to state-led environmental measures, the author highlights its inherent imperfections and suggests that the responsibility for reform lies with the states.

Among the main ISDS climate change disputes, particularly sensitive are those related to the 'fossil fuel phase-out'. The latter has been recognised as a necessary step also by UN Secretary-General António Guterres, who has

[30] UN Environment Programme, 'Global Climate Litigation Report 2023 Status Review' (2023) 70 <https://wedocs.unep.org/bitstream/handle/20.500.11822/43008/ global_clima te_litigation_report_2023.pdf>.

identified fossil fuels as the main obstacle to the international climate agenda. Following a meeting with civil society representatives involved in the fight against climate change in June 2023, Guterres urged that '[t]he world must phase out fossil fuels in a just and equitable way – moving to leave oil, coal and gas in the ground where they belong – and massively boosting renewable investment in a just transition'.[31]

From this perspective, Ladan Mehranvar analyses the role and relevance of investment treaties in promoting investment in renewable energy, with a particular focus on legal (and regulatory) stability. More specifically, she identifies the political instability and unclear regulatory environment in the energy sector as the main challenges for investment in these fields. In this context, the different perspectives of private investors and governments are highlighted. The former place a strong emphasis on protection from contractual and regulatory changes by the state (*e.g.*, in tax policy). The latter prefer to maintain a degree of flexibility that allows them to adapt their regulatory policies to changes in the public interest and the socio-political environment, as well as to international sustainability commitments. Linked to this is the difficulty for governments to manage and mitigate the risks and impacts of climate change, including the distribution of expected benefits and costs between the public and private sectors.

Indeed, government policies aimed at promoting the transition from fossil fuels to renewable energy can easily be detrimental to international investors, who may seek arbitration for violation of investment protection standards.

Giovanni Zarra focuses on the right to regulate, understood as the right of the host state to adopt regulations that derogate from its obligations under the investment agreement in non-compensatory terms when public interests

[31] UN Secretary General, 'Press conference on Climate' (15 June 2023), <https://www.un.org/sg/en/content/sg/press-encounter/2023-06-15/secretary-generals-press-conference-climate?gl=1*zr0mgd*_ga*OTQyMTk%200NzM3LjE2NjQ0N zYwNTc.*_ga_TK9BQL5X7Z*MTY5ODc2MTc2OC44LjAuMTY5ODc2MTc2OC4wLjAuMA.*_ga_S5EKZKSB78*MTY5ODc2MTc2OC4yLjAuMTY5ODc2MTc3MS41Ny4wLjA>.

of vital importance to the population concerned are at stake, such as the protection of the environment.[32]

The author illustrates how the *Santa Elena v Costa Rica* tribunal initially held a negative view of this right, stating that any government expropriation of an investment, even for environmental protection, always required compensation,[33] while this approach was later overturned in *Philip Morris v Uruguay*, which remains a key precedent in this area. In this case, the tribunal determined that the investment treaty must be interpreted in the light of the right to regulate. More specifically, the arbitrators established that a measure's admissibility depends on (i) whether it was adopted by the State in good faith in pursuit of important public interests, (ii) whether it was non-discriminatory, and (iii) whether it was proportionate to the aim to be pursued.[34]

On the procedural level, the main tool available to host states to respond to investors' breaches of environmental and human rights violations, if they are found to exist, may consist of lodging counterclaims in investment arbitration proceedings. This possibility has been repeatedly recognised as an

[32] The significance of the right to regulate in fostering the protection of the climate system was underscored by Judge Cleveland in her declaration attached to the International Court of Justice's Advisory Opinion on *Obligation of States in respect of Climate Change* (23 July 2025). See, in particulat, para 22: '[i]t is therefore important to underscore that the obligations of States in relation to the protection of the climate system impose significant responsibilities on States to adopt and implement appropriate environmental regulations to mitigate and adapt to climate change, including in co-operation with other States, while allowing States some discretion with respect to the particular regulatory paths that may be chosen. Accordingly, *the interpretation of investment instruments must be informed by States' obligations in respect of climate change under international law*, including the stringent due diligence standard to which States are bound in implementing such obligations' (emphasis added).

[33] *Compania del Desarrollo de Santa Elena, SA. v Costa Rica*, ICSID Case No ARB/96/1, award, 17 February 2000, para 72.

[34] *Philip Morris Brands S.À.R.L., Philip Morris Products S.A. and Abal Hermanos S.A. v Uruguay*, ICSID Case No ARB/10/7, award, 8 July 2016, para 305.

important factor in rebalancing the ISDS system, which has traditionally been seen as inherently asymmetrical in favour of private investors.

Simon Batifort, Irene Petrelli and Cyprien Mathié precisely explore the contentious issue of counterclaims from two different angles: (i) jurisdiction and the admissibility of a counterclaim, and (ii) the potential existence of substantive obligations of investors vis-à-vis states regarding sustainability, as the basis for the cause of action of the counterclaim. First, the general absence of references to counterclaims in investment treaties – albeit with some exceptions – and the broad arbitration clauses contained therein suggest that there are no obstacles to the possibility of bringing a counterclaim, notwithstanding the existence of certain substantive and procedural conditions. Second, the existence of obligations on the part of the investor is analysed according to a three-tier approach, namely, with reference to the rules laid down in the investment treaty, general international law, and domestic law.

The contribution concludes with consideration of the still problematic nature of counterclaims, particularly on the cause of action side.

These challenges have led Elena Cima to propose in her contribution a different avenue to enforce investors' duties on social and environmental sustainability, which goes beyond the doctrine of counterclaims. In particular, Cima suggests that sustainable investments may be incentivised by limiting the protection afforded by the ISDS system to certain types of investments only, namely those that meet specific sustainability-related requirements. The author suggests that this avenue can be pursued in three different ways: (i) by developing taxonomies of sustainable economic activities (or implementing already existing ones); (ii) by drafting IIAs in order to explicitly exclude certain activities or sectors from the treaty protection; or (iii) by elaborating more granular formulations of the different applicable standards of treatment.

The study concludes with a focus on a case analysis from Latin America, namely the Brazilian Cooperation and Facilitation Investment Agreements (CFIA), whose main innovation was to establish a unique relationship between investors and host states, focusing on dispute prevention rather than conflict resolution. From this standpoint, Leonardo Vieira Arruda Achtschin argues that the CFIA promotes environmental protection at both the procedural and the substantive levels. In particular, at the procedural level, investments that potentially or actually cause environmental damage can be addressed through the CFIA's dispute prevention mechanism. This is made possible by a consultation process conducted by the Joint Committee and by an executive role played by the Direct Investments Ombudsperson. This procedural competence is substantially supported by the adoption of a rule prohibiting states from reducing environmental protection and a comprehensive provision on corporate social responsibility.

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Sustainable Development Clauses in the New Italian Model BIT

Davide D'Urso

The entry into force of the Treaty on the Functioning of the European Union (TFEU) on 1 December 2009 has greatly limited the autonomy of Italy and the other twenty-six EU Member States with regard to bilateral investment treaties (BITs). Indeed, the TFUE has included the topic of foreign direct investment within the Common Commercial Policy[1]. Consequently, from that moment on, its regulation shall also be based on the European Union uniform principles and comply with the objectives of the Union's external action.

Subsequently, the subject of foreign direct investment was further addressed by Regulation 1219/2012 (so-called 'Grandfathering Regulation'),[2] entered into force on 9 January 2013. More precisely, the Regulation *inter alia* requires member states to obtain two authorizations from the European Commission: one to initiate and another to conclude negotiations directed at the conclusion of a new BIT with a third country (or the

[1] Treaty on the Functioning of the European Union (TFEU), art 207.

[2] Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries.

amendment of a BIT already into force).[3] Each request shall also be accompanied by the proposed BIT, as it stands, at the start and at the conclusion of the negotiations.

As regards the two authorizations, article 9 of the Grandfathering Regulation imposes four conditions on them: (*i*) compatibility of the draft BITs with EU law; (*ii*) absence of a decision to open negotiations with the chosen third country directly at EU level; (*iii*) compatibility of the draft BIT with the principles and objectives of the EU external action; (*iv*) the draft BITs shall not constitute a serious obstacle to the EU negotiation or the conclusion of investment protection agreements with other third countries.

Among the external action goals, pursued by the EU, compliance with the United Nations (UN) 2030 Agenda has undoubtedly played a paramount role. The Agenda, which was agreed in 2015 under the key thrust of the EU and that was later ratified by all the UN member states, required the signatories States to pursue seventeen Sustainable Development Goals (SDGs) within 2030. Indeed, the Agenda is based on the belief that the needs of present generations should not harm those of future ones. The EU and its member states are committed to implementing the 2030 Agenda and prioritizing the Sustainable Development Goals in their policies, including those related to investment.

Sustainable development is based on three interconnected pillars that must support each other: the economic, environmental, and social ones. The new Italian model BIT,[4] which was drafted following an intensive and still evolving dialogue with the EU Commission and lastly amended in August 2022, includes an entire section on 'sustainable development'. Notably, it consists of four central provisions, dealing with corporate social responsibility and responsible business conduct (article 19), investment and the environment (article 20), investment and climate change (article 21), investment and labor (article 22). There is also a fifth and final provision (article 23) under

[3] ibid, arts 7 and 9.

[4] 'Model BIT Italy' (2022) <https://investmentpolicy.unctad.org/international-investment-agreements/ treaty-files/6438/download>.

which the BIT contracting parties undertake to engage in dialogue and co-operate on issues related to investment and sustainable development.

Upon closer examination of articles 19-22, it is evident that these provisions only impose obligations on the BIT contracting parties and not on investors. This is explicitly confirmed by article 24(1), which specifies that infringements of the articles on sustainable development cannot be brought up in investor-States disputes. It was considered that violations like these should be settled through dialogue between the contracting parties, rather than being heard by an arbitral tribunal.

Section 3 of the new Italian model BIT opens with article 19, under the heading 'corporate social responsibility and responsible business conduct'. According to the latter, the contracting parties recognize the importance of due diligence by investors in their operations, production processes and other business relationships so as to identify and address detrimental impacts, in particular on the environment and labour conditions. The contracting parties also commit themselves to promoting the adoption of responsible business practices by their companies and investors. To this end, they shall encourage, within their territories, the dissemination and application of international agreements that they have formally adopted or endorse relating to business and human rights, social policy, multinational enterprises and due diligence.

In article 20, on 'investment and the environment', the contracting parties restate their right to determine their own policies and priorities on sustainable development, environmental protection standards. They also have the right to create or modify their own environmental laws or policies, provided that they do so in a manner consistent with internationally recognized standards and agreements on environmental protection. The second and third paragraphs outline the unlawfulness of the 'race to the bottom', *i.e.* the promotion of investment in the parties' territory through a series of initiatives aimed at weakening domestic legislation specifically established to protect the environment.[5] Finally, paragraph 4 includes the contracting parties' obligation to implement multilateral international agreements (and

[5] This prohibition is also replicated in relation to the domestic discipline regarding the protection of workers in art 22 (see infra).

related protocols and amendments) on the environment that have already been ratified, as well as an obligation to promote the development of investments that result in a high level of environmental protection.

Article 21, on 'investment and climate change', starts with the parties' recognition of the importance of taking urgent action to combat climate change and its effects, as well as of the role of investment in pursuing this goal in accordance with the provisions of relevant international instruments. Paragraph 2 expressly stipulates that each party shall (*i*) implement the UN Framework Convention on Climate Change (UNFCCC) and the Paris Agreement; (*ii*) promote investments capable of contributing to climate change mitigation and climate adaptation, including in goods and services that are more environment friendly, such as renewable energy, low-carbon technologies, and energy-efficient products and services; and (*iii*) cooperate with the other party, bilaterally and multilaterally, on aspects where investment and climate change policies are interrelated, as well as on specific actions in this regard.

Lastly, Article 22 expressly establishes the right of each party to regulate in order to set its own labour standards and to adopt or amend its laws and policies in accordance with internationally recognized labour standards. Article 22 further provides for the obligation of contracting parties to: (*i*) promote, respect and implement within their territories internationally recognized core labour standards as defined in the Core Conventions of the International Labour Organization (ILO);[6] (*ii*) implement ILO Conventions that they have ratified and make continuing efforts to ratify ILO Core Conventions, if such ratification has not yet been accomplished;[7] and (*iii*) promote investment policies that embrace the goals set forth in the ILO's Decent Work Agenda and a human-centered approach with a view to ensuring the future of work, adequate minimum wages, social protection, and health and safety at work.[8]

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[6] Model BIT Italy (n 4) art 22(4).

[7] ibid, art 22(5).

[8] ibid, art 22(6).

In conclusion, the new Italian model BIT is characterized by four express provisions on sustainable development that provide specific obligations for the contracting parties only. This is intended to encourage the latter's implementation of international commitments in this regard and to indirectly ensure that future foreign direct investment is increasingly in line with the urgent calls for responsible business conduct, the protection of the environment, the fight of climate change and the respect for fundamental workers' rights.

2

Investment Law and Climate Change Through the Lens of a Practitioner

Cecilia Carrara

1. Introduction

The awareness that anthropogenic climate change is real and is already causing material and economic effects has made its way to the international investment framework, which has seen a considerable growth of climate related-investments. Nonetheless, investment treaties are still for the great majority old ones and do not contain any provision on climate change. It follows that States should be prudent in implementing drastic measures in view of the energy transition to mitigate the risk of being sued by fossil fuels' investors. In this scenario, a new generation of investment treaties includes now clauses taking into account the need to foster sustainable investments and States may still rely on a number of legal and procedural tools to mitigate their responsibility in case their regulatory action impacts foreign investors.

2. Next Trends

The concept of climate finance refers to financing aimed at supporting mitigation and adaptation actions that are necessary to face climate change. Hence, climate change-related investment corresponds to investment in mitigation and adaptation: the former supports the reduction of greenhouse gas emissions; the latter entails investment in critical assets to increase resilience and help adapting to the consequences of climate change.[1] The United Nations Conference on Trade and Development's (UNCTAD) World Investment Report notes that investments in mitigation are obtaining significant results and are constantly increasing.[2] On the other hand, investments in adaptation are following a slower path that conflicts with the human and economic costs that climate change is already causing.

UNCTAD, which provides a taxonomy of investments in mitigation and adaptation and assesses whether they are publicly or privately funded and in what degree,[3] underlines that typical public goods sectors are less likely to attract direct private investments. Private investors will consider the various investments depending on the existence of a clear revenue model and on project-level risks. In this sense, international private investors are more interested in mitigation projects rather than in adaptation ones. In particular, private investments mainly target energy transition projects related to renewable energy, which are able to produce revenues in a stable and constant way. On the other hand, the picture for adaptation projects is way less thriving: since most of such projects are public goods, they are characterized by high upfront costs, long investment timelines, unclear revenue stream or less attractive risk level. It follows that the public support required for adaptation projects is substantially higher. The other trend related to climate change investments refers to the difference between developed and developing markets. Indeed, the growth of renewable energies

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[1] UNCTAD, Note by the UNCTAD Secretariat, 'Investment and climate change' (2022) para 3.

[2] For the present work, UNCTAD's 2022 and 2023 reports have been considered: 'World Investment Report 2022: International Tax Reforms and Sustainable Investment' (<https://unctad.org/system/files/official-document/wir2022_en.pdf>) and 'World Investment Report 2023: Investing in Sustainable Energy for All' (<https://unctad.org/system/files/official-document/wir2023_en.pdf>).

[3] UNCTAD, 'World Investment Report 2022' (n 2) 34.

has mostly interested exclusively developed countries,[4] where cost of capital does not represent a barrier.

In order to foster the growth of climate-change investments, the targets of climate change–related strategies should be embedded in investment promotion strategies and governments should support the project developments with all the available tools, such as equity participation to loans, incentives and investments in the necessary ancillary infrastructure. In developing countries, international private investors could be attracted by providing more support in investment planning and project preparation. International investment agreements also play a fundamental role in this sense: climate action and investment promotion provisions should definitely find their way in such agreements.

3. New Generation BITs

International investment agreements (IIAs) and their possible reforms represent one of the most debated topics in recent years. Indeed, the opportunity to use such tools to promote the transition to a greener economy without affecting the rights of those that invested in traditional sources of energy is central. The developments of the IIAs have recently seen the emergence of new types of investment-related agreements, the termination of bilateral investment treaties (BITs) and ongoing multilateral discussions on the reform of investor-State dispute settlement (ISDS) mechanisms.

The core point in the present discussion is that the network of IIAs is still dominated by old-generation IIAs, which do not provide regulatory action for the protection of the environment and for addressing climate change. Notwithstanding such predominance, the new generations BITs often include the State right to regulate and the investors' duty to protect the environment and respect human rights.[5]

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[4] UNCTAD, 'World Investment Report 2023' (n 2) xii.

[5] Stefan Newton, 'New Directions in International Investment Law: Towards Energy Transition' (*Kluwer Arbitration Blog*, 24 May 2022) <https://arbitrationblog.kluwerarbitration.com/2022/05/24/new-directions-in-international-investment-law-tow

The Dutch Model BIT, the Morocco-Nigeria BIT or the Singapore-Indonesia BIT are valid example of IIAs that include an explicit right to regulate for the State and environmental obligations for the investors.[6] In particular, Article 6 of the Dutch Model BIT, titled 'Sustainable development', mentions the reaffirmation by the parties of the obligations entered into 'under the multilateral agreements in the field of environmental protection, (…) such as the Paris Agreement, the fundamental ILO Conventions and the Universal Declaration of Human Rights'. Similar provisions can also be found in the Southern African Development Community (SADC) Model BIT,[7] the Belgium-Luxembourg Economic Union (BLEU),[8] as well as in the EU-Canada Comprehensive Economic and Trade Agreement (CETA)[9] or the EU-Vietnam Free Trade Agreement (FTA).[10]

Italy has recently adopted a new Model BIT that makes a step forward as to environmental protection and climate change. Indeed, the premises to the Model BIT recognize the parties 'commitment to the principles of sustainable development and transparency'. In addition, section 3 of the Model BIT is entirely dedicated to sustainable development and recognizes the importance to take 'urgent action to combat climate change and its impacts, and the role of investment in pursuing this objective, consistent with the United Nations Framework Convention on Climate Change (UNFCCC) and the purpose and goals of the Paris Agreement (…)'.[11]

Although the inclusion of climate change-related provisions in IIAs might be seen as a possible trend, as will be discussed in the next paragraph, there is a growing skepticism in the international general opinion and at

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ards-energy-transition/>; Ted Gleason and Catherine Titi, 'Right to Regulate the Environment and International Investment Agreements' in Michael Faure (ed), *Elgar Encyclopaedia of Environmental Law* (Elgar 2021) 638.

[6] See Singapore-Indonesia BIT, art 11; Morocco-Nigeria BIT, art 8(2).

[7] SADC, art 15.

[8] BLEU, art 15.

[9] CETA, art 8.9(1).

[10] EU-Vietnam FTA, art 8.1(1).

[11] Italian Model BIT, arts 20 and 21.

international legislative level on whether investment treaties are actually beneficial, or whether, to the contrary, they support investors and should therefore be gradually abandoned, especially if coupled to ISDS.

4. Investment Treaties and Regulatory Chill?

When governments decide to implement stricter policies on environment protection and climate change, they necessarily limit the production and the profits of fossil fuel industries and their investments. This entails that governments that take this actions bear the risk that investment arbitration tribunals will deem them in breach of their obligations under IIAs and order them to pay damages to investors.[12] As confirmed by the United Nations General Assembly (UNGA), this constitutes a considerable barrier to reach the international goals related to climate change.[13] Indeed, the dynamic just described may lead to a regulatory chill, whereby governments reduce their commitment to pass effective climate policies for the fear of having to answer for such actions before an arbitral tribunal that, with the current legal framework, will likely find them in breach of the investors' rights.[14]

As Table 1 shows, the impact that ISDS might have on the governments' policies depends on the energy sector being the most litigious in the international law framework.[15]

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[12] Martin Dietrich Brauch and others, 'Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation: Aligning International Investment Law with the Urgent Need for Climate Change Action' (2019) 36 Journal of International Arbitration 7, 19-20.

[13] UNGA, 'Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights' (13 July 2023) UN Doc A/78/168, 3 and 16.

[14] Tomas Restrepo Rodriguez, *Investment Treaty Law and Climate Change* (Springer 2022) 68ff.

[15] International Institute for Sustainable Development, 'Investor–State Disputes in the Fossil Fuel Industry' (2021) 9.

Table 1 **Top 10 most litigious economic sectors in IIL**

***Source*: Lea Di Salvatore, *Investor–State Disputes in the Fossil Fuel Industry, IISD Report* (International Institute for Sustainable Development 2021) 9 <https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf>**

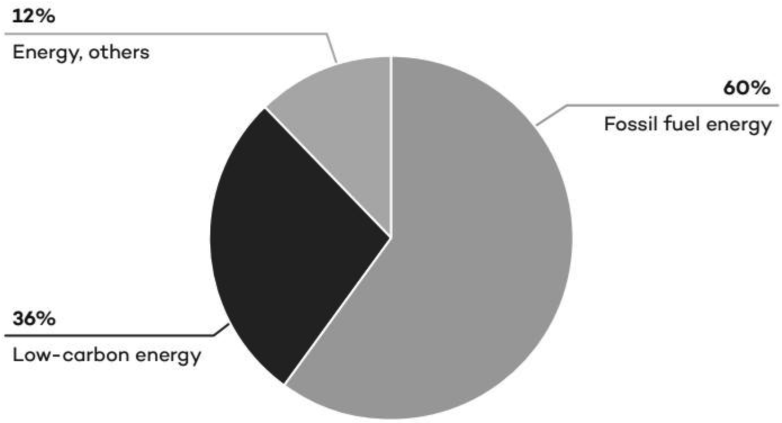
	Economic sector	Number of investor–state arbitrations
1	Energy	374
2	Mining industry	134
3	Finance and insurance	102
4	Infrastructure	87
5	Real estate	85
6	Information and communication	80
7	Transportation and storage	45
8	Agriculture, fishing, and forestry	41
9	Food and beverage	40
10	Automotive and mechanical industries	29

Amongst the energy-related ISDS cases, those involving fossil fuels are the vast majority (see Fig. 1).[16]

[16] ibid 10; UNGA, 'Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights' (13 July 2023) UN Doc A/78/168, 4.

Figure 1 Percentage of arbitrations by type of energy in the energy sector

***Source*: Lea Di Salvatore, *Investor–State Disputes in the Fossil Fuel Industry, IISD Report*, 10**



In this context, the Energy Charter Treaty (ECT) becomes extremely relevant, since it exclusively deals with investments in the energy industry.[17] The ECT has been at the center of the debate in the last years, since it has been used by foreign investors to reduce the regulatory power of the host States in defining their energy and environmental policies. Indeed, the number of arbitration proceedings initiated under the ECT has seen a considerable increase in this sector.[18]

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[17] Maria Rosaria Mauro, 'Investment Disputes and Fight Against Climate Change in Light of the Energy Charter Treaty: The Delicate Position of the European Union' (2023) Transnational Dispute Management 1.

[18] See *Metalclad Corporation v The United Mexican States*, ICSID Case No ARAB(AF)/97/1, Award, 30 August 2000; *Methanex Corporation v United States of America*, UNCITRAL, Award, 3 August 2005; *Biwater Gauff Ltd v United Republic of Tanzania*, ICSID Case No ARAB/05/22, Award, 24 July 2008; *Glamis Gold Ltd v United States of America*, UNCITRAL, Award, 8 June 2009; *Chemtura Corporation v Government of Canada*, PCA Case No 2008-01, Award, 2 August 2010.

The International Centre for Settlement of Investment Disputes (ICSID) case *Rockhopper v. Italy* represents a valid example of the regulatory chill that ISDS may provoke.[19] In May 2017, the oil and gas company Rockhopper initiated arbitration proceedings against Italy under the ECT. The company claimed that the Italian government had refused to grant it a concession for oil drilling on a site located 4 miles from the Italian coast, following the implementation of a general ban on the exploration and extraction of oil and gas within 12 miles from the coast. In 2022, the ICSID Tribunal ordered Italy to pay EUR 190 million to Rockhopper for having breached its obligation under the ECT. On 2 June 2025, the ICSID Committee annulled the award on the ground of improper tribunal constitution under Article 52(1)(d) of the ICSID Convention, due to the failure of one arbitrator to disclose circumstances that could give rise to justifiable doubts as to his impartiality.[20] However, on 7 July 2025, Rockhopper has announced that it intends to file a new request for arbitration.[21]

The above-described dynamic is one of the main reasons that brought States to consider withdrawal from the ECT. For this very reason, there have been extensive attempts to reform the ECT and align the treaty's substantive provisions with international climate obligations and goals.[22] On June 2022, an agreement in principle was reached.[23] However, the modernized ECT text included in such agreement did not remove fossil fuel investments from its scope of investment protection nor distinguished between traditional energy assets and green ones. The choice to exclude fossil fuel investments from ECT protection was left to the parties' agreement on a case-by-case basis. In this sense, only UK and EU members shared their

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[19] *Rockhopper Italia SpA, Rockhopper Mediterranean Ltd, and Rockhopper Exploration Plc v Italian Republic*, ICSID Case No ARB/17/14, Award, 23 August 2022.

[20] *Rockhopper* (n 19), Decision on Annulment, 2 June 2025.

[21] See Rockhopper's communication at <https://www.londonstockexchange.com/news-article/RKH/annulment-insurance-update/17121173>

[22] ESG Subcommittee of the IBA Arbitration Committee, 'Report on the use of ESG contractual obligations and related disputes' (2023) 27.

[23] The agreement is available at <https://www.energycharter.org/fileadmin/ Documents Media/CCDECS/2022/CCDEC202210.pdf>.

intention to adopt such carve-out provision.[24] The unsuccessful results of the negotiations led a considerable number of ECT contracting States to announce their intention to withdraw from the ECT,[25] and, lastly, on 28 June 2024, the EU Commission announced that the EU and the European Atomic Energy Community (EURATOM) had formally withdrawn from the ECT.[26] Nevertheless, and against all odds, the Energy Charter Conference adopted the text of the modernized ECT on 3 December.[27] The new text, which provisionally entered into force on September 2025,[28] provides, amongst the others: (i) the commitment to environmental protection by the contracting parties; (ii) the possibility for the contracting parties to exclude protection under the ECT of fossil fuels-related investments in their territories; (iii) tighter requirements for an investment to qualify for protection; (iv) a list of measures that constitute violation of the Fair and Equitable Treatment standard (FET); (v) new definitions of 'direct' and 'indirect' expropriation; and (vi) that the investor-State dispute settlement provisions in the amended text do not apply between EU States, meaning that an investor domiciled in one EU State would not be able to bring an ECT claim against another EU State.

Even though there is no shortage of criticism regarding the changes made to the text and their actual effectiveness and it is too soon to predict the

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[24] James McGlaughlin, 'ECT Modernisation Perspectives: Big Shoes to Fill? Governing Foreign Energy Investments in an Energy Charter Treaty Lacuna' (*Kluwer Arbitration Blog*, 8 May 2023) <https://arbitrationblog.kluwerarbitration.com/2023/05/09/ect-modernisation-perspectives-big-shoes-to-fill-governing-foreign-energy-investments-in-an-energy-charter-treaty-lacuna/>.

[25] Germany, Slovenia, Poland, The Netherlands, France, Spain, Luxembourg and Denmark are part of this group of countries.

[26] See <https://ec.europa.eu/commission/presscorner/detail/av/ip_24_3513>.

[27] 'The Energy Charter Conference Adopts Decisions on the Modernisation of the Energy Charter Treaty' (3 December 2024) <https://www.energycharter.org/ media/news/article/the-energy-charter-conference-adopts-decisions-on-the-modernisat ion-of-the-energy-charter-treaty/?tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1 %5Bact ion%5D=detail&cHash=2700d60aa897f2964e644c9e66a97028>.

[28] Full entry into force is subject to ratification by a minimum of three quarters of Contracting Parties.

long-term impact of the amendments, certain changes appear *prima facie* beneficial for fostering the States intervention on their climate change policies. Indeed, within the EU, where the exclusion of intra-EU claims removes an avenue to pursue ISDS, States gain more regulatory flexibility to implement climate policies without facing extensive arbitration risks.

5. Environmental Carve-outs in Investment Treaties

In addition to the reform process that involves IIAs, there are additional options for protecting policy space for climate change measures. In particular, it has been suggested that the inclusion in IIAs of exceptions based on the World Trade Organization (WTO)'s General Agreement on Tariffs and Trade 1994 (GATT) and on the General Agreement on Trade in Services (GATS) may represent a valid option.[29]

Indeed, within the WTO/GATT system, the best known of the so-called safeguard clauses in favor of sustainable development – and specifically environmental protection – is that provided for in Art. XX GATT, which falls within the sphere of general exceptions and allows states to apply restrictive measures to international trade under certain conditions and thus be exempted from the application of the GATT regulatory complex. Restrictions on trade motivated by environmental protection requirements are brought under two categories of exceptions: measures necessary for the protection of human, animal or plant life or health (Art. XX(b)) and measures related to the conservation of exhaustible natural resources when applied in conjunction with restrictions on domestic production or consumption (Art. XX(g)).

The legitimacy of these measures in the WTO/GATT system is conditioned on the absence of unjustified discrimination and protectionism in their application.[30] Art. XX plays an important role in determining the compatibility

[29] Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' (2023) 26 Journal of International Economic Law 285, 290.

[30] WTO, 'Analytical Index of the GATT, Interpretative Note Ad Article XX from Annex I' (1995) 565-586.

of measures taken to implement sustainable development in the WTO/GATT system by overriding protectionist needs over the promotion of free trade.

The 2022 UK–New Zealand FTA represents an example of the use of the GATT and GATS. Indeed, the agreement applies the GATT and GATS general exceptions clauses to its investment liberalization obligations and clarifies that the Parties accept that those exceptions would include 'measures necessary to mitigate climate *change*'.[31] The 2021 UK–Iceland, Liechtenstein and Norway FTA,[32] and the EU and UK's Preferential Trade Agreements (PTAs) with Japan also contain similar provisions.[33]

Carving-out climate change measures or fossil fuels investments from the scope of protection of the investment treaty constitutes an additional tool for safeguarding policy space for climate change.[34] An example of such mechanism has been provided in the above-mentioned text of the modernized ECT, where the EU Member States and the UK have secured an agreement to exclude some fossil fuel investments in their territories from treaty protection. Carve-outs from investments treaties may take two different directions: on one hand, parties to IIAs may provide carve-out in order to remove certain categories of government actions from the scope of the treaty or from certain obligations under the treaty; on the other hand, parties may provide a carve-out from ISDS, in order to eliminate the risk of retaliation through litigation/arbitration for having implemented stricter environmental/climate policies.[35] In particular, the latter may represent a more viable solution, since States would have to convince counterparties only to renounce to ISDS, with investors maintaining the possibility to resort to State-

[31] UK-New Zealand FTA, art 32.1.3.

[32] UK-Iceland, Liechtenstein and Norway FTA, art 14.1(3)(a)–(c) of the.

[33] EU-Japan EPA, art 16.4.5; UK-Japan FTA, art 16.4.5.

[34] ESG Subcommittee of the IBA Arbitration Committee, 'Report on the use of ESG contractual obligations and related disputes' (2023) 25.

[35] Joshua Paine and Elizabeth Sheargold, in 'A Climate Change Carve-Out for Investment Treaties' (2023) 26 Journal of International Economic Law 285, 292, underline that an analogy in this sense can be made with the carve-out provisions adopted for tobacco control measures.

to-State dispute settlement, the latter being also extremely useful to bar frivolous claims.

A recent case casted doubt on whether ISDS tribunals will accept the above-mentioned exceptions and possibly gave the chance to understand why carve-out may constitute a better tool to implement climate change policies. In *Eco Oro v Colombia*,[36] the Arbitral Tribunal found that the measures taken by Colombia to preserve ecosystems violated the FET. When the Tribunal assessed whether the measures could be justified under the general exceptions clause, it focused on the fact that the exception clause provided that 'nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures'.[37] The Tribunal concluded that the effect of the exception was to ensure that the treaty parties could adopt or enforce covered measures, but that compensation should be in any case payable to an investor if the measures violated a substantive provision of the treaty. Instead, where a carve-out is provided to exclude a measure from the scope of an IIA or from particular obligations, there is no legal base to find a duty to pay compensation for the State.

6. Counterclaims

The opinion that sees counterclaims in investment arbitrations as a useful tool for environmental protection and human rights is a growing trend.[38]

[36] *Eco Oro v Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021.

[37] Canada-Colombia FTA, art 2201(3).

[38] See Maxi Scherer, Stuart Bruce, Juliane Reschk, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36 ICSID Review 413; Paul E Trinel, 'Counterclaims and legitimacy in investment treaty arbitration' (2022) 38 Arbitration International 59; see also Maxi Scherer and Clara Reichenbach, 'Climate-Related Counterclaims in International Investment Arbitration' in Annette Magnusson and Anja Ipp (eds), *Investment Arbitration and Climate Change* (Kluwer Law International 2023) 105; Diego Mejía-Lemos, 'The Suitability of Investor-State Dispute Settlement and Host State Counterclaims for Implementing Climate Change International

From a general perspective, counterclaims in ISDS have not found much fortune before arbitral tribunals. In fact, although counterclaims are expressly provided by the ICSID Convention,[39] the number of States' counterclaims presented before arbitral tribunals is extremely low, even if often related to breaches of environmental obligations.[40] In addition, very few cases reached the analysis of the merits stage[41] and in just two cases an investor was condemned to pay damages to the State.[42] In the latter cases, the damages awarded were also extremely low.

In 2017, the debate on whether counterclaims should be explicitly allowed and regulated reached the institutional level.[43] Indeed, Member States of the United Nations Commission on International Trade Law (UNCITRAL) asked Working Group III to propose a set of possible reforms to state-investor arbitration. Working Group III for the first time recognized

Responsibility' (2023) 32 Review of European Comparative & International Environmental Law 334.

[39] ICSID Convention, art 46.

[40] *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v Government of Mongolia*, UNCITRAL, Award, 28 April 2011; *Rusoro Mining Ltd v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)12/5, Award, 22 August 2016; *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No ARB/08/5, Decision on Counterclaims, 7 February 2017; *Chevron Corporation and Texaco Petroleum Corporation v Republic of Ecuador (II)*, PCA Case No 2009-23, Second Partial Award on Track II, 30 August 2018; *David R Aven and others v Republic of Costa Rica*, ICSID Case No UNCT/15/3, Award, 18 September 2018; *Perenco Ecuador Ltd v Republic of Ecuador and Empresa Estatal Petróleos del Ecuador*, ICSID Case No ARB/08/6, Award, 27 September 2019.

[41] *Antoine Goetz et consorts v République du Burundi*, ICSID Case No ARB/95/3, Award, 10 February 1999; *Hesham TM Al-Warraq v Republic of Indonesia*, UNCITRAL, Award, 15 December 2014; *Urbaser SA and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v Argentine Republic*, ICSID Case No ARB/07/26, Award, 8 December 2016; *Burlington* (n 40); *Perenco* (n 40).

[42] *Burlington* (n 40); *Perenco* (n 40).

[43] See Anna De Luca and Crina Baltag, 'Counterclaims in Investment Arbitration: Reflections on UNCITRAL WG III Reform' (*Kluwer Arbitration Blog*, 5 November 2021) <https://arbitrationblog.kluwerarbitration.com/2021/11/05/counterclaims-in-investment-arbitration-reflections-on-uncitral-wg-iii-reform/>.

counterclaims as one of the elements for possible intervention,[44] and is currently working on the draft provision[45].

The fact that IIAs are usually silent on counterclaims does not preclude in any case that a provision on them could be included when negotiating new IIAs or that states could still try to raise a counterclaim in an investment arbitration despite the absence of an *ad hoc* provision in the IIA. However, some enforcement hurdles would remain in both scenarios. Indeed, even if counterclaims were not deemed precluded under the IIA, thus incorporating the requirement of the parties' consent to arbitrate also required for counterclaims,[46] there would still be the need to find the link of relevance between the investor's main claim and the state's counterclaim, a task that the

[44] UNCITRAL, 'Working Group III, Report on The work of its Thirty-Eighth Session' (2020) UN Doc A/CN.9/1004, para 24.

[45] On the 52nd session of the Working Group III, which will be held on late September 2025 in Vienna, the following drfat provision on counterclaims will be discussed:

> 1. Where a claim is submitted for resolution, the respondent may make a counterclaim:
> (a) Arising directly out of the subject matter of the claim or in [close] connection with the factual or legal basis of the claim; and
> (b) That the claimant has failed to comply with its obligations under the Agreement, domestic law, any relevant investment contract or any other instrument binding on the claimant.
> 2. The submission of a claim by the claimant constitutes its consent to the submission of any counterclaim by the respondent in accordance with paragraph 1.
> 3. A counterclaim shall be made no later than in the statement of defence, unless the Tribunal considers that the delay in the submission of the counterclaim was justified under the circumstances.
> 4. The respondent may not make a counterclaim, which it had initiated in another adjudicatory dispute resolution proceeding. When making a counterclaim, the respondent shall provide a statement that it will not initiate or continue any adjudicatory dispute resolution proceeding regarding the same claim.

[46] See ICSID Convention, art 46.

case law shows to be of no small importance,[47] especially considering that the holders of the rights affected are individuals and not states.[48]

7. Contributory Negligence and Mitigation of Damages

The idea that the damages that States have to pay in climate-related ISDS may be reduced due to the failure of the investors to adapt to the legal and political impacts of climate change is gaining ground. In particular, the concept of contributory negligence that can be found at national and international level, together with other similar concepts, may provide a valid defense for States involved in ISDS.

From a national perspective, it is widely accepted that respondents may rely on contributory negligence when they can prove that claimants' negligence contributed to their own loss or damages.[49] In such way, they can obtain a reduction or a complete elimination of the damages. International law provides a similar concept, *i.e.* the principle of contributory fault. According to such principle, an arbitral tribunal may reduce damages owed to an investor when the investor's conduct materially contributed to cause the loss.[50] A direct recognition of the principle can be found both in

[47] See Sergei Paushok (n 40); *Saluka Investments BV v the Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004.

[48] In this sense, see *Chevron* (n 40), where the Tribunal held that environmental damage claims could not be asserted by the state against Chevron.

[49] Erin Eckhoff, Sati Nagra and Jack McNally, 'A failure in adaptation: reduction to losses in climate related investment treaty disputes' (2023) Transnational Dispute Management, <https://www.transnational-dispute-management.com/journal-advance-publication-article.asp?key=1972>. See generally, Mees Brenninkmeijer and Fabien Gélinas, 'Counterclaims in Investment Arbitration: Towards an Integrated Approach' (2023) 38 ICSID Review 567.

[50] Craig Miles and David Weiss, 'Overview of Principles Reducing Damages' (*Global Arbitration Review*, 19 December 2022) <https://globalarbitrationreview.com/guide/the-guide-damages-in-international-arbitration/5th-edition/article/overview-of-principl es-reducing-da mages>

international instruments and tribunals' case law.[51] For example, in *MTD v Chile*,[52] the arbitral tribunal concluded that the claimant contributed to its own loss and, thus, had to pay 50% of the loss, 50% of the arbitration costs and the full amount of its own legal costs.

Furthermore, the international investment law concept of mismanagement may also help States to defend their position and reduce damages. Indeed, the term indicates the practice of 'investing in the host state when it was foreseeable that the host state could perform some conduct that would harm the investment',[53] which should allow liability to be shared between investor and host State.

A recent investment treaty arbitration represents a relevant precedent. In *Bear Creek v Peru*,[54] an ICSID Tribunal ordered Peru to pay around USD 18.20 million following its finding that a decree constituted an unlawful indirect expropriation of the Claimant's right to operate. Nonetheless, Prof. Sands provided a dissenting opinion extremely innovative. In particular, he sustained that the damages awarded should be halved on the basis that the Claimant failed to obtain a "social license", and therefore contributed to the social circumstances that led Peru to act to protect the public interest. According to Prof. Sands, the Claimant failed to give sufficient effect to the

[51] See International Law Commission, Draft Articles on the Responsibility of States for Internationally Wrongful Acts, Report of the International Law Commission on the work of its fifty-third session (23 April-1 June and 2 July-10 August 2001) UN Doc A/56/10, para 77, draft art 39. In several cases the arbitral tribunal recognized the principle without awarding a reduction in damages; see in this sense *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan (I)*, SCC Case No V 116/2010, Award, 19 December 2013; *Blusun SA, Jean-Pierre Lecorcier and Michael Stein v Italian Republic*, ICSID Case No ARB/14/3, Award, 27 December 2016; *South American Silver Limited v Bolivia*, PCA Case No 2013-15, Award, 22 November 2018.

[52] *MTD Equity Sdn Bhd and MTD Chile SA v Chile*, ICSID Case No ARB/01/7, Award, 25 May 2004.

[53] Martin Jarrett, 'Contributory Fault and Investor Misconduct in Investment Arbitration' (2019) European Journal of International Law 1588.

[54] *Bear Creek Mining Corporation v Republic of Peru*, ICSID Case No ARB/14/21, Award, 30 November 2017.

rights protected by Article 15 of the ILO Convention 169[55] and the implementing Peruvian law. Whilst the Tribunal noted that ILO Convention 169 imposes direct obligations only on States, Prof. Sands concluded that this did not mean that the Convention 'is without significance or legal effects for [foreign investors]'. To reinforce its point, Prof. Sands mentioned the *Urbaser v Argentina* case,[56] where the Arbitral Tribunal stated that the Argentina-Spain BIT 'has to be construed in harmony with other rules of international law of which it forms part, including those relating to human rights' and that Article 42(1) of the ICSID Convention, together with the governing law clause of the relevant BIT, provided that 'Tribunal shall apply the law of the host State and such rules of international law as may be applicable'.

The defence mechanism and argumentation presented in this paragraph could be applied by future tribunals concerned with climate-related disputes.[57] Host States involved in disputes with fossil fuel investors could argue that the investor failed to reduce or minimize its contribution to climate change, causing the State's intervention in line with climate obligations under international law, and, accordingly, ought to be held responsible for any harm or loss caused to the investor. Nonetheless, Professor Sands' analysis is largely inconsistent with traditional approaches to international law, whose obligations are normally considered binding only on States. Accordingly, it is unlikely that, at least in the short-term, such an argument might find fortune before courts and arbitral tribunals.

[55] Convention (No 169) Concerning Indigenous and Tribal Peoples in Independent Countries (adopted 27 June 1989, entered into force 5 September 1991) 1650 UNTS 383 (ILO 169 Convention).

[56] *Urbaser* (n 41).

[57] Eckhoff, Nagra and McNally (n 49) 16.

8. Conclusion

Although climate change has become a driving-theme of this century, the international investment framework appears slow to adapt to the new reality. Indeed, from a strictly economic perspective, investments are not directed towards the entire gamma of sectors that need financing in order to face the effects of climate change. In this sense, governments should provide a more attractive environmental policy in order to promote greener investments both in mitigation and adaptation projects. From the perspective of investment treaties, a multilateral intervention seems the only viable solution to reach climate goals. The investment treaties framework remains governed by old generation treaties that lack provisions in line with international climate-related goals. In the newly approved text of the modernized ECT, in particular in *Annex* NI,[58] Contracting Parties confirmed that it was an exceptional measure to allow fossil fuels to be excluded from investment protection. Thus, it remains to be seen whether this modernized version will really serve climate goals. In such circumstances, States may rely exclusively on their ability to conclude on a case-by-case basis new treaties with more favorable provisions. Certain legal remedies and defenses, such as counterclaims or the contributory fault principle, may play a role in the transition to a new investment framework. However, *per se* they are no alternative to a more structured approach based on investment law.

[58] Annex NI: *Non-Applicable Energy Materials and Products for Definitions of "Economic Activity in the Energy Sector.*

3

ISDS and Energy Transition: Smooth Sailing in Hot Water?

Agata Daszko

1. Introduction

The latest scientific and economic assessments of climate change distil into a series of stark realities: our world is, metaphorically, drowning, with the tides of climate impact already touching segments of the global population. The relentless combustion of fossil fuels by humans is the primary cause, and an immediate, effective shift to renewable energy is paramount to protecting life as we know it. Correspondingly, these assessments advocate for a dual-pronged strategy: a substantial upsurge in (private) investments directed towards renewable energy coupled with a steadfast commitment to phasing out of fossil fuels;[1] while navigating the complexities of the energy

[1] See, for example, IEA, 'Net Zero Roadmap' (*IEA*, 2023 Update) 57 <https://iea.blob.core.windows.net/assets/4d93d947-c78a-47a9-b223-603e6c3fc7d8/NetZeroRoadmap_AGlobalPathwaytoKeepthe1.5CGoalinReach-2023Update.pdf>; European Energy Agency, Briefing 'Decarbonising heating and cooling — a climate imperative' (*EEA*, February 2023) <https://www.eea.europa.eu/publications/decarbo nisation-heating-and-cooling>; Intergovernmental Panel on Climate Change, 'Climate Change 2022: Mitigation of Climate Change' (*IPCC*, 2022), chapter 14, para 81<https://www.ipcc.ch/report/ar6/wg3/>; IEA, 'Net Zero by 2050: A Roadmap'(*IEA*, 2021) 81 <https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR. pdf>.

trilemma.[2]

Yet, despite the consensus on the urgency of the energy transition, various stakeholders have pinpointed potential barriers that could impede its progress. One such perceived obstacle is the system of investor-State dispute settlement (ISDS). Namely, fears are mounting that faced with (the needed) moratoria on fossil fuel production or the revocation of oil & gas permits necessary to achieve the goals of the Paris Agreement, investors will turn to ISDS to claim substantial compensations.[3] Through a more critical lens, a 'secretive court' system that permits 'big oil' to sue States is viewed as a direct challenge to serious legislative efforts aimed at phasing out fossil fuels.[4] This is notwithstanding that such efforts are still few and far between.

This chapter does not seek to delve into the extensive domain of international investment law and environmental issues, which has been

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[2] World Energy Council, 'World Energy Trilemma Index 2022' (*World Energy Council*, 2022) <https://www.worldenergy.org/assets/downloads/World_Energy_Trilemma_Index_2022.pdf?v=1669842216>.

[3] See, generally, Daniel Behn and Malcolm Langford, 'Trumping the Environment? An Empirical Perspective on the Legitimacy of Investment Treaty Arbitration' (2017) 18 Journal of World Investment & Trade 14; Harro van Asselt, 'Governing Fossil Fuel Production in the Age of Climate Disruption: Towards an International Law of 'Leaving It in the Ground'' (2021) 9 Earth System Governance 5; see also Leonie Reins, Dylan Geraets, Thomas Schomerus, 'Fracking, Sovereignty over Natural Resources and International Investment Law' (2018) European Yearbook of International Economic Law 175; Frances Flanagan, 'Just Cessation: How Might the Climate Imperative to Phase Out Fossil Fuel Extraction Reshape the Concept of Just Transition?' (2023) 39 International Journal of Comparative Labour Law and Industrial Relations 393, 414.

[4] Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuels Industry' (*IISD Report*, December 2021) 18; Kyla Tienhaara et al, 'Investor-State Disputes Threaten the Global Green Energy Transition' (2002) 376 Science 701; Lorenzo Cotula, 'International Investment Law and Climate Change: Reframing the ISDS Reform Agenda' (2023) 24 Journal of World Investment & Trade 766, 780; UN Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment, 'Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights' (13 July 2023) UN Doc A/78/168.

comprehensively addressed elsewhere.[5]

In addition, excluded from the scope is the plausible, though still largely hypothetical, scenario in which claimants employ ISDS as a mechanism against States alleged to be breaching their energy transition commitments envisaged by the Paris Agreement. Rather, this chapter is centred on a doctrinal examination of relevant case law and broader dispute settlement practices involving claims against State measures largely aimed at facilitating energy transition. With States increasingly enacting (or communicating their willingness to enact) regulations to accelerate the transition towards sustainable energy, it is critical to analyse the developing body of jurisprudence to determine if aforementioned fears about ISDS impeding this progress are borne out in reality. This analysis is particularly pertinent given that some cases, previously flagged in academic discourse as potentially adverse to the energy transition, are now concluding with outcomes that align more favourably with environmental objectives.

The chapter is structured into two substantive parts. The first part reviews current and emerging case law directly related to the energy transition. Against this legal backdrop, the second part delves into the decision-making processes of the tribunals, focusing on the role of arbitrators in ISDS more widely, and rules on States' regulatory powers in more detail.

The conclusion concedes some flaws within the ISDS system but will argue that it is better equipped to manage claims arising from energy transition measures than many critics believe.

[5] See in particular Jorge E Viñuales, *The International Law of Energy* (Cambridge University Press 2022); see also Diane A Desierto, 'Environmental Protection in International Investment Arbitration: From Defences to Counterclaims' in Edgardo Sobenes, Sarah Mead and Benjamin Samson (eds), *The Environment Through the Lens of International Courts and Tribunals* (Springer 2021) 326; Jeff Sullivan and Valeriya Kirsey, 'Environmental Policies: A Shield or a Sword in Investment Arbitration?' (2017) 18 Journal of World Investment & Trade 100; Anne van Aaken, 'Mission Impossible? International Investment Law Between Property Protection and Climate Action' in Philipp B Donath al (eds), *Der Schutz des Individuums durch das Recht* (Springer 2023) 781; Arman Sarvarian, 'Invoking the Paris Agreement in Investor-State Arbitration' (2023) 38 ICSID Review 422.

2. Navigating Choppy Waters: Energy Transition Issues in ISDS Case Law

ISDS claims related to the energy transition involve State actions taken to shift away from fossil fuels, in favour of renewable energy sources as part of their climate change mitigation strategies.[6] Viñuales writes that 'between 1972 and 2020, at least 178 foreign investment claims with environmental components were filed [with] over half of them (76) concern(ing) the energy transition'.[7] These cases may stem from multitude of measures, for example: phasing-out of coal energy,[8] moratoria on certain fossil fuel energy production, and introduction and modification of incentive regimes in the production of renewable energy.[9] Such disputes, at the intersection of a State's right to regulate and its various obligations to protect foreign investments, often hinge on issues such as the fair and equitable treatment (FET), minimum standard of treatment (MST), the question of expropriation, and the guarantee of full protection and security (FPS) of the investment.

While numerous cases under instruments like the Energy Charter Treaty (ECT) have been classified as involving environmental matters,[10] research suggests that, historically, arguments explicitly anchored in environmental considerations have not been frequently advanced by the parties,[11]

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[6] For an overview on renewable energy and ISDS see Freya Baetens, 'Combating Climate Change Through the Promotion of Green Investment: From Kyoto to Paris Without Regime-Specific Dispute Settlement' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019) 107.

[7] Viñuales (n 5) 420-421.

[8] See e.g., recently discontinued *RWE v The Netherlands*, ICSID Case No ARB/21/4.

[9] See, with reference to case law arising from changes to Spanish law, e.g., Filip Balcerzak, *Renewable Energy Arbitration – Quo Vadis?* (Brill-Nijhoff 2023).

[10] Viñuales (n 5) 420-421.

[11] Anja Ipp, Annette Magnusson and Andrina Kjellgren, *The Energy Charter Treaty, climate change and clean energy transition: A study of the Jurisprudence* (Climate Change Counsel 2022), 25 and 32 <https://5f0d4bd4-3654-4903-9289-ada28e0c5373.filesusr.com/ugd/f1e6f3_d184e02bff3d49ee8144328e6c45215f.pdf>.

traditionally leaving tribunals with limited scope for their examination.[12] This trend appears to be shifting, with many recent cases seeing tribunals engage more with environmental consideration as these seem to form concrete parts of States' submissions, reflecting the growing global emphasis on the importance of addressing climate change through law and policy.[13]

As we consider the tangible impact of ISDS on energy transition policies, it becomes instructive to examine individual cases that epitomize the friction between investor protections and environmental regulation at all stages of the proceedings: jurisdiction, merits, and quantum. Three cases that have garnered attention in this context include *Westmoreland Mining v Canada,*[14] *Lone Pine v Canada,*[15] and *Bilcon v Canada.*[16] These disputes offer a microcosmic view of the broader debate, spotlighting not only the intricate balance between upholding investment treaties and embracing the imperatives of environmental stewardship but also ensuring that critics do not lose sight of the basics of international investment law.

2.1 'Westmoreland Mining v Canada' or 'Don't Forget About Jurisdiction'

The dispute, initiated in November 2018, saw the claimant seek redress under Chapter 11 of the North American Trade Agreement (NAFTA), alleging discriminatory exclusion from a compensatory framework tied to Alberta's Climate Leadership Plan. The Plan expedited the coal power phase-out timeline to 2030 and included a compensation scheme for affected investors.

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[12] On arbitral discretion see infra, para 4.

[13] See *Muszynianka v Slovak Republic*, PCA Case No 2017-08/AA629, Award, 7 October 2020, para 575; *Cortec Mining v Kenya*, ICSID Case No ARB/15/29, Award, 22 October 2018; *Aven v Costa Rica*, ICSID Case No UNCT/15/3, Award, 18 September 2018, paras 412-413; *Al Tamimi v Oman*, ICSID Case No ARB/11/33, Award, 3 November 2015, paras 387-389.

[14] *Westmoreland Mining Holdings, LLC v Canada*, ICSID Case No UNCT/20/3, Award, 31 January 2022.

[15] *Lone Pine Resources Inc. v Canada*, ICSID Case No UNCT/15/2, Award, 22 November 2022.

[16] *Bilcon of Delaware et al v Canada*, PCA Case No 2009-04.

Westmoreland Coal Company, as the sole US investor in Alberta's coal sector, argued that it was discriminatorily denied compensation while Canadian counterparts received benefits, contravening the national treatment and fair and equitable treatment (FET) standard in Articles 1102 and 1105 NAFTA. While acknowledging the Alberta government's prerogative to regulate for the public good,[17] the company contended that the regulations should not unfairly prejudice foreign investors. The tribunal, however, dismissed the claim. This 2022 dismissal followed the change in control of Westmoreland Coal Company's pertinent assets during bankruptcy proceedings, with the acquiring entity, Westmoreland Mining Holdings LLC, attempting to succeed the claim. The tribunal determined that the new entity was not entitled to pursue the initial claim,[18] leading to a dismissal without an in-depth analysis of the claim's substantive merits.

On the initial reading, this case concerned solely with jurisdictional prerequisites, may not be considered as seminal in the wider discourse of ISDS and energy transition. The UN Special Rapporteur, when listing the fossil fuel case law in his damming but also criticised report on ISDS, did not go into the detail of this case, simply stating that the case 'was dismissed in its entirety for technical reasons'.[19] However, the decision is important for at least two reasons pertaining to the discussion of ISDS and energy transition. First, jurisdictional objectives are a real hurdle that claimants need to clear in ISDS, many, including in infamous environmental cases have failed to do so, resulting in a win for States.[20] Indeed, ICSID reports that to date

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[17] *Westmoreland Mining* (n 14), Notice of Arbitration and Statement of Claim, 12 August 2019, para 12.

[18] *Westmoreland Mining v Canada* (n 14), Award, para 230.

[19] UN Special Rapporteur (n 4), Annex 2 to A/78/168, 2.

[20] For example, and related to energy disputes: *TC Energy v USA II*, where the majority found that the USD 15 billion claim following the cancellaion of the Keystone XL Pipeline, was time barred under the transition period envisaged under the USMCA (*TC Energy Corporation and TransCanada Pipelines Limited v United States of America (II)*, ICSID Case No ARB/21/63, Award, 12 July 2024); *Ballantine v Dominican Republic* case centred around a development project by a pair of missionaries holding dual citizenship who were denied the environmental approval necessary to continue development of a gated community. The tribunal dismissed the claims on jurisdictional grounds. The 'dominant and effective nationality' requirement under DR-CAFTA

21% of decided cases administered by the Centre, have resulted in dismissal of claims on jurisdictional basis.[21] Second, particular attention should be paid to the tribunal's summary of facts, which is warrants citation:

> 72. The following summary of the factual background comprises the Tribunal's assessment of the pertinent facts based upon the verified evidence on the record and provides the *necessary context* for the Tribunal's determination of those issues which were ordered to be bifurcated.
>
> 73. Given the increasing awareness of the negative environmental and human health impacts of coal combustion to produce electricity, governments around the world have increasingly been *committed to reducing emissions from coal-fired* electricity generation.[22]

This, at the very least, points to the fact that tribunals are not running away from the realities of energy transition and appreciate that such realities will provide necessary context for their deliberations.

2.2 'Lone Pine v Canada' and Appreciating Regulatory Space

Lone Pine Resources, a US-registered but Canadian-headquartered company, launched a claim in 2013 alleging that the Quebec Government had

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necessitated that the claimants' dominant and effective nationality be that of a non-Dominican Republic party to the treaty (PCA Case No 2016-17, Award, 3 September 2019); In *Cortec Mining v Kenya*, the tribunal dismissed the case on the basis of illegality of the investment. The dispute centred on the revocation of a Special Mining License (SML). The tribunal found it void due to non-compliance with significant legal requirements, including environmental impact assessments and allegations of corruption. The decision hinged on the SML not being a 'protected investment' due to its procurement in violation of Kenyan law, emphasizing that the BIT and the ICSID Convention should not protect investments made contrary to crucial public interest laws, especially those safeguarding the environment (ICSID Case No ARB/15/29, Award, 22 October 2018); See also *Bay View and Spalena Company v Rwanda*, ICSID Case No ARB/18/21 (concerning non-granting of mining licences).

[21] ICSID, 'The ICSID Case Law – Statistics' (*ICSID*, Issue 2023-2) 13 available at: <https://icsid.worldbank.org/sites/default/files/publications/2023.ENG_The_ICSID_Caseload_Statistics_Issue.2_ENG.pdf>.

[22] *Westmoreland Mining v Canada* (n 14), Award, paras 72-73 (emphasis added).

breached NAFTA provisions by the 'arbitrary, capricious, and illegal revocation'[23] of its valued right to mine for oil and gas beneath the St. Lawrence River. This legal action was a response to Quebec's legislative bill (Bill 18), which revoked, without compensation, all permits for oil and gas exploration within the St. Lawrence River Basin, tied to a wider moratorium on hydraulic fracturing (fracking).

The tribunal rejected claims based on Article 1110 (expropriation) NAFTA. It held that 'the test for expropriation must be applied to the relevant investment as a whole'.[24] Since Bill 18 impacted only a part of the investment, rather than the investment as a whole (which included multiple permits over various areas), no 'substantial deprivation, i.e., total or near-total deprivation, of the investor's property' took place.[25]

The majority's final decision – that Article 1105 (minimum standard of treatment) NAFTA was not breached – rested on a delicate balancing act between the investor's rights and the State's regulatory space, particularly in the realm of environmental policy. Throughout proceedings the claimants alleged that Bill 18, and especially non-compensation, was motivated by 'political' rather than environmental or public policy factors. The tribunal pointed out that while 'public perception against compensation was an important consideration',[26] this did not diminish other considerations including 'Québec Government's intention to encourage the sustainable development of natural resources with a view to protect the environment of the St. Lawrence River.'[27] Central to the tribunal's findings was the recognition that the legislative bill was enacted with a clear 'public policy objective of preservation of the fluvial environment under the St. Lawrence River.'[28] The tribunal underscored the necessity of affording a 'high measure of deference' to the host State's regulatory changes, which are anchored in the

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[23] *Lone Pine v Canada* (n 15) para 2.

[24] ibid, para 508.

[25] ibid, para 495.

[26] ibid, para 631.

[27] ibid.

[28] ibid.

public interest, with the tribunal resisting the temptation to 'substitute their own judgment for that of State legislators.'[29]

This decision is emblematic of a series of cases (discussed below) that underscore the tribunals' recognition of the sovereign regulatory powers of States, particularly when such regulations are pertinent to environmental preservation. This deference is crucial in the context of energy transition and reflects a level of judicial awareness of the importance of upholding environmental integrity within the ISDS framework. The deference and States powers to regulate, however, are not without their limits.

2.3 'Bilcon v Canada': A Win is (Not) a Win

While not related to energy transition per se, also owing to the small number of such cases, *Bilcon* can be used as a gateway to how we talk about arbitral outcomes, and the role of perspective. The case centred around the denial of Bilcon's proposal to develop a quarry and marine terminal in Nova Scotia. The investor challenged the Canadian environmental assessment process, managed by a federal-provincial Joint Review Panel (JRP), as being discriminatory and flawed. Bilcon argued that the rejection constituted unfair and inequitable treatment and was effectively an uncompensated expropriation of their investment, contrary to NAFTA provisions.

The JRP had conducted a thorough review but recommended against the project, citing significant potential environmental impacts. Among these were risks to marine species, including the endangered whales, and concerns over introducing parasitic diseases to local marine populations via shipping. The JRP also placed significant emphasis on 'community core values', noting that the project would introduce an irreversible industrial presence that conflicted with the community's sustainable development model.

The tribunal concluded that the environmental assessment process had indeed deviated from established Canadian standards, failing to meet Canada's obligations under NAFTA and breaching Bilcon's legitimate expectations of fair regulatory treatment. This led to the tribunal's decision in favour of Bilcon regarding liability. However, in the damages phase, the

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[29] ibid, para 623.

tribunal awarded only USD 7 million out of the USD 440 million claimed. The tribunal reasoned that Canada's breach resulted in the loss of a fair environmental assessment process – not the right to operate – with the claimants failing to prove that the project would have been approved under an alternative system. The claimants, believing that the quantum decision was a 'flagrant denial of justice', sought to have it set aside but were unsuccessful in front of the local court.[30]

The case underscores the need to examine contentious claims holistically, remembering that losses for the State are quantified in a variety of ways with tribunals exercising a large, arguably too large, level of discretion on the matter.[31] While some tribunals in cases concerning oil and gas, as well as mining investments may award sums which stir protests,[32] others may elect to award sunk costs only,[33] or indeed after establishing liability, award nothing in damages.[34]

3. Charting (Safer) Course: ISDS Decision-Making and Energy Transition

Notwithstanding the quiet optimism with which we could welcome some of the above decisions, the fact remains that decision-making in ISDS is case-specific. With several disputes pending in which claimants challenge State

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[30] *Clayton et al v Attorney General of Canada*, 2022 ONSC 6583, 22 November 2022.

[31] For a great analysis of the contentious question of calculation of damages in ISDS see Toni Marzal, 'Quantum (In)Justice: Rethinking the Calculation of Compensation and Damages in ISDS' (2021) 22 Journal of World Investment & Trade 249, 252-253.

[32] *Rockhopper v Italy*, ICSID Case No ARB/17/14, Award, 23 August 2022; *Odyssey Marine v. Mexico*, ICSID Case No UNCT/20/1, Final Award, 17 September 2024.

[33] *Dominion Minerals Corp v Panama*, ICSID Case No ARB/16/13, unreported see IAReporter at <https://www.iareporter.com/articles/analysis-arbitrators-in-dominion-minerals-v-panama-unanimously-dismiss-denial-of-benefits-objection-but-disagree-on-merits-and-damages/>.

[34] *Infinito Gold Ltd v Costa Rica*, ICSID Case No ARB/14/5, Award, 3 June 2021.

measures explicitly designed to protect the environment and facilitate energy transition,[35] it is crucial to re-examine the general decision-making authority of ISDS tribunals.

This part aims to delineate the actual role of arbitrators within the ISDS domain, elucidating their rights and obligations vis-à-vis the disputing parties. Understanding arbitrators' functions will set the stage for a deeper exploration of how they navigate and uphold States' regulatory powers, which often serves as a critical line of defence in cases pertaining to energy transition. Finally, this part will turn to the Vienna Convention on the Law of Treaties (VCLT), probing into the potential for tribunals to integrate broader considerations, such as the objectives of the Paris Agreement, into their adjudication of claims related to energy transition.

4. Role of Arbitral Tribunals in ISDS

The tribunal in *Phoenix v Czech Republic*, famously observed that 'nobody would suggest that […] protection should be granted to investments made […] in pursuance of torture or genocide or in support of slavery or trafficking of human organs.'[36] Quite clearly, the protection granted to foreign investors under international investment agreements (IIAs) is not limitless, and it is for the tribunals to decide whether the investors can access such protection (jurisdiction), whether the State's conduct amounted to a breach (merits), and if so how such breach should be compensated (quantum).

The role of tribunals is to assert and clarify the law within the scope accepted by the parties, and exercise a level of discretion when dealing with facts and legal arguments not raised in the proceedings or when there is

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[35] Pending cases alleging breaches of IIL following changes to State's regulatory landscape due to energy transition or similar concerns include *Ruby River Capital v Canada*, ICSID Case No ARB/23/5 (brought following cancellation of a project for the construction of a natural gas liquefaction complex, with the State also citing global greenhouse gas emissions as a factor in the decision-making).

[36] *Phoenix v Czech Republic*, ICSID Case No ARB/06/5, Award, 15 April 2009, para 78.

ambiguity in the wording of the specific provisions.[37] This autonomy, however, is balanced by the principle of *ne ultra petita*, which confines tribunals to decide solely based on claims advanced by the parties.[38] After all, 'each arbitrator in an individual case is bound to proceed on the basis of the factual evidence and legal submissions put before them.'[39] Arbitrators adjudicate claims through the interpretation of applicable law, anchored in the dispute resolution clauses of applicable IIAs and influenced by procedural rules such as those of the ICSID Convention or the UNCITRAL.[40] In terms of law applicable to the dispute, tribunals need to look to the language of the applicable treaty. Thus, in disputes administrated under the ICSID Convention, the guiding provision will be Article 42(1) (similar provision is found under Article 33 UNCITRAL Rules), whereby the Tribunal shall decide the merits of the dispute 'in accordance with such rules of law as may be agreed by the parties' in the absence of an agreement on the choice of applicable rules of law, the Tribunal shall apply the law of the host State 'and such rules of international law as may be applicable.' The ICSID Convention does not provide for any restriction in respect of these 'applicable rules of international law'; 'they necessarily include all such rules which according to their self-determined scope of application cover the legal issue arising in a particular case.'[41] While ISDS tribunals are not strictly bound by precedent,

[37] Andrea Bjorklund, 'Are Arbitrators (Judicial) Activists?' (2018) 17 The Law & Practice of International Courts and Tribunals 49.

[38] Attila M Tanzi, 'On Judicial Autonomy and the Autonomy of the Parties in International Adjudication, with Special Regard to Investment Arbitration and ICSID Annulment Proceedings' (2020) 33 Leiden Journal of International Law 57, 62.

[39] *ENERGY v Spain*, ICSID Case No ARB/14/18, Dissent on Liability and Quantum by Professor Philippe Sands, 6 May 2022, para 48.

[40] Mary Mitsi, *The Decision-Making Process of Investor-State Arbitration Tribunals* (Wolters Kluwer 2019), 38-40; Joshua Karton, 'The International Investment Arbitrator's Duty to Apply the Law' (2018) 17 The Law & Practice of International Courts and Tribunals 160.

[41] *Conocophillips v Venezuela*, ICSID Case No ARB/07/30, Award, 8 March 2019, para 87.

they engage with previous decisions, frequently invoking them as persuasive authority.[42]

IIAs, as all treaties in international law, are subject to rules of treaty interpretation under the Vienna Convention on the Law of Treaties (VCLT).[43] The relevant rules of treaty interpretation are embodied in Article 31, with the supplementary means of interpretation in Article 32 VCLT.[44] Here a certain observation on the role of the rules of interpretation is mandated. Outside of the discussion on the reform of the ISDS-treaty system,[45] calls have also been made for more liberal use of available interpretative tools by tribunals, and as such, a more active role of arbitrators. One of such tools would be 'systemic integration' under Article 31(3)(c), under which a treaty must be interpreted in harmoniously with both other systems, and general

[42] See e.g., *Caratube v Kazakhstan*, ICSID Case No ARB/08/12, Award, 5 June 2012, paras 234-235; *BayWa v Spain*, ICSID Case No ARB/15/16, Decision on Jurisdiction, Liability and Directions on Quantum, 2 December 2019, paras 297-314.

[43] See in detail Esme Shirlow and Kiran N. Gore (eds), *The Vienna Convention on the Law of Treaties in Investor-State Disputes: History, Evolution and Future* (Kluwer Law International 2022); see also Berta Boknik and Tarcisio Gazzini, 'Questions of Treaty Interpretation', in Christian J Tams, Stephan W. Schill and Rainer Hofmann (eds) *International Investment Law and General International Law* (Edward Elgar Publishing 2023) 82; Andrew D. Mitchell and James Munro, 'Someone Else's Deal: Interpreting International Investment Agreements in the Light of Third-Party Agreements' (2017) 28 European Journal of International Law 669; Martins Paparinskis, 'Analogies and Other Regimes of International Law' in Zachary Douglas, Joost Pauwelyn and Jorge E Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 85.

[44] For further discussion on other source of reference in the framework of interpretation in ISDS disputes, beyond the VCLT see Mitsi (n 40).

[45] Arman Sarvarian, 'Invoking the Paris Agreement in Investor-State Arbitration' (2023) 38 ICSID Review 422; Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' (2023) 26 Journal of International Economic Law 285; Anne van Aaken, 'Investment Law in the Twenty-First Century: Things Will Have to Change in Order to Remain the Same' (2023) 26 Journal of International Economic Law 166. On treaty language, environmental exemption clauses referring directly to climate change (e.g., 'supporting the transition to low carbon and climate resilient economies') are beginning to appear in some new treaties; see, e.g., Australia-UK FTA (signed 17 December 2021, in force 31 May 2023) art 13.18.

international law. Tribunals, however, have been careful vis-à-vis the provision, observing that, while

> the principle of systemic interpretation is part of the rules of interpretation of international treaties foreseen in Article 31 of the Vienna Convention[, t]his principle must be applied in harmony with the rest of the provisions of the same article and cautiously, in order to prevent the tribunal from exceeding its jurisdiction and applying rules to the dispute which the Parties have not agreed to.[46]

In any case, an interesting approach is being advocated by Alschner, whereby he argues that employing systemic interpretation, arbitrators could refer not solely to *other* system but rather to the States' evolving treaty practice. In other words, arbitrators should look to the treaties of today, often including more specific wording, to interpret the broadly-worded treaties of the old generation, effectively modernising the latter through best practices of today.[47]

In any case, tribunals' observance of public international law as the applicable law is logical: ISDS tribunals apply and interpret international treaties and, crucially, rule on international legal responsibility of States.[48] Moreover, as held by the tribunal in *Eco Oro* '[p]arties to a Treaty cannot contract out of the system of international law. When States contract with each other it is inherent that they do so within the system of international law.'[49]

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[46] *South American Silver v Bolivia*, PCA Case No 2013-15, Award, 22 November 2018, para 216. On further limits of this approach see Johannes Hendrik Fahner and Matthew Happold, 'The Human Rights Defense in International Investment Arbitration: Exploring the Limits of Systemic Integration' (2019) 69 International and Comparative Law Quarterly 741.

[47] Wolfgang Alschner, *Investment Arbitration and State-Driven Reform: New Treaties, Old Outcomes* (Oxford University Press 2022) 232-244.

[48] Eric De Brabandere, *Investment Treaty Arbitration as Public International Law* (Cambridge University Press 2014) 125.

[49] *Eco Oro v Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, para 626.

This is especially pertinent with regards to States' (customary) right to regulate, to which we will now turn.

5. States' Regulatory Powers: Right to Regulate and Police Powers

Claimants in investment dispute cases relating to energy transition or the environment, most often claim breaches of FET (and under certain treaties, of minimum standard of treatment (MST)) (5.1), or expropriation standards (5.2) of applicable IIAs.

5.1 Fair and Equitable Treatment

While, in very general terms, FET standard protects investors' (legitimate) expectations of a stable and predictable regulatory framework, this protection is not limitless. The FET standard does not 'freeze'[50] the regulatory framework at the time the investment is made, and it is each State's 'undeniable right and privilege to exercise its legislative power'[51] as long as the exercise is conducted within the limits prescribed by the FET standard. Namely, absent specific commitments made to the investor, States are free to regulate as long as the reforms are not unreasonable, arbitrary, discriminatory, or disproportionate, or adopted contrary to due process.[52] Thus, when considering the scope of discretion of States to regulate for the protection of the environment without incurring liability under the FET standard of an applicable treaty, tribunals will consider an array of factors.

Some tribunals have even held that 'not every non-transparent or inconsistent regulatory change' amounts to a breach of FET – instead, such

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[50] *Micula v Romania (I)*, ICSID Case No ARB/05/20, Final Award, 11 December 2013, para 673.

[51] *Parkerings-Compagniet v Lithuania*, ICSID Case No ARB/05/8, Award, 11 September 2007, para 332.

[52] *Muszynianka v Slovak Republic* (n 13) para 466 with further references; see also *Aven v Costa Rica*, ICSID Case No UNCT/15/3, Award (18 September 2018) paras 412-413.

change 'should rise to the level of a 'radical or fundamental' change, [and] it is obvious that the host State's regulatory authority should be afforded due deference in any determination of whether the regulatory change is a radical or fundamental one.'[53] This latter description sets a high standard for claimants, and is perhaps more similar to that of MST under customary international law often invoked in NAFTA/USMCA disputes,[54] as exemplified above in *Lone Pine v Canada*.

Regulation on environmental matters has been held as reasonable exercise of governmental powers in several recent cases. Thus, in the case of *Muszynianka v Slovak Republic*, Slovakia argued that the challenged constitutional amendment concerning water supply was rooted in climate change concerns. The tribunal majority concurred that the amendment did not infringe upon the claimant's legitimate expectations under the FET standard, noting that: 'The vital importance of this non-renewable resource cannot be overstated, especially *in an era of alarming climate change*. [...] No relevant private interest at issue therefore seems remotely capable of outweighing the public interests involved.'[55] Furthermore, in *Cavalum v Spain*, the tribunal considered that it is 'indispensable' for successful public services to be adaptable to change in evolving circumstances, including those introduced by environmental concerns.[56]

In a 2024 award in *Encavis v. Italy*, the tribunal cited energy transition explicitly, as a condition affecting the perceived stability. The paragraph warrants full citation:

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[53] *Sun Reserve v Italy*, SCC Case No V2016/32, Final Award (25 March 2020) paras 714, 735.

[54] For an overview of FET-MST see *Eco Oro v Colombia*, ICSID Case No ARB/16/41, Partial Dissenting Opinion of Professor Philippe Sands QC (9 September 2021) paras 7 et seq. See also Laura Tremblay, 'In Need of a Paradigm Shift: Reimagining Eco Oro v. Colombia in Light of New Treaty Language', 23 Journal of World Investment & Trade (2022) 915.

[55] *Muszynianka v. Slovak Republic* (n 13) para 575 (emphasis added).

[56] *Cavalum SGPS, SA v Kingdom of Spain*, ICSID Case No ARB/15/34, Decision on Jurisdiction, Liability and Directions on Quantum, 31 August 2020, paras 424 and 428.

> That said, the undertaking to "encourage and create stable […] conditions" is not absolute. […] States enjoy a sovereign right to amend their laws and regulations and to adopt new ones in furtherance of the public interest. In the global energy transition necessary to achieve the climate change mitigation and adaptation goals pursuant to the UNFCCC and agreements thereunder, it is critical that States are understood to continue to enjoy such sovereign right […].[57]

One can hope that arbitrators will continue to recognise the necessity of such regulations. Encouragingly, some in the field do and do so explicitly. As one prominent arbitrator pointed out, 'regulatory changes spawned by the Paris Agreement are likely to be considered 'reasonably foreseeable' and therefore ought to fall within the legitimate expectations of investors.'[58] Here too, however, enthusiasm should be tempered by the realities of ISDS. As the majority in the highly contentious award of *Odyssey Marine v Mexico* recently observed—somewhat oxymoronically: 'attempts to legitimately exercise regulatory powers should be encouraged; conduct that constitutes an abuse of regulatory powers should be sanctioned'.[59] The juxtaposition of encouraging 'attempts' yet sanctioning 'conduct' subtly frames regulation as precarious, if not inherently suspect. Here the formulation suggests that regulation is commendable in theory but problematic in practice.

5.2 (Indirect) Expropriation

It follows that if States introduce phase-outs and bans of certain fossil fuels, investments in these fields will at some point, lose their profitability. These assets will become stranded as they will have 'suffered from unanticipated

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[57] *Encavis AG and others v Italy*, ICSID Case No ARB/20/39, Award, 11 March 2024, para 652.

[58] Lucy Greenwood, 'Viewing Our World through a Different Lens: Environmental and Social Considerations in International Arbitration' (2022) 3 Global Energy Law and Sustainability 159, 164; see also Wendy Miles, 'EFILA Annual Conference 2023' (16 March 2023) <https://www.youtube.com/watch?v=WXDgQncituI>.

[59] *Odyssey Marine v Mexico* (n 32), para 447.

or premature write-downs, devaluations, or conversion to liabilities.'[60] As witnessed in the now discontinued case of *RWE v The Netherlands*, investors could allege that bans which prohibit, for example the use of coal for the production of electricity, amount to expropriatory measures, depriving investments of all value.[61] For a measure to amount to indirect expropriation it needs to be 'tantamount' or equivalent to direct expropriation or nationalization,[62] depriving the investment of 'virtually all value'.[63] This deprivation needs to be 'substantial, radical, severe, devastating, or fundamental [etc.].'[64]

However, just as not every change to State's regulatory framework will breach investors' rights under the FET standard, not every measure that results in depravation of investment's value will qualify as indirect expropriation necessitating compensation.[65] The customary concept of 'police

[60] Ben Caldecott et al, 'Stranded Assets and Scenarios' (*Stranded Assets Programme*, January 2014) <https://ora.ox.ac.uk/objects/uuid:e2328230-deac-4976-b270-4d97566f43c9>.

[61] *RWE* (n 8), Claimants' Memorial, 18 December 2021, paras 460-473. Agata Daszko, 'Humanising European Investors: BITs Are Dead, Long Live the ECHR? A Look to RWE v. The Netherlands' (2023) European Yearbook of International Economic Law 423; See also Julia Dehm, 'Law and the "Value" of Future Expectations: Climate Change, Stranded Assets and Capitalist Dynamics' (*VerfBlog*, 3 June 2020) <https://verfassungsblog.de/law-and-the-value-of-future-expectations-clima te-change-stranded-assets-and-capitalist-dynamics/>.

[62] For a NAFTA analysis see *Glamis Gold, Ltd v The United States of America*, UNCITRAL, Final Award, 8 June 2009, paras 355-358.

[63] *PL Holdings v Poland*, SCC Case No V2014/163, Partial Award, 28 June 2017; Rudolf Dolzer, Ursula Kriebaum & Christoph Schreuer, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022) 153.

[64] *Electrabel SA v Hungary*, ICSID Case No ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012.

[65] On the question of the relationship between compensation and indirect expropriation see Christian Riffel, 'Indirect Expropriation and the Protection of Public Interests' (2022) 71 International & Comparative Law Quarterly 957. Cf Ursula Kriebaum, 'Judicial Expropriation' (2024) ICSID Review 1, 12.

powers', safeguards States right to regulate for public interest.[66] There are, naturally, certain stipulations as 'the exercise of the right to regulate is not a blanket exception.'[67] Under most IIAs, a *bona fide,* proportionate and non-discriminatory measure, adopted for a public purpose will not amount to indirect expropriation.[68]

Recently tribunals have agreed with States who have explicitly defended their actions on the environmental basis as equating measures for the benefit of public purpose.[69] Thus, in *Eco Oro v Colombia*, the tribunal's majority found that Colombia's decision to ban mining activities in the Santurbán Páramo region did not amount to an unlawful expropriation. The arbitrators viewed the measures as a legitimate use of Colombia's police powers. The measures were non-discriminatory, adopted in good faith 'and applied to protect a legitimate public welfare objective, namely the protection of the environment', thus not constituting indirect expropriation.[70]

This evolving jurisprudence reinforces the principle that while States must act in good faith and within the bounds of proportionality, they retain the sovereign right to enact environmental protections without the automatic burden of compensating investors. This adds to the cautious optimism that ISDS tribunals, made up of reasonable members of the human species, recognise the necessity, legality and reasonableness of energy transition.

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[66] Dolzer et al (n 63) 176.

[67] *RWE* (n 8), Respondent's Counter-Memorial, 5 September 2022, para 745. On further limitations of police powers see Catharine Titi, 'Police Powers Doctrine in International Investment Law' in Andrea Gattini, Attila M Tanzi and Filippo Fontanelli (eds) *General Principles of Law and International Investment Arbitration* (Brill-Nijhoff 2018) 340.

[68] *Casinos Austria v Argentina*, ICSID Case No ARB/14/32, Award, 5 November 2021, paras 335-337.

[69] On *Rockhopper v Italy*, see Paolo Mazzotti, 'Rockhopper v. Italy and the Tension between ISDS and Climate Policy: A Missed Moment of Truth?' (*Völkerrechtsblog*, 21 December 2022) <https://voelkerrechtsblog.org/de/rockhopper-v-italy-and-the-tension-between-isds-and-climate-policy/>.

[70] *Eco Oro v Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, paras 642-643, 751.

6. Conclusion and Outlook

Notwithstanding even the best intentions of the (individual) arbitrators, investment tribunals operate within the system of international investment law and must adhere to its rules and demands. The system is by no means perfect. Indeed, it appears to be 'neither clear nor coherent'.[71] It allows for inconsistencies,[72] lacks guidance on key issues such as damages calculation and does not correct for mistakes. Nevertheless, this chapter has outlined that the ISDS system, despite its imperfections, is responsive to the broader context of States' regulatory measures and considerations of energy transition.

At present, drawing definitive conclusions about ISDS's role in facilitating or hindering the energy transition remains challenging, as the relevant body of case law is still in its formative stages. Much of the current discourse relies on broader 'environmental' case law, where the diversity of regulatory measures—from conservation efforts to pollution controls—complicates any direct extrapolation to energy transition-specific contexts. As tribunals continue to engage with disputes explicitly tied to climate-related energy policies, clearer patterns may emerge, allowing for a more precise assessment of ISDS's influence in this critical area.

While 'go with a flow' is by no means an option in light of the current climate crisis, we need to be careful not to steer the boat into even more dangerous waters.[73] It is imperative that the international community, including academics remain cautious but also well-informed. The continued observation

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[71] Harro van Asselt, 'Governing Fossil Fuel Production in the Age of Climate Disruption: Towards an International Law of "Leaving It in the Ground"' (2021) 9 Earth System Governance 7.

[72] See for example, Italian solar case law as discussed in *ESPF v Italy*, ICSID Case No ARB/16/15, Decision on Annulment, 31 July 2023, para 339.

[73] On haste alternatives to ISDS, see for example, Agata Daszko, 'The Energy Charter Treaty at a Critical Juncture: Of Knowns, Unknowns, and Lasting Significance' (2023) 26 Journal of International Economic Law 720.

of case law trends and the ISDS system's response to environmental imperatives is essential to effectively address its shortcomings.

A slightly more cautiously optimistic outlook could be warranted. However, this optimism should be tempered with the recognition that while perhaps ISDS does not wholly impede the energy transition, it also does not facilitate it. The onus remains on the States to stop incentivising fossil fuel investments and enact the necessary policies and regulations that will foster such transition, which appears to elude some policymakers.[74]

Finally, attributing the responsibility for the energy transition's pace to arbitrators is misplaced. They can neither redirect the course nor cool the seas. Such a perspective only obscures the fact that it is the States, as the architects of the system, who can foster substantive reform. Without State-led action, the reliance and advocating for higher discretion of arbitrators, may inadvertently breed further inconsistency, exacerbating the very issues it seeks to resolve.

[74] SEI, Climate Analytics, E3G, IISD, and UNEP, 'The Production Gap: Phasing down or phasing up? Top fossil fuel producers plan even more extraction despite climate promises' (Stockholm Environment Institute, Climate Analytics, E3G, International Institute for Sustainable Development and United Nations Environment Programme, 2023).

4

The Role and Relevance of International Investment Agreements in Promoting Renewable Energy Investments[1]

Ladan Mehranvar

1. Introduction

To achieve our global goals of ensuring universal access to clean energy and averting a climate crisis, we must shift away from fossil fuels and toward renewable energy investments. Much of this investment is expected to come from the private sector and private finance, necessitating cross-border transactions to direct capital and technology toward developing and emerging economies. To expedite the widespread increase in private investments in renewable energy, it is critical to address the key constraints that hinder such investments and identify key determinants that can accelerate the required capital for a sustainable energy transition. Understanding these factors is essential for informing policy-making across a range of

[1] This chapter draws heavily from Ladan Mehranvar and Lisa Sachs, 'The Role and Relevance of Investment Treaties in Promoting Renewable Energy Investments' in Anja Ipp and Annette Magnusson (eds), *Investment Arbitration and Climate Change* (Kluwer 2024) 263.

government agencies and functions, development finance institutions, and other international organizations.

To contribute to the understanding of what drives investments in renewables, we carried out a survey in 2022 targeting industry experts in the renewable energy space, to understand the range of political, regulatory and economic factors that shape their investment decisions. In the current intervention, I focus on one part of that analysis: namely, the role and relevance of investment protections in international investment agreements (IIAs),[2] like the Energy Charter Treaty (ECT), to investment decisions. I also review renewable energy cases brought under the ECT as compared to those brought under domestic and regional courts and consider their effect on governments' regulatory space and on the distribution of the costs and benefits of climate action.

2. Do IIAs Attract Inward Foreign Investment Flows?

IIAs provide guarantees of protection and treatment to investors from one Contracting State in the jurisdiction of the other Contracting State(s). Common substantive treaty provisions include protections against discrimination, uncompensated (direct or indirect) expropriation, and guarantees of fair and equitable treatment (FET) of foreign investors. Most of these treaties grant foreign investors the right to sue host governments and seek damages based on alleged treaty violations before ad hoc, party-appointed international arbitration tribunals (commonly known as ISDS, or investor-state dispute settlement). These tribunals issue binding awards, which may necessitate the host State to pay monetary compensation to claimant investors, often on the order of tens of millions of dollars and occasionally

[2] This includes free trade agreements with investment chapters, and multilateral and bilateral investment treaties.

billions.[3] As of 31 December 2024, there have been 1401 publicly-known treaty-based ISDS cases.[4]

Although IIAs restrict the ability of governments to act (or not act) in ways that may impact the economic interests of foreign investors who seek to invest, or who have invested, in those countries, almost every country has signed several such IIAs over the past half century. They have done so under the assumption that additional legal protections for foreign investors that are enforceable outside of their own domestic judicial system will encourage further investment.[5] This assertion is based on the idea that IIAs will deter capricious, arbitrary, and discriminatory State conduct and protect investors from costs incurred in the event of a breach of those commitments,[6] thereby reducing a barrier to investment and increasing investment flows, which, in turn, will promote domestic development.

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[3] Carolina Moehlecke and Rachel L Wellhausen, 'Political Risk and International Investment Law' (2022) 25 Annual Review of Political Science 485, 486.

[4] UNCTAD Investment Policy Hub, Investment Dispute Settlement Navigator, <https://investmentpolicy.unctad.org/investment-dispute-settlement>.

[5] Lise Johnson et al, 'Costs and Benefits of Investment Treaties: Practical Considerations for States', CCSI Policy Paper (March 2018) <http://tinyurl.com/mt9whfsc>; Lise Johnson, Lisa Sachs and Nathan Lobel, 'Aligning International Investment Agreements with the Sustainable Development Goals', CCSI Briefing Note (November 2020) <http://tinyurl.com/2eu9wm6p>; Joachim Pohl, 'Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence' (2018) OECD Working Papers on International Investment 1/2018, 16-17 <http://tinyurl.com/2jny5wjd>; Eric Neumayer and Laura Spess, 'Do bilateral investment treaties increase foreign direct investment to developing countries?' (2005) 33(10) World Development 1567. See also Jason Yackee, 'Do BITs Really Work? Revisiting the Empirical Link Between Investment Treaties and Foreign Direct Investment' in Karl Sauvant and Lisa E Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows* (Oxford University Press 2009) 379, 381.

[6] Zachary Elkins, Andrew T Guzman, and Beth A Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000' (2006) 60 International Organization 811, 823-24; Neumayer and Spess (n 5) 1572. See also Julia Calvert and Kyla Tienhaara, 'Beyond 'Once BITten, Twice Shy': Defending the Legitimacy of Investor-

However, decades of empirical analysis, supplemented by more recent surveys of renewable energy investors, fail to establish that the legal protections contained in these IIAs have a discernible impact on foreign direct investment [FDI) flows.[7] For instance, a 2021 meta-analysis of seventy-four studies looking at the effects of IIAs on FDI found that IIAs 'have an effect on FDI that is so small as to be considered as negligible or zero'.[8] Another meta-analysis from 2015 concluded that '… the empirical evidence on the basis of a meta-analysis suggests that the FDI promotion effect of [bilateral investment treaties] seems to be economically negligible'.[9] In the case of renewable energy investments, researchers have found no evidence that the ECT has had a positive influence on FDI inflows in the sector.[10]

Despite the absence of conclusive evidence, proponents of the IIA regime – and of the ECT in particular – continue to recycle the argument that these treaties are necessary, or at least effective, at mobilizing FDI, and are therefore critical to advancing renewable energy investments needed today. This narrative gains traction, particularly amid mounting criticism of the ongoing protection of fossil fuel investments by IIAs, which clashes with the goals of the Paris Agreement. Advocates contend that the increasing number of ISDS cases involving renewable energy investments under IIAs is one way to hold governments accountable for their climate action and

State Dispute Settlement in Peru and Australia' (2022) 30 Review of International Political Economy 1799.

[7] See Karl P Sauvant and Lisa E Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009); Lauge N Skovgaard Poulsen, 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence' in Karl P Sauvant (ed), *Yearbook on International Investment Law and Policy 2009/2010* (Oxford University Press 2010) 539; Pohl (n 6); Josef C Brada, Zdenek Drabek and Ichiro Iwasaki, 'Does Investor Protection Increase Foreign Direct Investment? A Meta-Analysis' (2021) 35 Journal of Economic Surveys 34.

[8] Brada et al (n 7) 58.

[9] Christian Bellak, 'Economic Impact of Investment Agreements' (2015) Department of Economics Working Papers No 200, 19.

[10] Kyla Tienhaara and Christian Downie, 'Risky Business? The Energy Charter Treaty, Renewable Energy, and Investor-State Disputes' (2018) 24 Global Governance 451.

mitigation goals, suggesting that the sector of the claimant justifies the mechanism and its outcomes.

Understanding the factors that investors consider most critical or important in their decision-making process regarding energy investments offers a complementary path to assessing the relative importance of IIAs against other factors. The findings of our 2022 survey of renewable energy investors and industry experts on what really matters to them when investing in new foreign markets support the empirical conclusions that IIAs are not decisive in investment decision-making.[11] When asked to choose the top-five factors that deterred their company from investing in a new market, only one out of 32 foreign investors identified the absence of international legal protections by way of IIAs as among their top five.[12] The survey and complementary interviews show that other legal elements, as well as relevant economic and financial components, are far more decisive in investment decision-making.

While investors may not consider or prioritize the existence of IIAs between their home State and a potential host State when deciding where to invest, they may take advantage of the strong protections afforded by IIAs in case of a post-establishment dispute. This does not imply that these investors would have refrained from making their investments in the absence of a treaty. Indeed, law firms often advise their clients who have already decided to invest in a specific jurisdiction to (re)structure their investments to benefit from additional treaty-based protections.[13] For instance, investors have been encouraged to 'audit their corporate structure and change it, if needed, to ensure they are protected by an investment treaty,' and that such

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[11] Mithatcan Aydos et al, 'Scaling Investment in Renewable Energy Generation to Achieve Sustainable Development Goals 7 (Affordable and Clean Energy) and 13 (Climate Action) and the Paris Agreement: Roadblocks and Drivers' (CCSI 2022) <http://tinyurl.com/2s4dtp8t>.

[12] Ladan Mehranvar and Sunayana Sasmal, 'The Role of Investment Treaties and Investor State Dispute Settlement in Renewable Energy Investments' (CCSI 2022) 7 <http://tinyurl.com/29ch2wcf>. See also Poulsen (n 7) 541-542.

[13] For example, Jones Day, 'Restructuring Recommended after CJEU Decision on Intra-EU Bilateral Investment Treaties' (*Jones Day Insights*, March 2018) <http://tinyurl.com/mvjjvh4c>.

restructuring 'should take place before any climate-related dispute with the State has arisen or is reasonably foreseeable'.[14] In essence, IIAs offer supplementary protections to investors without actually influencing their initial investment decisions.

To assess whether foreign investors view ISDS as a critical risk mitigation tool, the survey asked respondents to rank six different tools in order of importance in their investment decisions. Treaty-based ISDS was one of the two lowest-ranked options, together with green insurance.[15]

3. Legal Stability as a Driving Factor for Renewable Energy Investments

While the presence of IIAs and the reliance on ISDS do not appear to be important to most renewable energy investors, the survey results do confirm the importance of stability to investors' decision-making process. Among the factors driving foreign investment in renewables, an overwhelming majority of respondents considered political stability, legal (or regulatory) stability, and the stability of fiscal and energy markets as critical or very important factors in their investment decisions. While the political stability of the host State may improve predictability for foreign investors, the economic stability of a foreign market, like the rate of inflation, may reduce the risks that may undermine the economic outcome of a business venture. Legal stability, on the other hand, may improve predictability and reduce economic risks, and focuses on the stability of the underlying investment contract or the applicable regulatory framework on which the investment relies in the host State.[16] Here, I focus only on legal stability.

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[14] Jones Day, 'Climate Change and Investor-State Dispute Settlement' (*Jones Day Insights*, February 2022) <http://tinyurl.com/43skx93m>.

[15] Mehranvar and Sasmal (n 12) 9.

[16] Federico Ortino, 'Guarantees of Legal Stability in the Strict Sense' in Federico Ortino (ed), *The Origin and Evolution of Investment Treaty Standards: Stability, Value, and Reasonableness* (Oxford University Press 2019) 5, 6-7.

When scoping out a new market, investors consider various legal factors, including the development of a State's legal institutions, the friendliness of legal frameworks to foreign investment, access to effective dispute settlement processes, and the entrenched nature of the rule of law. States also have a vested interest in maintaining a stable investment climate. Legal instability, such as frequent, unpredictable, and arbitrary regulatory changes by the State, can deter investments or lead to disputes with investors, ultimately impacting the development of the country's renewable energy sector.[17] Similarly, the stability of an investment project is critical for the State and the public, as stalled renewable energy projects can hinder the achievement of sustainable, low-carbon, and affordable energy targets.

The expected stability of a State's legal and regulatory framework should therefore be defined by several key characteristics, including that laws and regulations are publicly available, uniformly administered and applied, and provide a means for affected actors to communicate with relevant authorities;[18] that laws and regulations serve clear policy objectives, such as economic development, social welfare, or environmental protection,[19] are based on sound legal and empirical evidence, and allow for mutual benefits for both investors and the State, as well as the public; that the governance framework is responsive to changing circumstances affecting either the State or the investor;[20] and that investors are protected from arbitrary or discriminatory government decisions, and domestic courts offer impartial

[17] Miguel Mendonça, Stephen Lacey and Frede Hvelplund, 'Stability, Participation and Transparency in Renewable Energy Policy: Lessons from Denmark and the United States' (2009) 27(4) Policy and Society 379.

[18] OECD, 'Transparency and Predictability for Investment Policies Addressing National Security Concerns: A Survey of Practices' (2008) <http://tinyurl.com/32f2ttfp>.

[19] OECD and Korea Development Institute, 'Improving Regulatory Governance: Trends, Practices and the Way Forward' (OECD Publishing 2017) 20 <http://tinyurl.com/ydvueecn>.

[20] Lisa E Sachs et al, 'Impacts of Fiscal Reforms on Country Attractiveness: Learning from the Facts' in Karl P Sauvant (ed), *Yearbook on International Investment Law and Policy 2011-12* (Oxford University Press 2013) 345, 375. See also Lou Wells, 'It's Just a Clause, isn't it?' (CONNEX Support Unit) <http://tinyurl.com/y8rprskz>.

means to uphold investors' legal rights (and obligations) and enforce their commercial contracts.[21]

The concept of legal or regulatory stability, however, can become contentious, depending on one's interpretation of its stringency. For instance, a foreign investor may expect a State to guarantee a very high level of protection against the risk of contractual or regulatory change, especially if that change is in any way harmful for its investment. In this way, the interpretation of stability means a strict or absolute stability obligation by the host State. For example, if a tax policy is modified during the lifetime of an investment and that modification negatively impacts the expected profitability of that investment, the foreign investor may expect to be compensated for the adverse regulatory change. However, from the perspective of the host State, an absolute stability obligation toward any investor is impractical. States are constantly balancing competing interests of the public and the private sectors, as well as protecting the environment, upholding their other international obligations, and preventing the collapse of the public purse. Therefore, they may need to adjust their regulatory policies when demands change, or in response to a global pandemic or a financial crisis, for instance. Thus, while some stability and continuity of regulations can support informed investor decision-making, it is important for States to retain sufficient flexibility in the law to review, reassess, and modify ineffective or costly regulations.

[21] Joseph L Staats and Glen Biglaiser, 'The Effects of Judicial Strength and Rule of Law on Portfolio Investment in the Developing World' (2011) 92 Social Science Quarterly 609, 613.

4. Investor-State Disputes Involving Renewable Energy Investments

One of the most controversial tools advocated by some lawyers and international institutions to meet an investor's expectations for legal stability in a host State is the use of IIAs, including their centrepiece, the ISDS mechanism.[22] However, many ISDS tribunals have interpreted IIAs as providing for absolute stability in the legal and business environment of host States, which far exceeds aspects of regulatory stability that matter to investors or that are realistically feasible for States to meet. For instance, the tribunal in *Occidental v Ecuador I* noted that under the FET standard, 'there is an obligation not to alter the legal and business environment in which the investment has been made',[23] and that the stability requirement is 'an objective requirement that does not depend on whether the Respondent has proceeded in good faith or not'.[24]

To discuss the challenges of stability, I turn to the renewable energy cases brought under the ECT, and in particular those against Spain, of which there

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[22] Paul E Comeaux and N Stephan Kinsella, 'Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance' (1994) 15 New York Law School Journal of International and Comparative Law 1; Priyanka Kher and Dongwook Chun, 'Policy Options to Mitigate Political Risk and Attract FDI' (World Bank Group 2020) <http://tinyurl.com/uacbt2wm>. See also Matthew Coleman and Thomas Innes, 'Managing Political Risk Through Bilateral Investment Treaties' (*Steptoe & Johnson LLP*, 2 October 2018) <http://tinyurl.com/2pebjtz9>.

[23] *Occidental Exploration and Production Company v Republic of Ecuador (I)*, LCIA Case No UN3467, Award, 1 July 2004, para 191.

[24] *Occidental v Ecuador I* (n 23), para 186. More recent cases, including several of the cases brought by renewable energy investors against Spain, have maintained the strict standard of absolute stability, even over the objections of dissenters. As one dissenting arbitrator opined in the *RENERGY v Spain* case, '[t]he expectation of a relatively (or absolutely) immutable rate of return identified by the Majority is not supported by the evidence or the case-law. It is an approach that is neither legitimate nor reasonable'. *See RENERGY v Spain*, ICSID Case No ARB/14/18, Award, 6 May 2022, paras 707-708, and Dissent on Liability and Quantum of Professor Philippe Sands, 22 April 2022, para 11.

have been at least 51 over the past decade and a half. All these cases challenged Spain's regulatory modifications to its feed-in-tariffs (FIT) schemes, initially designed to attract investment in renewable energy. While Spain's FIT schemes successfully garnered significant investment, the 2008 financial crisis, which resulted in the reduction of electricity consumption,[25] as well as technological advances, which reduced costs and increased the efficiency of renewable energy generation, transmission and use,[26] prompted many European countries, including Spain, to reconsider their renewable energy support policies.[27] In Spain, the cost of the FIT scheme increased from EUR 194 million in 2007 to EUR 2.6 billion in 2009, a thirteen-fold increase.[28] By the end of 2012, Spain's tariff deficit exceeded EUR 29 billion (approximately 3% of its GDP),[29] and by 2013, it had exceeded EUR 40 billion (approximately 4% of its GDP).[30] In response, the Spanish Government, as well as other governments both in the European Union (EU) and elsewhere, scaled back or revoked renewable energy incentives to curb the

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[25] *9REN Holding v Spain*, ICSID Case No ARB/15/15, Award, 31 May 2019, para 247.

[26] For instance, the cost of PV solar modules dropped from about five Euro/watt in 2006 to about 50 Eurocents/watt in mid-2014. See Zachary Shahan, 'Solar PV Module Prices Have Fallen 80% Since 2008, Wind Turbines 29%' (*Clean Technica*, 6 May 2013) <http://tinyurl.com/yns7czjc>; Daniel Behn and Ole Kristian Fauchald, 'Governments under Cross-Fire: Renewable Energy and International Economic Tribunals' (2015) 12 Manchester Journal of International Economics Law 117, 118; Carmen Otero García-Castrillón, 'Spain and Investment Arbitration: The Renewable Energy Explosion' (November 2016) CIGI Investor-State Arbitration Series, Paper No 17, 4 <http://tinyurl.com/45pt68m7>.

[27] Theodoros G Iliopoulos, 'Price Support Schemes in the Service of the EU's Low-Carbon Energy Transition' in Theodoros Zachariadis et al (eds), *Economic Instruments for a Low-Carbon Future* (Elgar 2020); García-Castrillón (n 26).

[28] Lucía Bárcena and Fabian Flues, 'From Solar Dream to Legal Nightmare: How Financial Investors, Law Firms and Arbitrators are Profiting from the Investment Arbitration Boom in Spain' (*TNI and Powershift*, 31 May 2022) 10 <http://tinyurl.com/m26zp7t5>.

[29] Pablo del Río and Pere Mir-Artigues, 'A Cautionary Tale: Spain's Solar PV Investment Bubble' (IISD 2014) 9 <http://tinyurl.com/47kphscx>.

[30] *Foresight v Spain*, SCC Case No 2015/150, Award, 14 November 2018, para 117.

tariff deficit from growing further[31] and to reduce the costs of energy bills for the public.[32]

Because of the alleged impact of these regulatory changes on their investment profitability, investors (both domestic and foreign) implemented diverse legal strategies to defend their economic interests. They claimed that the regulatory changes violated protections afforded to them under national and EU laws, such as the principles of legal certainty and legitimate expectations, or in the case of foreign investors, their legitimate expectations through the FET standard under the ECT (among other alleged breaches). As of December 2024, of the 40 concluded ECT cases against Spain, 31 have been decided in favour of the investor.[33] However, of the cases brought against Spain in domestic courts as well as before the Court of Justice of the European Union (CJEU), none have been decided in favour of the investor. Spain owes around EUR 1.5 billion in compensation to foreign investors,[34] which is more than 'the country's entire spending commitment to fight the climate crisis or five times what it spent to alleviate energy

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[31] Theodoros Iliopoulos, 'Renewable Energy Regulation: Feed-in Tariff Schemes under Recession Conditions' (2016) 4(2) Lexxion: The Legal Publisher 110, 110 <http://tinyurl.com/2mwwtrce>; Sofia-Natalia Boemi and Agis M Papadopoulos, 'Times of Recession: Three Different Renewable Energy Stories from the Mediterranean Region' in Evanthie Michalena and Jeremey Maxwell Hills (eds), *Renewable Energy Governance: Complexities and Challenges* (Springer 2013) 263.

[32] Sondra Faccio, 'The Italian Energy Reform as a Source of International Investment Disputes' (2016) 52 Rivista di diritto internazionale privato e processuale 460, 461.

[33] I have included three cases in which a Final Award has not yet been made, but for which a Decision on Jurisdiction, Liability and Directions on Quantum has been made, in favour of the investor. These three cases are: *Kruck and others v Spain*, ICSID Case No ARB/15/23; *Infracapital v Spain*, ICSID Case No ARB/14/12; and *Sevilla Beheer and others v Spain*, ICSID Case No ARB/16/27. It is also noteworthy that in 10 of the 26 awards in which the investor prevailed, the Respondent State's appointed arbitrator wrote a dissenting opinion in which they disagreed with the majority's finding of liability.

[34] 'EU Commission tells Spain not to pay up in long-running renewable subsidies case' (*Reuters*, 24 March 2025) <https://www.reuters.com/sustainability/climate-energy/eu-commission-tells-spain-not-pay-up-long-running-renewable-subsidies-case-2025-03-24/>.

poverty in 2021'.[35] In addition, Spain owes at least another EUR 116 million in associated legal and arbitration fees.[36]

The Spanish ISDS cases point to the troubling fact that IIAs are being used as a weapon against effective governance, especially in a changing and highly regulated space, where good faith actions are taken in the public interest to achieve climate goals. These cases also expose the fact that IIAs have created a discriminatory system where foreign investors (or domestic investors with foreign subsidiaries) have access to legal protections that go far beyond those granted to investors under domestic and regional laws; and allow for speculative damages (for lost future profits for example) to be awarded, while most domestic disputes limit damages to sunk costs only.[37]

All the claims under the ECT against Spain allege that the contested regulatory measures breached investors' legitimate expectations, thereby breaching the ECT's FET standard. Although the protection of legitimate expectations is not an explicit component of the FET provision, it has become 'the dominant element of the standard'[38] and perhaps the most controversial.[39] The crux of these cases hinges on the assessment of whether the investors' expectations at the time of investment were reasonable and

[35] Bárcena and Flues (n 28) 4. In that report, the authors state that Spain owes more than EUR 1.2 billion in compensation as of May 2022. Since then, several other cases have been decided and awarded, which together increase the total cost owed by Spain by at least EUR 200,000.

[36] Bárcena and Flues (n 28) 4, which reports EUR 101 million up to May 2022. However, the costs have increased given the more recent cases.

[37] *Eurus Energy v Spain*, ICSID Case No ARB/16/4, Decision on Jurisdiction and Liability, 17 March 2021, paras 447-54.

[38] *Saluka Investments BV v Czech Republic*, UNCITRAL-PCA, Partial Award, 17 March 2006, para 302.

[39] One dissenting arbitrator observed that 'the assertion that fair and equitable treatment includes an obligation to satisfy or not to frustrate the legitimate expectations of the investor [...] does not correspond, in any language, to the ordinary meaning to be given to the terms 'fair and equitable''. *See Suez et al. v Argentina*, ICSID Case No ARB/03/17, Separate Opinion of Arbitrator Pedro Nikken, Decision on Liability, 30 July 2010, paras 3, 20-21.

legitimate, and if so, determining whether those expectations were violated in breach of the treaty. While the concept of legitimate expectations has been the basis for many of the claims brought against Spain in the renewables sectors under domestic and EU law,[40] striking differences exist in how domestic (and regional) courts have demarcated and applied three important elements of legitimate expectations as compared to ISDS tribunals. These elements include: the legitimacy of investors' expectations of stability; the level of diligence expected from investors in the highly regulated energy sector; and the extent to which States' pursuit of the 'public interest' factors into an assessment of a potential treaty violation.[41]

5. Investors' Expectations of Stability

The first element adjudicators consider when assessing a legitimate expectations claim is the source of the claimant's expectations. Under Spanish and EU law, in the absence of a specific commitment made by the State to freeze the regulatory framework applicable to the investment at the time the investment is made, investors cannot have a legitimate expectation of absolute stability in the regulatory environment of that State. According to the Spanish Supreme Court and the CJEU, the crucial issue for the claimant is to demonstrate that the representation, in whatever form it was derived, was sufficiently precise and specific to give rise to a legitimate expectation

[40] Federico Ortino, 'The Public Interest as Part of Legitimate Expectations in Investment Arbitration: Missing in Action?' in Charles N Brower et al (eds), *By Peaceful Means: International Adjudication and Arbitration: Essays in Honour of David D Caron* (Oxford University Press 2024) 2.

[41] Ortino (n 40) 2. In addition to these three elements, the difference in the valuation of damages between ISDS awards and Spanish domestic law is also noteworthy. ISDS awards frequently award investors damages based on an estimate of future lost profits. As the Spanish government argued, 'the Spanish Supreme Court has rendered more than one hundred judgments rejecting the speculative quantification methods used by the Claimant [Eurus]. According to the Supreme Court that method 'lacks [the] necessary rigour and certainty'. See *Eurus* (n 37), para 448.

of legal stability and to be in accordance with the applicable law.[42] In fact, '[t]he great majority of claims for breach of legitimate expectation fail because the applicant cannot establish the requisite precise and specific assurance'.[43]

On the other hand, ISDS tribunals have broadened the scope of the source of a claimant's expectations by allowing them to rely on general regulatory or administrative acts, which are not specifically addressed to an individual investor but are targeted to a group of investors.[44] A number of tribunals, for example, have held that the Spanish royal decrees – on which investors seemingly relied[45] when investing – established a framework guaranteeing a FIT scheme that would not be subject to future modifications.[46] In other

[42] Sentencia del Tribunal Supremo (STS) 7961/2009, ECLI:ES:TS:2009:7961, 3 December 2009; Michele Potestà, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Review 88, 94; Yaaser Vanderman, 'Substantive Legitimate Expectation' (2016) 21 Judicial Review 174, 174. See also Court of First Instance (European Union), *Kyowa Hakko v Commission*, Case No T-223/00, 9 July 2003, para 39.

[43] Paul Craig, 'Legal Certainty and Legitimate Expectations' in Paul Craig (ed), *EU Administrative Law* (2nd edn, Oxford University Press 2012) 549, 569.

[44] *Cube Infrastructure v Spain*, ICSID Case No ARB/15/20, Final Award, 26 June 2019, para 388.

[45] The concept of reliance – whether an investor relied on the expectation that a specific measure or regulatory framework would remain unchanged throughout the lifespan of its investment – is another important element that adjudicators in domestic and regional courts typically take into account when deciding whether a legitimate expectation should be upheld, but in the majority of the renewable energy cases against Spain, the concept has received scarce treatment.

[46] Nikos Braoudakis et al, 'Protecting Renewables with the Energy Charter Treaty: A False Good Idea' [July 2021] Veblen Institute for Economic Reforms, 10 and fn 30. See, e.g., *Masdar Solar v Spain*, ICSID Case No ARB/14/1, Award, 16 May 2018, para 503 ('RD661/2007 and other texts included a stabilisation clause [which] is sufficient to exclude any modification of the law, so far as investors, which had made investments in reliance upon its terms, were concerned'). See also *Antin Infrastructure v Spain*, ICSID Case No ARB/13/31, Award, 15 June 2018, paras 538 and 554; *Cube Infrastructure and others v Spain*, ICSID Case No ARB/15/20, Decision on Jurisdiction, Liability and a Partial Decision on Quantum, 19 February 2019, para 388; *SolEs Badajoz v Spain*, ICSID Case No ARB/15/38, Award, 31 July 2019, para 313; *OperaFund v Spain*, ICSID Case No

words, these policies created a specific commitment on the part of the State. In the *9REN v Spain* case, for instance, the tribunal reasoned that while '[t]here is no doubt that an enforceable 'legitimate expectation' requires a clear and specific commitment ... there is no reason in principle why such a commitment of the requisite clarity and specificity cannot be made in the regulation itself[.]'[47] Contrary to the approach of domestic courts, these tribunals essentially converted general legislation into specific commitments made by the State, which then gave rise to investors' expectations that the remuneration regime would remain unchanged.

Such an interpretation of the FET standard – to allow for the expectation of regulatory stability even absent a specific commitment of stability – essentially requires host States that are governing in a highly regulated space to compensate affected foreign investors for otherwise legitimate policy changes that respond to new and evolving circumstances.[48] This has a chilling effect on States, disincentivizing the critical policy measures necessary to pursue their policy-oriented objects and responsibilities. In the cases brought by renewable energy companies, the protected expectation of absolute stability of the FIT regime undermined the precise flexibility and adaptability that governments need to navigate the complex and evolving transformation of regional energy systems, flexibility that is expressly recognized and protected under domestic and regional laws.

ARB/15/36, Award, 6 September 2019, para 485. See also *ESPF and others v Italy*, ICSID Case No ARB/16/5, Award, 14 September 2020, para 512. A small number of tribunals have held that such general legislation cannot give rise to legitimate expectations that the regulatory framework would remain unchanged. See, e.g., *Charanne v Spain*, SCC Case No 062/2012, Final Award, 21 January 2016, para 499; *Isolux Infrastructure v Spain*, SCC Case No V2013/153, Award, July 2016, para 775; *WA Investments v Czech Republic*, PCA Case No 2014-19, Award, 15 May 2019, para 569.

[47] *9REN v Spain* (n 25), para 295.

[48] But see *Continental Casualty v Argentina*, ICSID Case No ARB/03/9, Award, 5 September 2008, para 258 ('it would be unconscionable for a country to promise not to change its legislation as time and needs change, or even more to tie its hands by such a kind of stipulation in case a crisis of any type or origin arose. Such an implication as to stability in the BIT's Preamble would be contrary to an effective interpretation of the Treaty; reliance on such an implication by a foreign investor would be misplaced and, indeed, unreasonable').

6. Investor's Due Diligence Analysis

A second important element of legitimate expectations is the extent to which investors are expected to have conducted a diligent analysis of the regulatory framework before making their investment.[49] Under EU and Spanish law, if the disputed measure or conduct could have been reasonably foreseeable at the time the investment was made by a prudent and diligent investor, there is no scope for the operation of the protection of legitimate expectations.[50] This is especially true in the energy sector because it is subject to intense administrative intervention due to its significance to the general public interest.[51]

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[49] *Charanne v Spain* (n 46), paras 505-7; *Foresight v Spain*, SCC Case No 2015/150, Partial Dissenting Opinion of Arbitrator Raúl E Vinuesa, 30 October 2018, paras 39-47.

[50] Court of Justice (European Union) (CJEU), *Di Lenardo and Dilexport v Ministero del Commercio con l'Estero*, Joined Cases C-37/02 and C-38/02, 15 July 2004, para 70 ('Any trader on the part of whom an institution has promoted reasonable expectations may rely on the principle of the protection of legitimate expectations. However, if a prudent and circumspect trader could have foreseen that the adoption of a Community measure is likely to affect his interests, he cannot plead that principle if the measure is adopted'). See also CJEU, *Agrenergy Srl and Fusignano Due Srl v Ministero dello Sviluppo Economico*, Joined Cases C-180/18, C-286/18 and C-287/18, 11 July 2019, para 31; *Federazione nazionale delle imprese elettrotecniche ed elettroniche (Anie) and others and Athesia Energy Srl and others v Ministero dello Sviluppo Economico and Gestore dei servizi energetici (GSE) SpA*, Joined Cases C-798/18 and C-799/18, 15 April 2021, para 42. In the latter case, brought by investors against Italy, the CJEU reaffirmed the Italian Constitutional Court's reasoning that 'the alteration of the incentive scheme at issue in the main proceedings was neither unforeseeable nor unexpected, so that a prudent and circumspect economic operator would have been able to take account of possible legislative developments, considering the temporary and changeable nature of support schemes' (para 16).

[51] García-Castrillón (n 26) 8; Spanish Constitutional Court (STC) 270/2015, BOE No 19, 6370, 22 January 2016 ('Respect for [the principle of legal certainty], and its corollary, the principle of legitimate expectations, is compatible with the modifications in the remuneration system for renewable energies carried out by Royal Decree-Law 9/2013, even more – as in the present case – in an area subject to a high administrative intervention by virtue of its impact on general interests, and a complex regulatory system that makes unfeasible the claim that the most favourable elements are invested with

Indeed, an investor seeking to invest in the renewables sector would have been on notice that several publicly available judgments of the Spanish Supreme Court, even as early as 2006,[52] established that producers do not have an unmodifiable right to the incentives scheme.[53] There were also pronouncements by the Spanish government advising of the regulatory risks of FIT schemes that had become financially untenable and subject to change.[54] Thus, investors entering the Spanish market, especially post-2010, should have expected or foreseen the adjustments.

Unlike the Spanish Supreme Court or the CJEU, the ISDS cases against Spain have typically given much less weight to the role of the claimant's due diligence assessment of the legal framework at the time of investing. For instance, in *Foresight v Spain*, even though the '[e]vidence shows that [the claimants] have commissioned no due diligence on Spanish as well as on EU law,'[55] the majority of the tribunal considered 'that it is reasonable for an investor to assume that its legal advisors would have raised a red flag had they detected any risk of fundamental change to the regulatory regime.'[56] Some tribunals have even denied that due diligence is a requirement of a claimant's legitimate expectations. In *Cube Infrastructure v Spain*, the tribunal said that claimants did not need to demonstrate that they had carried out 'any particular form or scale of legal due diligence.'[57] In the tribunal's opinion, the claimants 'were professional investors, used to evaluating risk, and did in fact procure legal advice from Spanish counsel, even though

permanence or inalterability in the face of the exercise of a legislative power that obliges public powers to adapt said regulation to a changing economic reality').

[52] Spanish Supreme Court, Case STS 6317/2006, ECLI: ES:TS:2006:6317 (15 December 2005). See also *Eurus v Spain* (n 37), para 143 (the tribunal provides a summary of a number of the decisions issued by the Spanish Supreme Court since 2005).

[53] STS 6317/2006 (n 52).

[54] Real Decreto-ley 6/2009 (30 April 2009) on the adoption of certain measures in the energy sector and the approval of the social bond (BOE No 111, 39404, 7 May 2009).

[55] *Foresight* (n 49), para 44.

[56] *Foresight* (n 30), para 380.

[57] *Cube* (n 46), para 396.

no detailed written opinion was filed in these proceedings.'[58] The tribunal's focus, therefore, appears to be on the investor's perception of regulatory stability, rather than on how that perception was formed or whether it was reasonably grounded.

7. Consideration of the Public Interest

A third important element of legitimate expectations is the extent to which the consideration of the public interest may trump investor expectations of regulatory stability. Typically, adjudicators assess the rationale for a contested measure against the impact that the measure has on investors who relied on past policies or practices.[59] So, even though investors may be found to have had legitimate expectations of stability, a legitimate public interest can potentially override those expectations.

In the domestic claims brought against Spain, the Spanish Supreme Court has held that investors are not immune to changing circumstances, especially in light of an overriding public interest.[60] Accordingly, their legitimate expectations were not found to have been infringed by the Spanish government, given the need to weigh in the public interest at stake, as well as the financial and deficit crisis experienced in the electricity sector. Like most domestic legal systems, the EU legal system also provides investors with a high level of protection against unjustified restrictions on their investments. However, it also allows for markets to be regulated in order to pursue legitimate public policy objectives, which may have consequences for foreign investors.[61] The CJEU reaffirmed the Italian Constitutional Court's reasoning that the reform in Italy's incentives policy 'constitutes an intervention

[58] *Cube* (n 46), para 401.

[59] Craig (n 43) 579.

[60] Spanish Supreme Court, Case STS 5493/2015, ECLI:ES:TS:2015:5493, 15 December 2015, 5.

[61] European Commission, 'Communication from the Commission to the European Parliament and the Council: Protection of intra-EU investment' (19 July 2018) 1 <https://tinyurl.com/msfwec4a>.

that, as regards the fair balancing of the opposing interests at stake, addresses a public interest intended to combine the policy of supporting the production of energy from renewable sources with making the related costs payable by end users of electricity more sustainable'.[62]

On the other hand, ISDS tribunals have not considered Spain's public policy justification for the contested measures, taken in the midst of a massive tariff deficit and a financial crisis, in the public interest.[63] In the *Masdar v Spain* case, for example, despite Spain's contention that the aim of the modifications had been to 'guarantee the economic sustainability of the system and to correct over-remuneration,'[64] the tribunal found that Spain had breached the FET with no reference to its public interest justification.[65] In the *Eiser v Spain* case, while the tribunal acknowledges that the legitimate expectations of any investor have 'to include the real possibility of reasonable changes and amendments in the legal framework, made by the competent authorities within the limits of the powers conferred on them by the law,' it regarded the modified regulatory framework as 'profoundly unfair and inequitable' because it 'stripp[ed] Claimants of virtually all of the value of their investment'.[66] While allegedly raising the bar for liability to only 'radical' changes made to past regulations, the tribunal still found the Spanish measures 'radical' – without considering the devastating economic circumstances Spain was facing, or any reference to the interests of other stakeholders such as consumers and taxpayers, or Spain's broader commitments under EU and international law that might outweigh an individual investor's legitimate expectations.

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[62] Joined Cases C-798/18 and C-799/18 (n 50), para 16.

[63] Ortino (n 40) 17-19.

[64] *Masdar* (n 46), para 451.

[65] See also *NextEra v Spain*, ICSID Case No ARB/14/11, Decision on Jurisdiction, Liability and Principles of Quantum (12 March 2019), paras 596, 599 and 601; *9REN* (n 25), paras 253-59; *Watkins v Spain*, ICSID Case No ARB/15/44, Award, 21 January 2020, paras 538 and 562.

[66] *Eiser v Spain*, ICSID Case No ARB/13/36, Award, 4 May 2017, para 365.

8. Conclusion

The surge in treaty-based ISDS claims challenging changes to renewable energy incentives imposes significant costs on States.[67] If modifications to general legislation loosely relied upon by a foreign investor, who may not have conducted a diligent analysis before investing, result in a loss for that investor, a State may be held liable for frustrating the investor's legitimate expectations, irrespective of the policy justifications for the modifications. This is the situation in which Spain finds itself.

However, beneath these regulatory changes lie governments' complex considerations and deliberations about how to manage and mitigate the risks and impacts of climate change, including the distribution of anticipated benefits and costs between the public and private sectors.[68] These decisions involve diverse interests and complex issues, raising challenges during periods of contestation. A State's ability to respond to changing circumstances – like evolving technologies, financial crises, and assumptions about costs and markets[69] – is a critical aspect of effective governance, including in the energy transition.[70] This very dynamic and responsive regulation, however, exposes States to potential ISDS claims and awards. This effectively redirects funds that could have been used to support new renewable energy production to securing excessively high returns on existing facilities.[71] States committed to achieving climate goals should consider withdrawing

[67] Johnson et al (n 5).

[68] Cara Dowling et al, 'Climate Change and Sustainability Disputes Between Foreign Investors and States' (2021) 17 International Arbitration Report <https://tinyurl.com/3fv75hbr>.

[69] James Zhan and Joachim Karl, 'Investment Incentives for Sustainable Development' in Ana Teresa Tavares-Lehman et al (eds), *Rethinking Investment Incentives* (Cambridge University Press 2016) 204; Lise Johnson and Perrine Toledano, 'Investment Incentives: A Survey of Policies and Approaches for Sustainable Investment' (CCSI 2022) 55, 119 <http://tinyurl.com/ns3urcr4>.

[70] Ella Merrill et al, 'International Investment Law and the Extractive Industries' (CCSI 2022) 9 <https://tinyurl.com/y3a879kr>.

[71] Behn and Fauchald (n 26) 136-137.

from IIAs to preserve flexibility for implementing effective and urgent climate action policies.[72]

[72] Martin Dietrich Brauch, 'Should the European Union Fix, Leave or Kill the Energy Charter Treaty?' (*CCSI*, 9 February 2021) <http://tinyurl.com/3n5n8ve2>. Indeed, the European Renewable Energies Federation is also calling on the 'EU and Member States to join France, the Netherlands, Poland and Spain and to initiate their withdrawal from the Energy Charter Treaty (ECT) because the so-called agreement in principle on the modernisation of the ECT sustains EU fossil fuel dependency and impedes the transition to 100% renewable energy EU.' See also European Renewable Energies Federation, 'Time to End the Energy Charter Treaty (ECT) and to Move on with the European Energy Transition' (24 October 2022) EREF Press Release <http://tinyurl.com/h988z6pm>.

5

The Right to Regulate in International Investment Law

Giovanni Zarra

1. The Concept

'Any State has the right to regulate in order to carry out its public functions'.[1] This is a mantra which may be located in many investment awards, and rightly so. However, this statement, which is an expression of the basic principle of State sovereignty, shall not be confused with the so-called 'right to regulate' (or 'power to regulate' or 'police powers' of the State). The latter is a rule proper to international investment law, specifically applicable in cases of expropriation, which may be defined as the host State's right to regulate, under exceptional circumstances, in derogation of the obligations it has undertaken by means of an international investment agreement with the consequence of avoiding breaching international law (and, as a

[1] Zachary Douglas, 'Instead of Principles, Slogans' (2023) 38 ICSID Review 1, 1: 'I start with an explanation that I owe you: what is the meaning of my title "Instead of Principles, Slogans"? It comes from an article written by the British-born American theatre critic, Eric Bentley. The full quote is this: "Ours is the age of substitutes: instead of language, we have jargon: instead of principles, slogans: and, instead of genuine ideas, bright ideas." […] From the respondent's side, there are different slogans, but they are shouted with the same deafening rigour. The sovereign right to regulate! This apparently unlocks every secret of State responsibility, as well as the mysteries of the universe'.

consequence of the lack of a violation, incurring in the duty to compensate).[2] By way of clarification, it should be highlighted that the exceptional reasons justifying the recourse to the power to regulate cannot be enshrined in advance, but may include the necessity to safeguard the environment, to protect fundamental rights of local populations or, e.g., to issue special regulations in times of emergency.

The case law, from which it is possible to infer the existence of a source of general international law,[3] shows that the right to regulate finds its typical scope of application in the cases of indirect expropriation, i.e. those expropriations which are not the result of a single expropriatory act, but of a series of measures which deprive the investment of its economic value and are, therefore, tantamount to expropriation. For the sake of clarity, the right to regulate doctrine does not find, in principle, application in the less grave cases of violations of the fair and equitable treatment (FET) standard, which have to be assessed on the basis of the principle of proportionality:[4] To detect a violation of the FET, it is necessary to ascertain whether State measures limiting investors' rights are necessary, suitable and proportional *stricto sensu* with respect to their goals; if the answer is in the positive, no violation took place. The situation is obviously different in the cases where there is a treaty clause of general application (the so-called 'exception clauses' or lists of 'non precluded measures') providing for the applicability of the right to regulate rule to all policy measures which fall into the scope of application of the same clause. The reference applies, usually, to

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[2] Shotaro Hamamoto, 'Aikaterini Titi, The Right to Regulate in International Investment Law' (2016) European Yearbook of International Economic Law 835. The expropriation may take place also at a very preliminary stage of the investment's life, due to a State's denial of the permission for the investment going on as an exercise of the States' 'Golden Power'. See Fulvio Maria Palombino, '*Golden Power* e *Power to Regulate* a fronte dell'emergenza sanitaria: due facce della stessa medaglia' (2020) Democrazia e diritti sociali 237.

[3] See the analysis and the conclusions reached by Donato Greco, 'Multinational Enterprises and Labour Standards in International Investment Law and Arbitration' (2022) 1 Diritti Lavori Mercati Internationali 57.

[4] Fulvio Maria Palombino, *Fair and Equitable Treatment and the Fabric of General Principles* (TMC Asser Press 2018) 123ff.

those measures which find an objective motivation in the necessity to act in prejudice of investors' rights in order to safeguard public interests.[5]

The role of the right to regulate in the current debate on international investment law is crucial because it is considered essential to integrate non-economic concerns in an area of international law which, at least according to the wording of 'old generation' or 'first generation' bilateral investment treaties (BITs), was detached from this kind of values and only set forth very general commitments of States towards foreign investors without any duty of investors in carrying out their investment.[6] It is not by chance that, as we will see, on the one hand, modern BITs (pertaining to the so-called 'new generation') endorse the right to regulate without further specification (hence, justifying the violation of any of the standards of treatment contained therein) within their texts, and, on the other hand, arbitral tribunals have applied this doctrine – especially in expropriation cases, i.e. on the basis of its content as recognised in general international law –, even if it was not enshrined in the wording of the relevant treaty.

No doubt that the right to regulate, which will be hereby analysed in general terms, may find specific applications in 'climate-change-related investment arbitration cases',[7] in which States may adopt measures prejudicial to investors' rights with the goal of either safeguarding the environment from the negative consequences of climate change or preventing climate change.[8]

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[5] Domenico Pauciulo, *La promozione dello sviluppo sostenibile negli accordi internazionali sugli investimenti esteri* (Edizioni Scientifiche Italiane 2023) 195.

[6] Saverio Di Benedetto, *International Investment Law and the Environment* (Edward Elgar Publishing 2013). Nowadays the situation is changing. BITs refer to investors duties and the case law has stated that general international law provides for investors' rights and duties. See *David R Aven and Others v Republic of Costa Rica*, ICSID Case No UNCT/15/3, Award, 18 September 2018, paras 689ff.

[7] In this regard, see Laurent Guiffés and Melissa Ordonez, 'Climate change in international arbitration, the next big thing?' (2021) 40(2) Journal of Energy and Natural Resources Law 1, 14ff.

[8] Apart from this, it is likely that investors will be increasingly burdened by duties related to ESG (environmental, social, governance) as testified by the adoption, in particular in the EU, of Regulations and Directives that require them to comply with

On the basis of the above clarifications on the concept of 'right to regulate' and referring to the doctrine as developed in general international law, below we will briefly discuss, *first*, the approaches which have characterised the application of this concept; *second*, the doctrine's interaction with the protection of investors' legitimate expectations; and, *last*, the role of proportionality in the application of the right to regulate.

2. Approaches to the Right to Regulate

This Section will discuss how the concept of the right to regulate has been treated in the case law. It will start by discussing the so-called 'sole effects doctrine' and then discuss the gradual affirmation of the doctrine as an essential attribution of States in order to arrive at the analysis of the case law which affirms that no violation of international investment law takes place when there is a legitimate exercise of the right to regulate.

2.1 Phase 1: The 'Sole Effects Doctrine'

The 'sole effects doctrine' is an approach to indirect expropriation which only takes into account – to the end of ascertaining the existence of an expropriation – the effects of the measures adopted by States, which shall be 'tantamount to expropriation' (in this regard it is possible to talk of 'regulatory takings'). This approach was mainly allowed due to the generic wording of older BITs (the so-called 'first generation' BITs), which gave investors the possibility to claim damages in the presence of expropriatory measures, regardless of the aim of the State implementing the measure.

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certain obligations (also in terms of accountability) as to the respect of ESG standards. These duties might have a role to play in investment arbitration at least where relevant investment treaties include a so-called 'in accordance with the host State law' clause, the application of which may deprive of protection investments which have been started not in compliance with the relevant duties in terms of ESG. See, as to the applicability of the 'in accordance with the host State law' clause, Giovanni Zarra, 'International Investment Treaties as a Source of Human Rights Obligations for Investors' in Martina Buscemi et al (eds), *Legal Sources in Business and Human Rights* (Brill-Nijhoff 2020) 56ff.

According to the tribunal in *Santa Elena v Costa Rica*,[9] expropriatory measures, no matter how laudable and beneficial as a whole, are similar to any other expropriatory measure that a State may take in order to implement its policies. Where propriety is expropriated, even for environmental purposes, whether domestic or international, the State's obligation to pay compensation remains.

Not far from this approach are the decisions in *Pope & Talbot v Canada*[10] and *Patrick Mitchell v Congo*.[11]

These awards, which are not very recent, confirm the idea that in the vast majority of cases the sole effects doctrine has found application in decisions preceding 2010. More recently, possibly also in order to legitimise their role as neutral adjudicators, arbitral tribunals are particularly caring about the public concerns behind States' measures and are either finding ways to balance them with investors' economic rights or trying in any case to offer adequate reasons for awarding damages to claimants notwithstanding the existence of a certified public purpose behind States' measures.[12]

Surprisingly enough, and indeed in an isolated case, in the more recent *Rockhopper v Italy* decision,[13] the Tribunal, while awarding damages to the investor, did not even consider the environmental purpose behind the measures assumed by the Respondent. In this regard, we are not claiming that the solution adopted by the Tribunal in the merits is wrong, but simply that it should have been better argued in order to clarify why the Tribunal

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[9] *Compañia del Desarrollo de Santa Elena SA v Republic of Costa Rica*, ICSID Case No ARB/96/1, Award, 17 February 2000.

[10] *Pope & Talbot Inc v The Government of Canada*, UNCITRAL, Decision, 6 September 2000.

[11] *Mr Patrick Mitchell v Democratic Republic of the Congo*, ICSID Case No ARB/99/7, Award, 9 February 2004.

[12] Giovanni Zarra, 'The Issue of Incoherence in Investment Arbitration: Is There Need for a Systemic Reform?' (2018) 17 Chinese Journal of International Law 137.

[13] *Rockhopper Exloration PLC, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic*, ICSID Case No ARB/17/14, Final Award, 23 August 2022, paras 190ff.

decided to overcome the environmental arguments made by Italy. To this respect, it is worth noting that the *Rockhopper* award was recently annulled by an ICSID *ad hoc* Committee on procedural grounds concerning the constitution of the arbitral tribunal, and more precisely the failure of an arbitrator to disclose a past criminal conviction.[14]

2.2 Phase 2: Gradual Affirmation of the 'Right to Regulate' as a Way to Avoid Compensation

Following the significant backlash against the allegedly too investor-friendly attitude assumed by arbitral tribunals, the idea that the right to regulate is an essential attribution of States started gaining importance, notwithstanding the fact that 'first generation' BITs were still there. Tribunals started to include this kind of States' attribution, which gradually started to be treated as a general rule of international law (regardless of the truthfulness of this statement),[15] within their reasoning by way of interpretation of existing treaties. Certain soft law instruments had been certainly useful to achieve this goal. The reference applies, in particular, to Article 15 of the 1961 Harvard Draft Convention for State Responsibility for Injury to Aliens, which in presence of the necessity to safeguard essential public interests justifying expropriatory measures still considers a taking (i.e. an expropriation) existing but excludes the necessity of a compensation.

Tribunals adhering to this approach, indeed, mainly tended to exclude compensation by States, notwithstanding the finding of an expropriation. In *Chemtura v Canada*,[16] the Tribunal stated that the State took expropriatory measures within its mandate, in a non-discriminatory manner, motivated by the awareness of the risks posed by lindane (a pesticide produced by the

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[14] *Rockhopper Exloration PLC, Rockhopper Italia SpA and Rockhopper Mediterranean Ltd v Italian Republic*, ICSID Case No ARB/17/14, Decision on Annullment, 2 June 2025.

[15] Giovanni Zarra, 'Right to Regulate, Margin of Appreciation and Proportionality: Current Status in Investment Arbitration in Light of Philip Morris v. Uruguay' (2017) 14 Brazilian Journal of International Law 96.

[16] *Chemtura Corporation v Government of Canada*, UNCITRAL, Award, 2 August 2010, paras 265-266.

investor) for human health and the environment. For this reason, compensation was not due.

A similar approach was taken in *Saluka v Czech Republic*,[17] *Marfin v Cyprus*,[18] *Casinos Austria v Argentina*.[19]

In all these cases, unlawful expropriations were still taking place, but the Tribunal considered it worthwhile to avoid any form of compensation due to the legitimate exercise of police powers.

2.3 Phase 3: The 'Right to Regulate' as a Way to Avoid Expropriation

According to a third approach, the exercise of the right to regulate is a way to exclude the very existence of an expropriation. This is due to the affirmation of a rule of general international law, which is a more specific expression of the principle of State sovereignty, peculiar to the field of international investment law.[20]

Traces of this rule may be found in newly drafted international investment agreements, in soft law instruments and in the case law.

As to treaties, it is possible to mention Article 3 of Annex 8 of the Comprehensive Economic Trade Agreement between the European Union and Canada (CETA), which excludes the existence of a taking in presence of an exercise of the right to regulate (even if not in cases of manifestly excessive

[17] *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paras 260-262.

[18] *Marfin Investment Group v The Republic of Cyprus*, ICSID Case No ARB/13/27, Award, 26 July 2018, para 826.

[19] *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft v Argentine Republic*, ICSID Case No ARB/14/32, Award, 5 November 2021, paras 333-34.

[20] See Pauciulo (n 5) 185, 211.

measures taken by the State); the Italian,[21] Moroccan[22] and Indian[23] Model BITs; Article 23 of the Nigeria-Marocco BIT of 2016; Article 33 of the Canada-China BIT. In any case, almost all modern investment treaties refer to the police powers of the State (either in the preamble or in the main text).[24]

As to soft law instruments, it is possible to mention the 1987 Third Restatement of Foreign Relations Law, which affirms that 'a State is not responsible' if it legitimately uses its police powers.

As to the case law, many decisions have applied this kind of approach regardless of the wording of the relevant investment treaty. The first of them is the *Methanex* award, in which the tribunal stated that measures constituting an exercise of the power to regulate are not expropriatory and, thus, not compensable.[25]

In *Philip Morris v Uruguay*,[26] the Tribunal affirmed that non-discriminatory and proportionate measures, adopted in good faith, are not expropriatory, if they are aimed at ensuring the public welfare.

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[21] See Italian Model Bilateral Investment Treaty (2022), Preamble and art 6.

[22] See Moroccan Model Bilateral Investment Treaty (2019), art 10.8(c): 'Conformément au droit des Etats à réglementer et aux principes du droit international coutumier relatifs aux pouvoirs de police de l'Etat, les mesures législatives et réglementaires de bonne foi et non discriminatoires prises par une Partie dans le but de protéger ou améliorer les objectifs légitimes de bien-être public tels que la santé publique, la sécurité, l'environnement et le travail, ou qui donnent lieu à une imposition générale légitime ou à une modification de la valeur de la monnaie nationale ou tout type d'action communément accepté comme entrant dans le cadre du pouvoir de police des Etats, ne constituent pas une expropriation indirecte en vertu du présent article et ne seraient donc soumises à aucune exigence de compensation'.

[23] Indian Model Bilateral Investment Treaty (2015), art 5.

[24] See Pauciulo (n 5) 185ff.

[25] *Methanex Corporation v United States of America*, UNCITRAL, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, pt 4, ch D, para 7.

[26] *Philip Morris SARL et al v Oriental Republic of Uruguay*, ICSID Case No ARB/10/7, Award, 8 July 2016.

In *Olympic Entertainment v Ukraine*,[27] this approach was endorsed notwithstanding the fact that Article 5 of the Estonia-Ukraine BIT recognised that all expropriations were compensable, an argument that the tribunal overcome by arguing that the treaty parties agreed on the applicability of the police powers doctrine to investment located in their territory.

The same approach was adopted in *Infinito v Costa Rica*[28] and *Eco Oro v Colombia*[29] (where the majority of the Tribunal held that the respondent State's decision to prohibit mining activities in environmentally sensitive wetlands did not amount to an unlawful expropriation by operation of the right to regulate, as per the Canada-Colombia Free Trade Agreement's Annex on expropriation).

3. Relationship with Legitimate Expectations and Proportionality

Not everybody agrees with a bold application of the third approach to the doctrine of the power to regulate. As witnessed by Grigera Naon's Dissenting Opinion[30] in *Eco Oro* (which, however, has been criticised by scholarship),[31] according to somebody, if there are specific commitments assumed by the State, they have to be taken into account notwithstanding the

[27] *Olympic Enterntainment Group AS v Ukraine*, PCA Case No 2019-18, Award, 15 April 2021, paras 62ff.

[28] *Infinito Gold Ltd v Costa Rica*, ICSID Case No ARB/14/5, Award, 3 June 2021, para 699.

[29] *Eco Oro Minerals Corp v Republic of Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, 9 September 2021, para 699. See Robert Garden, 'Eco Oro v Colombia: The Brave New World of Environmental Exceptions' (2023) 38 ICSID Review 17.

[30] *Eco Oro* (n 29) para 11.

[31] See Garden (n 29) 20: 'Eco Oro majority's approach appears well founded, given that the FTA did not explicitly exclude the application of general international law or otherwise conflict with the application of the police powers doctrine under general international law'.

legitimate exercise of the right to regulate. According to Grigera Naon, Colombia's conduct was to be considered forbidden by falling within the 'rare circumstances' enshrined in the FTA's expropriation Annex, because 'normal circumstances require not applying retroactively laws or regulations interfering with contractual rights and defeating acquired rights or expectations associated with such rights', and, 'if such interference happens, a "rare circumstance" is engendered, and compensation may be appropriate'.

As it was said in *Castillo Bozo v Panama*,[32] deference to States' measures is not a *carte blanche* and States' police powers are not absolute.

How could we overcome this conundrum? A solution might be found in the principle of proportionality,[33] which, in order to consider whether a measure is expropriatory, applies a tripartite test based on suitability, necessity and proportionality *stricto sensu*. This means that expropriatory measures shall be *(i)* apt to reach their goals; *(ii)* the less intrusive measure among those at the State's disposal; and *(iii)* concretely proportional to the goals behind their enactment.[34]

This approach has the advantage to allow tribunals to consider all concrete circumstances.[35]

While the Third Restatement and the Harvard Draft Convention do not mention it, it may find a genesis in the *Tecmed v Mexico*[36] award.

In *Olympic Entertainment*,[37] Ukraine enacted a ban of gambling involving the withdrawal of the investor's licence which was allegedly sudden,

[32] *Leopoldo Castillo Bozo v Republica de Panama*, PCA Case No 2019-40, Final Award, 8 November 2022, para 514.

[33] See Pauciulo (n 5) 205.

[34] See Palombino (n 4) 123ff.

[35] A need expressed by Piero Bernardini, 'Reforming Investor–State Dispute Settlement: The Need to Balance Both Parties' Interests' (2017) 32 ICSID Review 38.

[36] *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, UNCITRAL, Award, 29 May 2003, para 122.

[37] *Olympic Enterntainment* (n 27) paras 90ff.

unexpected and not followed, as it was promised, by the creation of gambling zones in Ukraine. The Tribunal included proportionality in its analysis on the legitimate exercise of police powers and it recognised the role of proportionality as an 'important factor' in international investment law, defining it as 'one of the principles of justice recognised by the principal legal systems of the world'. In this regard, it seems that the Tribunal treated proportionality as a general principle common to domestic legal systems, while other scholars framed it as a general principle originated in the international legal system. Apart from this theoretical discussion, the Tribunal found that no weight was attributed by the State to the investor's needs, no dialogue with the investor took place before the assumption of the prejudicial measures which had immediate effect. The investor did not have at its disposal any remedy to the measure, and no compensation was foreseen notwithstanding a substantial deprivation of its rights took place through the withdrawal of the licence.

In *Bank Melli v Bahrein*,[38] the Tribunal affirmed that the suspension of a bank licence must be necessary (i.e. the less intrusive possible means). Should the requirement of necessity not be respected – or should the Respondent not offer evidence of this respect – the principle of proportionality is not considered respected.

In light of the above, recent case law shows that to avoid expropriation States should adopt measures that comply with the principle of proportionality.

As generally stated by Cannizzaro, proportionality thus works as a tool which is necessary for the functioning of other international law rules, and, in our opinion, these rules might include the power to regulate waiving to commitments assumed to international investors.[39]

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[38] *Bank Melli Iran and Bank Saderat Itan v The Kingdom of Bahrain*, PCA Case No 2017-25, Award, 9 November 2021, paras 682ff.

[39] Enzo Cannizzaro, *Il principio di proporzionalità nell'ordinamento internazionale* (Giuffrè 2000) 429.

On this basis, it was also proposed[40] that proportionality is used in order to graduate the amount of damages due to investors in presence of regulatory takings. However, while this approach is fascinating, it brings uncertainty, considering that it is difficult to imagine a 'contributory fault' model applicable in this kind of situation: how would a tribunal determine how much to ask to a State? This is the reason why a similar approach was already abandoned by the European Court of Human Rights.[41]

[40] Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 Journal of World Investment & Trade 717.

[41] See Maria Luisa Padelletti, 'Protocollo n. 1 – Art. 1', in Sergio Bartole et al (eds), *Commentario breve alla Convenzione Europea dei Diritti dell'Uomo* (Cedam 2012) 800-801.

6

Counterclaims in ISDS: Solution or Distraction?[1]

Simon Batifort, Irene Petrelli, Cyprien Mathié

1. Introduction

States are 'perpetual respondents' in investment treaty arbitration.[2] They cannot initiate arbitral proceedings because international investment agreements (IIAs) contain only the contracting States' advance offer to arbitrate, not the investor's.[3] The extent to which States can present counterclaims is also debated, as IIAs are often unclear as to the jurisdiction of

[1] The views expressed herein are the authors' own and do not necessarily reflect those of Curtis, Mallet-Prevost, Colt & Mosle or its clients.

[2] Mehmet Toral and Thomas Schultz, 'The State, A Perpetual Respondent in Investment Arbitration? Some Unorthodox Considerations' in Michael Waibel et al (eds), *The Backlash Against Investment Arbitration* (Kluwer 2010) 578.

[3] See Jan Paulsson, 'Arbitration without Privity' (1995) 10 ICSID Review 232: '[t]his new world of arbitration is one where the claimant need not have a contractual relationship with the defendant and where the tables could not be turned: the defendant could not have initiated the arbitration, nor is certain of being able to bring a counterclaim'.

arbitral tribunals over counterclaims and they rarely contain express substantive investor obligations.[4]

Such a structural 'anti-State bias'[5] has long been decried for creating an imbalanced system of investor-State dispute settlement (ISDS).[6] Criticism has intensified over the past two decades with the development of concepts such as corporate social responsibility[7] and in reaction to instances in which investors were alleged to have caused damage to the environment or violated human rights.[8]

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[4] See infra, para 2.

[5] Ina C Popova and Fiona Poon, 'From Perpetual Respondent to Aspiring Counterclaimant? State Counterclaims in the New Wave of Investment Treaties' (2015) 2(2) BCDR International Arbitration Review 224.

[6] See e.g. Andrea K Bjorklund, 'The Legitimacy of the International Center for the Settlement of Disputes' in Nienke Grossman et al (eds), *Legitimacy and International Courts* (Cambridge University Press 2018) 476.

[7] For one of the first major reports highlighting the necessity of the concept and its modern contours, see UNCTAD, 'Social Responsibility' (2001) UNCTAD/ITE/IIT/22 (identifying several areas including the environment, labor, competition, transfer pricing, corruption and bribery, technology transfer, and transparency that have since been addressed in a significant number of international investment agreements). The OECD has conducted significant work on the intersection between investment treaties and investor responsibilities *inter alia* with respect to the environment and human rights. See David Gaukrodger, *Business Responsibilities and Investment Treaties* (OECD 2020) (analyzing developments potentially relevant to investment treaty policy in the area of business and investor responsibilities); David Gaukrodger, *The Future of Investment Treaties - Possible Directions* (OECD 2021) (surveying the potential role of investment treaties in 'contributing to sustainable development and responsible business conduct').

[8] In the context of ISDS cases, see e.g. *Pacific Rim v El Salvador*, ICSID Case No ARB/09/12 (alleged contamination of water by toxic products related to the activities of a mining company); *Chevron Texaco v Ecuador (II)*, PCA Case No 2009-23 (alleged contamination resulting from crude oil production in the Amazon region); *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA Case No 2012-2 (alleged human rights violations against local communities opposed to a mining concession). See generally UN General Assembly, 'Report of the Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment, David R Boyd' (13 July 2023) UN Doc A/78/168, 2 (arguing that 'investor-

Against this backdrop, commentators and stakeholders have often portrayed the recognition of States' right to counterclaim as a key element for resolving the legitimacy crisis facing ISDS. Many argue that allowing counterclaims will increase the 'faith' of States in ISDS and will contribute to achieving a new equilibrium.[9] Discussions on this topic within UNCITRAL Working Group III on ISDS reform have also referred to counterclaims as

State dispute settlement has become a major obstacle to the urgent actions needed to address the planetary environmental and human rights crises').

[9] Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' (2011) Czech Yearbook of International Law 154; Charles Brower, *Judging Iran* (Disruption Books 2023) 230 (arguing that 'the system has historically been geared toward allowing investors to sue states – not the way around' but that this is 'less of a problem than it has been in the past' as illustrated by the fact that Ecuador 'won a huge counterclaim for environmental damage in the *Perenco* case'); Andrea K Bjorklund, 'The role of counterclaims in rebalancing investment law' (2013) 17 Lewis & Clark Law Rev 461, 465 ('[c]ounterclaims show some promise as a means to rebalance investment law by bringing all claims related to the subject matter at hand within the purview of a single tribunal's authority'); Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' (2019) 113 American Journal of International Law 33 ('counterclaims in investment arbitration may promote the thicker elements of the rule of law such as accountability to the law, access to justice, and fairness in the application of the law'); Maggie Ng, 'Can Human Rights Counterclaims Succeed in Investment Treaty Arbitration' (2018) 15(5) Transnational Dispute Management 1 (arguing that counterclaims 'can be a useful tool in balancing the asymmetry caused in part by responding States being always on the defence in investment disputes, and that tribunals ought not to shy away from proper consideration of human rights counterclaims where legal conditions allow'); Flavia Marisi, *Environmental Interests in Investment Arbitration* (Kluwer Law International 2020) 237, 250 ('[a]llowing governments to make counterclaims would also enhance the legitimacy of the ISDS system, contrasting worries regarding lack of ISDS symmetry, due to states being denied the rights and remedies enjoyed by investors'); Alison MacDonalds, Peter Webster and Mubarak Waseem, 'Climate change, international investment law and arbitration' (*Essex Court Chambers*, 7 March 2023) <https://essexcourt.com/publication/climate-change-international-investment-law-and-arbitration-week-4-series-2/> ('[t]he ISDS system is sometimes criticised as being "asymmetrical", providing protections only for investors, without providing sufficient protection for States. However, the potential exists for States to bring counterclaims against investors in appropriate circumstances').

an important tool for reducing uncertainty, enhancing procedural efficiency, and promoting the rule of law.[10]

In this contribution, we discuss the extent to which counterclaims are likely to constitute a solution to the legitimacy crisis faced by ISDS. In section 2, we recall the main legal hurdles to State counterclaims that have been identified and debated. In section 3, we discuss recent arbitral and treaty practice addressing those hurdles. In section 4, we argue that, even if counterclaims were made broadly accessible, this may have a limited impact in practice due to the current structure of investment treaty arbitration. Section 5 concludes.

2. Recurring Legal Hurdles

Four main issues have surfaced in ISDS practice when considering counterclaims.

First, the existence and scope of a tribunal's jurisdiction over counterclaims depend on the parties' consent to counterclaims in the applicable treaty. Some treaties expressly provide that a dispute can be brought to arbitration only by the investor, which some tribunals have found precludes jurisdiction over counterclaims.[11] However, the majority of IIAs are silent on the

[10] See UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its forty-ninth session (Vienna, 23-27 September 2024)' (16 October 2024) paras 71-81; UNCITRAL, 'Annotations to the draft provisions on procedural and cross-cutting issues' (8 July 2024) A/CN.9/WG.III/WP.245, para 37; UNCITRAL, 'Annotations to the draft provisions on procedural and cross-cutting issues' (31 July 2023) A/CN.9/WG.III/WP.232, para 27; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020)' (10 November 2020) A/CN.9/1044 para 60; UNCITRAL 'Possible Reform of Investor-State Dispute Settlement (ISDS)' (22 January 2020) A/CN.9/WG.III/WP.193, para 38; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November-1 December 2017)' (26 February 2018) A/CN.9/930/Add.A/Rev.1, para 5.

[11] See e.g. *Rusoro Mining Ltd. v Bolivarian Republic of Venezuela* ('*Rusoro v Venezuela*'), ICSID Case No ARB(AF)/12/5, Award, 22 August 2016, paras 622-627 (holding that a treaty providing that 'an investor may submit a dispute' to arbitration

possibility of counterclaims. In such cases, investment tribunals have generally found that they had jurisdiction over counterclaims, including in the following circumstances: (*i*) where the dispute resolution clause of the applicable treaty is broadly worded, subjecting 'any' or 'all' or simply 'disputes' to arbitration;[12] (*ii*) where the ISDS provision excludes counterclaims only in specific circumstances, prompting tribunals to hold that the treaty *a contrario* generally envisions counterclaims;[13] and (*iii*) where consent to counterclaims was found to derive from the choice of arbitration

did not permit the respondent State to assert counterclaims). See also *Spyridon Roussalis v Romania* ('*Roussalis v Romania*'), ICSID Case No ARB/06/1, Award, 7 December 2011, paras 865-869; *Iberdrola Energía, S.A. v The Republic of Guatemala (II)* ('*Iberdrola v Guatemala II*'), PCA Case No 2017-41, Final Award, 24 August 2020, para 391.

[12] See e.g. *Saluka Investments BV v The Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004, para 39 (in which the tribunal held that 'the jurisdiction conferred upon it […] is in principle wide enough to encompass counterclaims' based on Art 8 of the Netherlands-Czech BIT, which stated that 'all disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter' were subject to arbitration); *Urbaser SA and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic*, ICSID Case No ARB/07/26, Award, 8 December 2016, para 1144 (analysing the dispute resolution clause of the Argentina-Spain BIT under which any dispute between the parties could be submitted to arbitration and any of the parties could start proceedings, and holding that 'the dual possibility to initiate an arbitration [...] does include [...] the hypothesis of a counterclaim […]. Indeed, when both parties are entitled to lodge a claim, it cannot happen that in acting first one party could prevent the other from raising its claim. This can be avoided only by admitting the possibility of a counterclaim').

[13] See e.g. *David R Aven and Others v Republic of Costa Rica*, ICSID Case No UNCT/15/3, Award, 18 September 2018, paras 691-694. The tribunal analysed the Dominican Republic–Central America Free Trade Agreement (DR-CAFTA), which provides that '[a] respondent may not assert as a defense, counterclaim, right of set-off, or for any other reason that the claimant has received or will receive indemnification or other compensation for all or part of the alleged damages pursuant to an insurance or guarantee contract', and found that this clause meant that the DR-CAFTA generally permitted counterclaims except in those specific circumstances.

rules providing for such counterclaims, such as Article 40 of the ICSID Arbitration Rules.[14]

Second, a counterclaim must be sufficiently connected to the principal claim to be admissible. The ICSID Convention specifically refers to counterclaims 'arising directly out of the subject matter of the dispute'.[15] Other arbitration rules are generally silent on this point but some tribunals have found that this requirement reflects a 'general principle' that must be applied nonetheless.[16] One key question that has arisen is whether the counterclaim must have the same legal basis as the primary claim (*de jure* connection), whether it must arise out of the same factual circumstances (*de facto* connection), or both.[17]

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[14] See, for example, *Antoine Goetz & Consorts et SA Affinage des Métaux v République du Burundi*, ICSID Case No ARB/01/2, Award, 21 June 2012, paras 278-279 (holding that, by entering into a BIT that does not refer expressly to counterclaims but provides for ICSID arbitration, the parties accepted the tribunal's jurisdiction over such counterclaims). See also *Spyridon Roussalis v Romania*, ICSID Case No ARB/06/1, Declaration of W Michael Reisman, 28 November 2011 ('when the State Parties to a BIT contingently consent, inter alia, to ICSID jurisdiction, the consent component of Article 46 of the Washington Convention is ipso facto imported into any ICSID arbitration which an investor then elects to pursue.'). Cf *Iberdrola v Guatemala (II)*, PCA Case No 2017-41, Final Award, 24 August 2020, paras 389 and 391 (finding that this reasoning cannot apply 'where the wording of the Treaty provision indicates, to the contrary, that only the investor can claim').

[15] ICSID Arbitration Rules (2022), art 46.

[16] See e.g. *Saluka* (n 12) para 76 (relying on 'a general principle as to the nature of the close connection which a counterclaim must have with the primary claim').

[17] ibid, paras 78-79, in which the tribunal opted for a *legal* connection, holding that 'a general legal principle as to the nature of the close connection which a counterclaim must have with the primary claim' exists and insisting upon the 'interdependence and essential unity of the instruments on which the original claim and counterclaim [are] based'. By contrast, in the more recent case of *Inmaris v Ukraine*, the tribunal relied on the fact that the counterclaim was 'a component of the larger dispute that Claimants have consented to submit'. See *Inmaris Perestroika Sailing Maritime Services GmbH and Others v Ukraine*, ICSID Case No ARB/08/8, Award, 1 March 2012, para 432. This requirement was also specifically considered by the tribunal in *Oxus Gold v Uzbekistan* to dismiss the state's counterclaim. See *Oxus Gold v Republic of Uzbekistan*, UNCITRAL, Final Award, 17 December 2015, paras 952-956. Regarding the need for a

Third, a State has no standing to claim damages that it has not itself suffered. This gives rise to debates when a counterclaim is based on a violation of human or environmental rights belonging to the nationals of the host State rather than to the State itself,[18] or when a counterclaim results from a breach of contract to which the State is not a party.[19]

Fourth, even if a tribunal upholds jurisdiction and finds the counterclaim admissible, the host State still has to establish that it is grounded in a cognizable cause of action, *i.e.* a substantive environmental or human rights obligation that the investor has breached. The question then arises as to which sources of law define the investor's obligations: treaty provisions, other sources of international law, and/or domestic law. Establishing a cause of action for a counterclaim based on international law obligations can prove to be difficult, as few direct international obligations are imposed

legal connection, tribunals have found in some cases that domestic law-based counterclaims were insufficiently connected to principal claims based on IIAs. See *Saluka* (n 12) para 79; *Sergei Paushok et al v The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, paras 684-95; *Marco Gavazzi and Stefano Gavazzi v Romania*, ICSID Case No ARB/12/25, Decision on Jurisdiction, Admissibility and Liability, 21 April 2015, para 154. That solution has been criticized; see Xuan Shao, 'Environmental and Human Rights Counterclaims in International Investment Arbitration: at the Crossroads of Domestic and International Law' (2021) 24 Journal of International Economic Law 157, 171 (arguing that 'where other factors favour the admissibility of an environmental or human rights counterclaim, its domestic law basis, even public law basis, should not stop the tribunal from hearing the counterclaim.').

[18] In *Chevron Texaco v Ecuador (II)*, PCA Case No 2009-23, Second Partial Award on Track II, 30 August 2018, the tribunal dismissed Ecuador's counterclaim for environmental damage having found that 'individual claims for personal harm from environmental damage ... are not and cannot be claims asserted by the Respondent in its own right against Chevron' (para 7.39), as it was 'a right belonging only to these individual plaintiffs alleging personal harm' (para 7.42).

[19] In *Hamester v Ghana*, the tribunal rejected the host State's counterclaims *inter alia* because they were based on a contract to which Ghana was not a party. See *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No ARB/07/24, Award, 18 June 2010, para 356.

on non-State actors such as investors.[20] The primary source for investor's environmental and human rights obligations is domestic law. And some tribunals have dismissed counterclaims precisely because they were based on the host State's domestic law and not on any specific provision of the treaty.[21]

3. Evolutions in Arbitral and Treaty Practice

States lodge counterclaims relatively rarely, in approximately 3 per cent of known cases based on IIAs.[22] While counterclaims had a slow start, they appear to be on the rise, with more than half of the 36 arbitrations based on IIAs we have identified as involving counterclaims filed since 2015. Beyond the numbers, recent arbitral and treaty practice tends to reflect a favorable evolution when it comes to the acceptance of counterclaims.

Several tribunals have admitted jurisdiction over counterclaims, and some have awarded damages to States. However, on closer examination, these developments may be less significant than they appear. Some of these cases involved the rare scenario of an express agreement between the parties on counterclaims or express substantive obligations in a treaty. In the well-

[20] Shao (n 17) 161 ('[u]nder current international law, general international human rights law only affects the obligations of private actors "indirectly" through domestic laws. Also, there is little evidence supporting the proposition that general international environmental law imposes direct obligations on private actors.').

[21] *Anglo American PLC v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/14/1, Award, 18 January 2019, para 529; *Rusoro Mining Ltd v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/12/5, Award, 22 August 2016, paras 619-629. A number of investment treaties contain 'in accordance with the law' provisions, under which any investment must be made in accordance with the host State's laws. However, those clauses have generally been invoked to deny jurisdiction over investments that are not made in accordance with the host State's laws, rather than to impose liability upon investors.

[22] Our review of known ISDS cases based on IIAs reveals that only 36 cases have involved counterclaims out of over 1,200 known investment treaty arbitrations (as of 2022).

known *Burlington v Ecuador* case, the tribunal upheld jurisdiction where the parties had entered into an agreement to allow Ecuador to raise counterclaims based on Ecuadorian law, leading to an award of damages for the State.[23] The tribunal awarded only a fraction of the counterclaim, which was offset by the large amount of compensation awarded to the claimant.[24] In *Al Warraq v Indonesia*, the tribunal upheld jurisdiction over counterclaims for violation of domestic laws, which was based on an express provision in the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organization of the Islamic Conference (OIC) imposing an obligation on investors *inter alia* to comply with domestic laws. The tribunal held that this provision raised the general obligation of an investor to comply with the host State's laws 'from the plane of domestic law (and jurisdiction of domestic tribunals) to a treaty obligation binding on the investor in an investor state arbitration'.[25]

Another line of cases recognized the availability of counterclaims but ultimately rejected them. In *Urbaser v Argentina*, while the tribunal found jurisdiction over the State's counterclaim and held that investors do have obligations under international law, it ruled that a corporation cannot be

[23] *Burlington Resources Inc v Ecuador*, ICSID Case No ARB/08/5, Procedural Order No 8, 21 July 2011 (formalizing the parties' agreement enabling Ecuador to submit counterclaims); ibid, Decision on Liability, 14 December 2012, para 93 (upholding Ecuador's counterclaim). In the *Perenco* case concerning the same project, no express agreement was entered between the parties regarding the possibility of counterclaims, but Perenco did not contest the jurisdiction of the tribunal or the admissibility of the claims. Perenco argued only that Ecuador's counterclaims were identical to those raised in the *Burlington* case and should be dismissed on grounds of *res judicata*, an argument that the tribunal rejected. See *Perenco Ecuador Ltd v The Republic of Ecuador and Petroecuador*, ICSID Case No ARB/08/6, Interim Decision on the Environmental Counterclaim, 11 August 2015, paras 35-36.

[24] While Burlington was awarded USD 379 million together with interest and Perenco more than USD 449 million, the two companies were ordered to pay Ecuador USD 42 million and USD 54 million respectively – only a fraction of the counterclaims advanced by Ecuador (USD 2.5 billion). See *Burlington* (n 23), Decision on Reconsideration and Award, 7 February 2017, para 635; ibid, Decision on Counterclaims, 7 February 2017, paras 1075 and 1099; *Perenco* (n 23) Award, 27 September 2019, para 1023.

[25] *Hesham Talaat M Al-Warraq v The Republic of Indonesia*, UNCITRAL, Final Award, 15 December 2014, para 663.

responsible for the violation of the human right to water, which falls under the sole responsibility of the State, and dismissed the counterclaim.[26] The situation might be different in the context of obligations to abstain from harming the environment and human rights, which can be more easily applied to private parties. For example, in *David Aven v Costa Rica*, the tribunal found that the view that investors may have certain international law obligations is 'particularly convincing when it comes to rights and obligations that are the concern of all States, as it happens in the protection of the environment', that DR-CAFTA could be read as providing an obligation for investors to 'abide by and comply with the measures taken by the host State to protect the environment', and that there were no reasons of principle preventing a respondent State from presenting a counterclaim under the treaty.[27] At the same time, it noted that the treaty did not provide that 'any violation of state-enacted environmental regulations will amount to a breach of the Treaty which could be the basis of a counterclaim' and rejected the counterclaim on that ground as well as untimeliness.[28]

With regard to treaty practice, a number of so-called new-generation IIAs contain express references to investor obligations and to States' ability to bring counterclaims to enforce them. The first treaty to do so was the 2007 Common Market for Eastern and Southern Africa (COMESA) Investment Agreement, which provides for certain investor obligations, including 'to comply with all applicable domestic measures', and specifies that the contracting States may bring counterclaims in case of breach by the investor.[29]

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[26] *Urbaser* (n 12), para 1220 ('[r]espondent does not state any legal ground for any individual's right to claim damages as a consequence of an alleged violation of the human right to water').

[27] *David R Aven and Others v Republic of Costa Rica*, ICSID Case No. UNCT/15/3, Award, 18 September 2018, paras 738-739.

[28] ibid, paras 745-747. This was because the counterclaim was not sufficiently precise as to the damages sought and did not follow any proper method of valuation for remedies, as required under arts 20 and 21 of the United Nations Commission on International Trade Law (UNCITRAL) Rules of Procedure.

[29] COMESA Investment Agreement (signed 23 May 2007) art 28.9 ('[a] Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defense, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement,

Likewise, the 2012 Southern African Development Community Model (SADC) Model BIT imposes a general obligation on investors to respect human rights,[30] establishes minimum standards with which investors must comply,[31] and provides that the host State may bring counterclaims in case of breach.[32] Many other treaties contain similar provisions.[33]

However, the treaties in question rarely, if ever, serve as a basis for ISDS claims in practice. The treaties most commonly invoked by investors remain old-generation treaties entered into by North American and European States with developing countries, which do not contain express provisions on counterclaims or investor obligations.[34] States participating in UNCITRAL Working Group III have been negotiating the text of a multilateral convention and related protocols that could result in modifying old-generation treaties to enable counterclaims.[35] Discussions on draft

including the obligations to comply with all applicable domestic measures or that it has not taken all reasonable steps to mitigate possible damages').

[30] Art 15(1) of the SADC Model BIT (2012) states that '[i]nvestors and their investments have a duty to respect human rights in the workplace and in the community and State in which they are located. Investors and their investments shall not undertake or cause to be undertaken acts that breach such human rights. Investors and their investments shall not assist in, or be complicit in, the violation of the human rights by others in the Host State, including by public authorities or during civil strife'.

[31] See SADC Model BIT, arts 15(2) and 15(3); Morocco-Nigeria BIT, arts 18(3) and 18(4).

[32] SADC Model BIT (2012), art 19.2 ('[a] Host State may initiate a counterclaim against the Investor before any tribunal established pursuant to this Agreement for damages or other relief resulting from an alleged breach of the Agreement').

[33] See e.g. Morocco-Nigeria BIT (2016), arts 18, 26, 28; Iran-Slovakia BIT (2016), art 14(3); Argentina-UAE BIT (2018), art 28(4); Indian Model BIT (2016), art 14(1); Economic Community of West African States (ECOWAS) Supplementary (2008) art 18(5); Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (2018), art 9.19(2).

[34] Even new models issued by developed countries rarely contain express provisions on counterclaims. See, for example, Dutch Model BIT (2019); Czech Republic Model BIT (2016); Norway Model BIT (2015).

[35] The current draft of this multilateral convention appears in UNCITRAL, 'Draft multilateral instrument on ISDS reform' (8 July 2024) A/CN.9/WG.III/WP.246.

provisions on counterclaims are ongoing and the extent to which States participating in negotiations will actually opt into any such provisions remains uncertain.[36]

As treaties, arbitral practice, and science continue to evolve, it remains to be seen whether States and arbitral tribunals will increasingly rely on principles of environmental law and human rights law to bring counterclaims.[37]

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[36] The current text appears in UNCITRAL, 'Draft provisions on procedural and cross-cutting issues' (8 July 2024) A/CN.9/WG.III/WP.244, Draft Provision 10, which provides:

> 1. Where a claim is submitted for resolution, the respondent may make a counterclaim:
> (a) Arising directly out of the subject matter of the claim;
> (b) In connection with the factual and legal basis of the claim;
> (c) That the claimant has failed to comply with its obligations under the Agreement, domestic law, any relevant investment contract or any other instrument binding on the claimant.
> 2. For the avoidance of doubt, the consent of the respondent to the submission of a claim by the claimant is subject to the condition that the claimant consents to any submission of a counterclaim referred to in paragraph 1.
> 3. A counterclaim shall be made no later than in the statement of defence, unless the Tribunal considers that the delay was justified under the circumstances.

[37] See Arman Sarvarian, 'Invoking the Paris Agreement in Investor-State Arbitration' (2023) 38 ICSID Review 422, 438 (arguing based inter alia on cases brought before domestic courts that host States may consider making counterclaims under the Paris Agreement for losses sustained either in terms of higher-than-anticipated emissions from investments or lower-than-anticipated mitigation benefits from green investments); Maxi Scherer, Stuart Bruce and Juliane Reschke, 'Environmental Counterclaims in Investment Treaty Arbitration' (2021) 36 ICSID Review 413, 432 (arguing that States may establish a cause of action in a counterclaim even absent a positive international law obligation to protect the environment, based on the plethora of treaty, customary, general and non-binding international environmental law which would progressively entail a negative international law obligation for investors not to engage in conduct that materially undermines the goals of the relevant international law). On other roles that environmental law and human rights obligations can play in ISDS proceedings, see, for example, International Chamber of Commerce, 'Resolving Climate Change Related Disputes Through Arbitration And ADR' (2019) ICC Commission Report 39, para 5.63 ('[e]ven where there is no reference to the Paris Agreement in the applicable bilateral investment treaty, international obligations are

4. Persisting Structural Obstacles

Even if the legal hurdles discussed above were to be surmounted, the room for counterclaims would likely remain limited due to the difficulty in most cases in identifying a viable counterclaim on the merits.

In cases concerning the environment, the investor often challenges a State measure enacted to prevent a potentially harmful project from being implemented. In that scenario, the investor has by definition not (yet) perpetrated any environmental damage that might substantiate a counterclaim. For example, in January 2021, US President Joseph Biden signed an executive order cancelling a permit for the Keystone XL pipeline, triggering the filing of a USD 15 billion claim under the United States-Mexico-Canada Agreement.[38] Similarly, in the recent *Rockhopper v Italy* case, the investor challenged the State's decision to discontinue an offshore oil project on environmental grounds.[39] States in such cases may invoke environmental considerations

usually interpreted on a progressive basis and it is likely that the Paris Agreement, and NDCs, will inform the investing party's legitimate expectations in determining, for example, a fair and equitable treatment claim.'); Jeffrey Turk, 'Compensation for "Measures Tantamount to Expropriation" under NAFTA: What It Means and Why It Matters' (2005) 1 International Law and Management Review 41, 71 (discussing how the polluter-pays principle may be used in adjusting the amount of compensation for expropriation); Tomoko Ishikawa, 'The Role of the Precautionary and Polluter Pays Principles in Assessing Compensation' (2015) RIETI Discussion Paper Series 15-E-107 20 (discussing how the precautionary and polluter-pays principles may provide a theoretical basis for the reduction of compensation when the investment-environment balance is at issue); Wendy Miles and Merryl Lawry-White, 'Arbitral Institutions and the Enforcement of Climate Change Obligations for the Benefit of all Stakeholders: The Role of ICSID' (2019) 34 ICSID Review 1, 17 (arguing that the relevance to arbitral tribunals of climate obligations reflected in the Paris Agreement and other sources 'is beyond doubt' and 'might be relevant to determining other conceptions of public policy, such as in assessing the scope of regulatory powers, of investor expectations (including where based on due diligence), and of what it means to protect and develop').

[38] *TC Energy Corporation and TransCanada Pipelines Limited v United States of America*, ICSID Case No ARB/21/63.

[39] *Rockhopper Italia SpA, Rockhopper Mediterranean Ltd, and Rockhopper Exploration Plc v Italian Republic*, ICSID Case No ARB/17/14, Final Award, 23 August 2022, para 6.

inter alia as a justification for their conduct in the context of assessing whether they breached treaty standards such as Fair and Equitable Treatment (FET), or whether the disputed measure falls within the scope of an exceptions clause in a treaty. But absent actual harm to the host State, it is not easy to see a basis for a counterclaim.

Similarly, while human rights due diligence and environmental impact assessments (EIAs) are commonly required for the implementation of large-scale projects, failure to comply with those requirements generally does not independently cause damage to the State. States can invoke such failures in the context of objecting to the jurisdiction of arbitral tribunals, justifying governmental measures adopted vis-à-vis the investment, or assessing the quantum of claims of breach of IIAs.[40] But again, such a failure cannot give rise to a counterclaim if the host State is unable to point to actual harm caused to it.

More generally, the potential of counterclaims is constrained by the current structure of investment treaty arbitration, where investors are the only parties deciding which cases to bring and which cases not to bring. While investors can actively decide which disputes to litigate, States are always in the passive position of waiting and seeing which disputes are brought against them. Thus, if an investor causes damage to the host State that could potentially serve as a basis for a counterclaim, but the investor has not initiated an arbitration, the host State has no forum to bring the counterclaim. And an investor that has caused environmental damage or violated human rights will normally think twice before bringing an arbitration against the host State.[41] Unless the system of investment treaty arbitration is fundamentally changed to allow States to bring affirmative claims against investors, States' ability to seek redress for environmental damage

[40] *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v Republic of Kenya*, ICSID Case No ARB/15/29, Award, 22 October 2018, paras 153-155 (dismissing claim for lack of jurisdiction on the ground inter alia that the claimant had not completed the EIA required to obtain mining rights).

[41] In the rare cases in which environmental counterclaims have been successfully deployed, e.g. in the *Burlington* and *Perenco* cases against Ecuador, the tribunals awarded only a fraction of damages claimed by the host State – an amount that was dwarfed by the damages awarded to the claimants. See supra, n 24.

and human rights violations will remain circumscribed to presenting counterclaims in cases that investors have elected to litigate.

5. Conclusion

The ability of States to present counterclaims is often presented as a key missing piece to enhance the legitimacy of ISDS. Commentators have extensively analysed and debated the legal hurdles to counterclaims, and arbitral decisions and new treaties are increasingly finding ways to surmount those hurdles. Yet even if counterclaims were made broadly accessible, their potential would remain severely limited due to the structure of investment treaty arbitration, where States cannot seek redress for environmental damage or human rights violations before an investment treaty tribunal unless the investor who caused the damage initiates an arbitration in the first place. Given this fundamental limitation, enabling counterclaims is unlikely to be in itself a solution to the crisis faced by ISDS. Focusing excessively on counterclaims may distract from other important issues, including the need to take into account environmental and human rights considerations when assessing claims that the State breached IIAs, and when assessing investors' claims of compensation in ISDS. Such issues are particularly pressing in a context where the climate crisis is increasingly acute and State action to address it may give rise to growing numbers of claims under investment treaties.[42]

[42] A 2022 study identified some USD 340 billion in potential ISDS claims from oil and gas companies if governments were to begin limiting production; see Kyla Tienhaara et al, 'Investor-state disputes threaten the global green energy transition' (5 May 2022) 376 Science 701-703. In UN Doc A/78/168 (n 8) para 5, UN Special Rapporteur David Boyd also noted that the number of claims based on fossil fuel investments has skyrocketed with an average amount awarded of USD 600 million, i.e. the quintuple of the average amount awarded in arbitrations not related to fossil fuels.

7

'Both Directions at Once': Advancing Sustainability Through Investor Obligations in IIAs[1]

Elena Cima

1. Introduction

When we think about international investment law, we hardly see it as a two-way street.

Since its inception, international investment law has pursued a single, very clear objective: the promotion and protection of foreign investments.[2] Originally, international investment treaties – together with the dispute settlement mechanism they provide – were conceived as the necessary tools to 'replace the politics of diplomatic protection with expert legal solutions

[1] The title of the chapter is inspired by the album of John Coltrane, *Both Directions at Once: The Lost Album* (Impulse! 2018).

[2] Rudolph Dolzer et al, *Principles of International Investment Law* (3rd edn, Oxford University Press 2022); Andrew Newcombe and Lluís Paradell, *Law and Practice if Investment Treaties* (Kluwer Law International 2009). Kenneth J Vandevelde, *Bilateral Investment Treaties. History Policy and Interpretation* (Oxford University Press 2010); Kate Miles, *The Origins of International Investment Law* (Cambridge University Press 2013).

developed through impartial international adjudication'.[3] The underlying rationale was to establish safeguards to protect foreigners investing in a state where, as non-nationals, they lacked formal rights to participate in the state's political or public policy processes, and yet they were subject to its law-making authority.[4] Over time, these treaties have multiplied and a growing body of investment norms has emerged, whose sole purpose and focus has been investment protection and promotion.[5] This purpose materialized in the form of a series of *rights* granted to foreign investors and corresponding *obligations* imposed on the host state. And investor-state dispute settlement, or ISDS, reflects a similar asymmetry as only foreign investors can initiate a dispute against the host state, while the reverse is simply not possible.[6]

This 'asymmetric' or 'one-sided' nature of international investment law may have made perfect sense when the first investment agreements were concluded: at the time, it was deemed necessary to offer foreign investors a certain degree of protection – preferably even greater than that afforded to nationals of the host state – with the underlying objective of enhancing the

[3] Lorenzo Cotula, 'Democracy and International Investment Law' (2017) 30 Leiden Journal of International Law 351. See Ibrahim Shihata, 'The Settlement of Disputes Regarding Foreign Investment: The Role of the World Bank, with Particular Reference to ICSID and MIGA' (1986) 1(1) American University International Law Review 97.

[4] Cotula (n 3) 358. W Michael Reisman, 'International Investment Arbitration and ADR: Married but Best Living Apart' (2009) 24 ICSID Review 185. Elena Cima, 'Parliamentary Scrutiny over Investment Projects: Tanzania's Reform of its Natural Resources Law' in Avidan Kent et al (eds), *Public Participation and Foreign Investment Law* (Brill 2021) 177.

[5] Take, as an example, the preamble of the very first bilateral investment treaty, concluded between Germany and Pakistan in 1959: '*Desiring* to intensify economic co-operation between the two States, *Intending* to create favourable conditions for investments by nationals and companies of either State in the territory of the other State, and *Recognizing* that an understanding reached between the two States is likely to promote investment, encourage private industrial and financial enterprise and to increase the prosperity of both the States'.

[6] See e.g. Jan Paulsson, 'Arbitration Without Privity' (1995) 10 ICSID Review 232.

country's attractiveness to foreign investment.[7] As time passed, however, the protection offered to foreign investors started being perceived as too broad, undermining states' efforts to legislate in the public interest and limiting their sovereign right to regulate.[8] This phenomenon has been quite fittingly referred to as 'regulatory chill' as states can find themselves effectively 'frozen', refraining from adopting new laws or regulations due to the fear of litigation by foreign investors operating in their territory.[9] At the same time, it has become increasingly clear that the protection afforded to foreign investors is entirely disconnected from – and independent of – their conduct:[10] as soon as an economic activity qualifies as a 'foreign investment' under the applicable international investment agreement (IIA), it can instantly and automatically benefit from the agreement's protection – regardless of whether it emits high levels of greenhouse gases (GHGs) or operates in ways that are unsustainable. As a result, the asymmetric nature of international investment law tends to be 'hard' on states – constraining their actions and limiting their ability to pursue public policy objectives, including social and environmental goals – while remaining 'soft' on investors, offering them protection even in instances of harmful or irresponsible conduct.

[7] Dolzer et al (n 2) 4.

[8] See e.g. Catharine Titi, *The Right to Regulate in International Investment Law* (Bloomsbury 2014); Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15 Journal of International Economic Law 223; Crina Baltag et al, 'Recent Trends in Investment Arbitration on the Right to Regulate, Environment, Health and Corporate Social Responsibility: Too Much or Too Little?' (2023) 38 ICSID Review 381.

[9] See e.g. Stephan W Schill, 'Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?' (2007) 24(5) Journal of International Arbitration 469; Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7 Transnational Environmental Law 229.

[10] Elena Cima, 'The Missing Link: Integrating Investment Considerations in Trade-Related Climate Strategies' (2025) Journal of World Investment & Trade 375, 388. See also, on the fact that international investment law protects 'all types of investments', Jorge E Viñuales, 'Investment Treaties and Climate Change Policy: A Possible Legal Pathway' (2025) ICSID Review.

The one-sided nature of international investment law has been the subject of debate for many years.[11] More recently, it has been flagged as a serious concern in a Report titled *Paying Polluters: The Catastrophic Consequences of Investor-State Dispute Settlement for Climate and Environment Action and Human Rights*, authored by UN Special Rapporteur David R. Boyd and presented to the UN General Assembly in July 2023.[12] The report denounced the one-sided nature of international investment law and critically examined how ISDS mechanisms can impede environmental and human rights initiatives.[13] Other chapters in this volume address one of the key dimensions of the debate stemming from the one-sided nature of international investment law – namely how to overcome the 'regulatory chill' that these rules create and strengthen the state's right to regulate. This chapter, on the other hand, focuses on the second dimension – probably less-explored, at least until recently: how to reduce the asymmetry by introducing obligations or duties for foreign investors (and not just for states) to ultimately hold them accountable for the harm they may cause to the environment or human rights.[14]

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[11] See e.g. Gus Van Harten, 'Investment Treaty Arbitration, Procedural Fairness and the Rule of Law' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 627; Alessandra Arcuri, 'The Great Asymmetry and the Rule of Law in International Investment Arbitration' in Lisa E Sachs et al (eds), *Yearbook on International Investment Law & Policy 2018* (Oxford University Press 2019) 394.

[12] Report of the Special Rapporteur on the Issue of Human Rights Obligations Relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment, David R Boyd, 'Paying Polluters: The Catastrophic Consequences of Investor-State Dispute Settlement for Climate and Environment Action and Human Rights (13 July 2023) UN Doc A/78/168.

[13] ibid, Section A.

[14] See, generally, on the topic of investor obligations: Patrick Abel, *International Investor Obligations: Towards Individual International Responsibility for the Public Interest in International Investment Law* (Nomos 2022); Nathalie Bernasconi-Osterwalder, 'Inclusion of Investor Obligations and Corporate Accountability Provisions in Investment Agreements' in Julien Chaisse et al (eds), *Handbook of International Investment Law and Policy* (Springer 2021) 463; Yueming Yan, 'Anti-Corruption Provisions in International Investment Agreements: Investor Obligations, Sustainability Considerations, and Symmetric Balance' (2020) 23 Journal of International Economic Law 989; Nicolas Bueno et al, 'Investor Human Rights and

International investment law is hardly seen as a two-way street. But could it be? It has been suggested that the complete absence of duties and obligations for investors in investment agreements is a 'deliberate choice of the contracting parties and nothing would prevent them from including in these treaties substantive obligations or best endeavor commitments upon foreign investors.'[15] What would a new generation of investment treaties look like if we were to go in 'both directions at once' and provide obligations for both states and investors? Would it help achieve more balance between them? Could it allow investment treaties to become instruments that help foster sustainable development? After a few introductory considerations (section 2), this chapter explores the existing practice in investment treaty-making concerning the inclusion of obligations for foreign investors (section 3). It then addresses some of the challenges that this new approach encounters – challenges that are of both of a procedural and theoretical nature (section 4). Finally, section 5 proposes alternatives to the existing practice and section 6 concludes.

2. Why Make Investors Responsible? And Why Through IIAs?

In 2013, Richard Heede published a fascinating yet alarming report that is generally know with the short title 'Carbon Majors'.[16] Through meticulous historical analysis, Heede found that nearly two-thirds of all industrially sourced carbon emissions between 1880 and 2010 could be traced to just 90 large companies. As alarming as these findings may be, carbon emissions are just the tip of the iceberg: over the years, research has shown that corporations are often at the heart of significant environmental harm and

Environmental Obligations: The Need to Redesign Corporate Social Responsibility Clauses' (2023) 24 Journal of World Investment & Trade 179.

[15] Tarcisio Gazzini, 'Bilateral Investment Treaties and Sustainable Development' (2014) 15 Journal of World Investment & Trade 929.

[16] Richard Heede, 'Tracing Anthropogenic Carbon Dioxide and Methane Emissions to Fossil Fuel and Cement Producers, 1854–2010' (2014) 122 Climate Change 229.

severe human rights violations.[17] While respecting human rights, protecting the environment, and mitigating climate change have traditionally been part of a state's duties under international law, it is now widely recognized that corporations, including foreign investors, contribute greatly to environmental degradation as well as to climate change.

In 2002, the Plan of Implementation of the UN World Summit on Sustainable Development stated very clearly that one of the most critical and urgent actions with regard to sustainable development was the need to 'enhance corporate environmental and social responsibility and accountability'.[18] The primary forum where such efforts have been pursued has been the United Nations, which as early as the 1970s attempted – albeit unsuccessfully – to negotiate a code of conduct for multinational corporations. These efforts spurred a response from the members of the Organization for Economic Cooperation and Development (OECD), which launched their own initiative, giving rise to a set of guidelines that later became known as the *OECD Guidelines for Multinational Enterprises*. Introduced in 1976, the Guidelines established broad, non-binding standards and practices aimed at encouraging multinational corporations to contribute positively to economic and social development, and have been amended several times – including, lastly, in 2022. They were followed by several other instruments, including in particular the *UN Guiding Principles on Business and Human Rights*, endorsed unanimously by the Human Rights Council in 2011.[19]

These two instruments – together with many others that have been adopted over the years – provide practical guidance on how states and corporations can enhance standards and practices so as to achieve tangible results for affected individuals and communities. However, they are *not* legally binding treaties and they *do not* create new obligations. While it is safe to say

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[17] See e.g. John G Ruggie, *Just Business: Multinational Corporations and Human Rights* (WW Norton & Company 2013).

[18] United Nations, 'Plan of Implementation of the World Summit on Sustainable Development' (4 September 2002) para 18. Earlier recognition can be found in Chapter 30 on the 1992 UN Action Plan 'Agenda 21'.

[19] Human Rights Council, 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' (21 March 2011) UN Doc A/HRC/17/31.

that the claim of the orthodox positivist doctrine according to which 'only States are subjects of international law' no longer holds true today,[20] we are still very far from conceiving international law as a law that provides obligations for corporations. Corporations, however, do have *rights* under international investment law (as long as they qualify as 'foreign investors' operating a 'foreign investment'), and are therefore recognized as possessing, at a minimum, a limited form of legal personality within the international legal order. And this is precisely why international investment law can appear as a promising avenue to hold foreign investors accountable for their impact on the environment or human rights. These are treaties that – unlike the rest of international law – already apply to (foreign) corporations. One could say that we are already halfway there. We just need a few more steps. And some countries are already taking them.

3. The State of Play

In 2015, the UN Conference on Trade and Development (UNCTAD) published the *Investment Policy Framework for Sustainable Development*, centered around the idea that – with the appropriate investment policies and agreements – foreign investments could contribute to sustainable development.[21] While largely focused on the role that states can play in ensuring that foreign investments pursue sustainable development goals, the *Policy Framework* does mention the possibility to balance state commitments with investor obligations in the context of promoting responsible investment.[22] The focus, however, is mostly on the possibility for IIAs to refer to commonly recognized international corporate and social responsibility (CSR) standards or to include a requirement for investors to comply with

[20] Hersch Lauterpacht, 'International Law and Colonial Questions, 1870-1914' in *Cambridge History of the British Empire*, vol III (1959) 667.

[21] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015).

[22] ibid 77.

investment-related national laws of the host state when making and operating an investment.[23]

Both sets of provisions are featured in a growing number of IIAs, which include both bilateral investment treaties (BITs) and investment chapters in free trade agreements (FTAs). The first type of obligations are generally known as *indirect obligations*, as they are addressed to states – rather than investors – expecting them to encourage investors to adopt a specific responsible conduct when they invest in their territory. The *Italian Model BIT* from 2022, for instance, features such an indirect obligation in its preamble, where the Parties encourage 'enterprises operating within their territory or subject to their jurisdiction to respect internationally recognized guidelines and principles of corporate social responsibility, including the OECD Guidelines for Multinational Enterprises, and to pursue best practices of responsible business conduct'.

Other IIAs provide for similar obligations in the dispositive part of the treaty. Canada's 2008 FTAs with Peru and Colombia, for instance, provide that:

> [e]ach Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties […] The Parties remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies.[24]

These provisions constitute significant developments in the landscape of IIAs, reflecting the importance that the contracting state parties attach to internationally recognized standards. However, while the ultimate aim is to foster investor adherence to these standards, the obligations are typically

[23] ibid 77-78.

[24] Canada-Peru FTA and Canada-Colombia FTA, art 810. See also Indonesia-Switzerland BIT, art 13: '[e]ach Party shall encourage legal entities operating within its territory or subject to its jurisdiction to voluntarily incorporate into their internal policies those internationally recognized standards, guidelines, and principles of corporate social responsibility that have been endorsed or are supported by that Party'.

framed as duties of the host state, which is expected – often through hortatory language – to 'encourage' such conduct among foreign investors operating in its territory.

The other option mentioned in the UNCTAD *Policy Framework* is the possibility for IIAs to include a requirement for investors to comply with investment-related national laws of the host state when making and operating an investment. This option was also put forward in the 2012 Revision of the *International Chamber of Commerce (ICC) Guidelines for International Investment*, which refer to investors' obligations to comply with the laws and regulations of the host state at all times and, in particular, to their obligation to comply with national and international labor laws.[25]

At first glance, this second category of provisions may seem to represent a meaningful step toward the inclusion of direct investor obligations within IIAs, as they are *directly* addressed to foreign investors rather than host states. However, since the obligation is merely to comply with the domestic laws of the host state, responsibility effectively shifts back to the host state. The substantive standard of conduct expected from investors – whether in relation to environmental protection or human rights – ultimately hinges on the regulatory framework of the host state, which, as we know, varies significantly across jurisdictions.

A third option exists, which the UNCTAD *Policy Framework* does not mention – on the contrary, it explicitly stops short 'of framing IIAs so as to impose outright obligations on investors.'[26] Providing for investor obligations directly in the text of the treaty is an option, however, that a few countries seem to be willing to experiment with.

As of today, there are very few examples of IIAs imposing obligations directly on the investor: only 44 out of the 2598 treaties mapped by UNCTAD contain CSR provisions (outside of the treaty's preamble).[27] The most

[25] ICC, 'ICC Guidelines for International Investment' (2012) 9.

[26] UNCTAD, 'Investment Policy Framework for Sustainable Development' (2015) 77.

[27] Data available on the UNCTAD Investment Policy Hub, at <https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping>.

notable examples can probably be found in the African continent.[28] The BIT concluded between Morocco and Nigeria in 2016 is, without any doubt, one of them.[29] This is a treaty that is often mentioned as a perfect example of a new generation of 'more progressive' or 'more balanced' BITs, as it goes way past the traditional approach centered around the protection of foreign investments. Regarding, more specifically, the inclusion of direct obligations for investors, several provisions come to mind. Article 24, titled 'Corporate Social Responsibility' makes it very clear that investors have obligations that go beyond the simple duty to comply with all applicable laws and regulations of the host state. In fact, investors – although here the language suddenly becomes softer – '*should* apply the ILO Tripartite Declaration on Multinational Investments and Social Policy as well as specific or sectorial standards of responsible practice where these exist' and '[w]here standards of corporate social responsibility increase, investors *should* strive to apply and achieve the higher level standards'.[30] Articles 17 through 19 change the tone and provide for a series of binding obligations for foreign investors, using mandatory language. According to Article 18, for instance,

> 2) investments *shall* uphold human rights in the host state.

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[28] The treaties concluded by or between African countries are 16 and include: the Investment Protocol to the AfCFTA (2023), the Angola-Brazil BIT (2015), the Benin-Canada BIT (2013), the Brazil-Malawi BIT (2015), the Brazil-Mozambique BUT (2015), the Burkina Faso-Canada BIT (2015), the Cameroon-Canada BIT (2014), the Canada-Côte d'Ivoire BIT (2014), the Canada-Guinea BIT (2015), the Canada-Mali BIT (2014), the Canada-Nigeria BIT (2014), the Canada-Senegal BIT (2014), the Ghana-Turkey BIT (2016), the Morocco-Nigeria BIT (2016), the Nigeria-Singapore BIT (2016) and the SADC Investment Protocol (2006). See Makane M Mbengue and Stefanie Schacherer, 'The "Africanization" of International Investment Law: The Pan-African Investment Code and the Reform of the International Investment Regime' (2017) 18 Journal of World Investment & Trade 414, 435-7.

[29] See Arpan Banerjee and Simon Weber, 'The 2019 Morocco Model BIT: Moving Forwards, Backwards or Roundabout in Circles?' (2021) 36 ICSID Review 536; Hamed El-Kady and Yvan Rwananga, 'Morocco's New Model BIT: Innovative Features and Policy Considerations' (*IISD Investment Treaty News*, 20 June 2020) <https://www.iisd.org/itn/2020/06/20/moroccos-new-model-bit-innovative-features-and-policy-considerations-hamed-el-kady-yvan-rwananga/>.

[30] Morocco-Nigeria BIT, art 24 (emphasis added).

> 3) Investors and investments *shall* act in accordance with core labour standards as required by the ILO Declaration on Fundamental Principles and Rights of Work, 1998.

While Article 19(1)(a) provides that '[i]nvestments *shall* meet or exceed national and internationally accepted standards of corporate governance for the sector involved, in particular for transparency and accounting practices'.

The most recent example, and probably the most progressive one, can be found in the *Investment Protocol to the African Continental Free Trade Area* (AfCFTA).[31] The Protocol, adopted in 2023, prioritizes sustainable and inclusive development, offering an innovative framework for regulating foreign investment that balances national and regional interests with social and environmental responsibility. Part V of the Protocol is entirely devoted to 'Investor Obligations' and it lays them out – divided by issue area – over 10 articles. These provisions spell out, in great detail, the obligations that investors *shall* respect with regards to *inter alia* business ethics, human rights and labor standards (Art. 33), environmental protection (Art. 34), indigenous peoples and local communities (Art. 35), socio-political aspects (Art. 36), and anti-corruption practices (Art. 37). What makes these provisions unique is the fact that they do not refer broadly to national or international standards, neither do they mention specific international standards – as it was the case in the *Morocco-Nigeria BIT*. Instead, these provisions spell out very precise duties and give detailed instructions as to what is expected of investors. Let us use Article 34 on 'Environmental Protection' as an example:

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[31] Hamed El-Kadi et al, 'The Protocol on Investment to the Agreement Establishing the African Continental Free Trade Area: What's in it and what's next for the Continent?' (*IISD Investment Treaty News*, 1 July 2023) <https://www.iisd.org/itn/2023/07/01/the-protocol-on-investment-to-the-agreement-establishing-the-african-continental-free-trade-area-whats-in-it-and-whats-next-for-the-continent/>; Makane M Mbengue et al, 'Investment Facilitation under the AfCFTA Protocol on Investment' (*ODI Global Briefing/policy Paper*, 11 October 2024) <https://odi.org/en/publications/investment-facilitation-under-the-afcfta-protocol-on-investment/>; Jack Bownes, 'The AfCFTA Investment Protocol' (*Daily Jus*, 6 November 2024) <https://dailyjus.com/world/2024/11/the-afcfta-investment-protocol>.

> 1. Investors and their investments shall, in carrying out their business activities, respect and protect the environment, and, in particular shall:
> a. respect the right to a clean, healthy and sustainable environment, as reflected in Article 24 of the African Charter of Human and Peoples' Rights, and the Resolution of the United Nations General Assembly A/RES/76/300 ('The human right to a clean, healthy and sustainable environment');
> b. comply with the principles of prevention and precaution when conducting their business activities to anticipate and prevent any risk of significant harm to the environment;
> c. carry out an environmental impact assessment, in accordance with the best international standards and practices and as required by domestic law;
> d. apply the precautionary principle to their environmental impact assessment and to decisions taken in relation to a proposed investment, including any necessary mitigating or alternative approaches to the investment, or precluding the investment if necessary; and
> e. where their business activities cause or may cause harm to the environment, take steps to mitigate the harm, to restore impacted sites and ensure a clean, healthy and sustainable environment.
> 2. Investors shall not exploit or use natural resources to the detriment of the rights and interests of the Host State and local communities.

The result is a treaty that appears significantly and substantially more balanced, as it provides both rights and duties for foreign investors.

4. Challenges

There is hardly any doubt that a new generation of IIAs is emerging, characterized by efforts to introduce greater balance through the inclusion of investor obligations – whether direct or indirect, binding or aspirational. The overarching goal is to ensure that, while investors continue to benefit from robust protections, they are also expected to uphold certain standards, particularly in relation to environmental protection, labor rights, human rights, and the interests of local communities. However, the shift toward using IIAs as instruments not only of protection but also of accountability faces at least two major sets of challenges.

The first one is of a *procedural* nature. While introducing investor obligations is a necessary step, it is not in itself sufficient: without effective mechanisms to enforce these new rules, accountability remains elusive. The main (existing) mechanism that can allow the enforcement of investor obligations that a treaty may contain is the possibility for the host state to bring a counterclaim against the foreign investor.[32] To what extent, however, counterclaims will be a viable route to enforce treaty obligations for investors remains a highly debated question.

In simple terms, a counterclaim is an autonomous claim brought by the host state against the investor, which, though reactive and thus incidental to the primary claim, seeks more than the mere dismissal of that claim by pursuing an independent remedy or form of relief.[33] This may provide a channel through which host states can seek to hold investors liable for harm allegedly arising from their investment-related conduct.[34] However, the use of counterclaims has proven particularly problematic in treaty claims, precisely because of the asymmetric nature of most investment treaties, and, as a result, only a handful of counterclaims have been successful in practice.[35]

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[32] Edward Guntrip, *Counterclaims in Investment Arbitration. Holding Foreign Investors Accountable for Violations of International Law* (Brill 2024); Mees Brenninkmeijer and Fabien Gélinas, 'Counterclaims in Investment Arbitration: Towards an Integrated Approach' (2023) 38 ICSID Review 567.

[33] Anna De Luca and Crina Baltag, 'Counterclaims in Investment Arbitration: Reflections on UNCITRAL WG III Reform' (*Kluwer Arbitration Blog*, 5 November 2021) <https://legalblogs.wolterskluwer.com/arbitration-blog/counterclaims-in-investment-arbitration-reflections-on-uncitral-wg-iii-reform/>.

[34] Tomoko Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration' Symposium on Investor Responsibility: The Next Frontier in International Investment Law (2019) 113 AJIL Unbound 35.

[35] Counterclaims based on domestic law breaches have been successful only in a few exceptional instances, i.e. *Burlington v Ecuador* (ICSID Case No ARB/08/5) and *Perenco v Ecuador* (ICSID Case No ARB/08/6). A thorough discussion on the admissibility of counterclaims in general falls beyond the scope of this contribution. For an analysis of these issues, see Jorge E Viñuales, *Foreign Investment and the Environment in International Law* (Cambridge University Press 2009) 92-94; Pierre Lalive and Laura Halonen, 'On the Availability of Counterclaims in Investment Treaty Arbitration' in

Most IIAs – even those that include investor obligations, such as the *Morocco-Nigeria BIT* – do not contain specific rules on counterclaims.[36] The inclusion of such a rule is instead still an open question as far as the *Investment Protocol* to the AfCFTA is concerned as the part of the Protocol devoted to the settlement of disputes is still to be concluded. Its predecessor, the 2016 *Draft Pan-African Investment Code* (PAIC), remains one of the rare examples of a treaty containing such a provision: it allowed the host state to bring a counterclaim '[w]here an investor or its investment is alleged […] to have failed to comply with its obligations under this Code or other relevant rules and principles of domestic and international law'.[37] This meant that a state could invoke any violation of any provision of the Code or any relevant international treaty protecting the environment, human rights, indigenous people rights, or even labour standards under the PAIC's provision on counterclaims.

This said, it is important to note that the mere silence of an investment treaty on counterclaims, or its express limitation to investors' rights to initiate claims, does not in itself warrant a restrictive approach to the admissibility of respondent counterclaims. A tribunal's ability to exercise jurisdiction over a host state's counterclaim depends on the procedural rules governing the arbitration. Relevant provisions include Article 46 of the ICSID Convention and Article 21 of the UNCITRAL Arbitration Rules, both of which explicitly recognize the possibility of counterclaims, subject to specific jurisdictional and admissibility conditions. In the case of ICSID, the conditions for counterclaims are 'identity of subject-matter with the main dispute, parties' consent for the counterclaims to be arbitrated before ICSID and jurisdiction of an ICSID tribunal to hear them'.[38]

Czech Yearbook of International Law – Rights of Host States within the System of International Investment Protection (Czech Society of International Law 2011) 141; Anne K Hoffman, 'Counterclaims in Investment Arbitration' (2013) 28 ICSID Review 438; Dafina Atanasova et al, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31 Journal of International Arbitration 357.

[36] Bernasconi and Osterwalder (n 14) 472.

[37] Draft Pan-African Investment Code, art 43.

[38] Lalive and Halonen (n 35) 141, 144.

What does all of this mean for the enforceability of investor obligations incorporated in IIAs? A few issues come to mind.

First, as stated very clearly in Article 46 of the ICSID Convention, 'the Tribunal shall […] determine any […] counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre'. These three conditions need to *cumulatively* exist, thereby limiting significantly the breaches of investor obligations that a state can raise in practice in a given case. Regarding the first condition – the so-called 'close connection test' – investment tribunals have adopted diverging approaches, with some tribunals having required a legal connection (namely, that both claims arise under the same legal instrument)[39] and others having taken a broader view, assessing the connection on factual grounds and focusing on whether the counterclaim concerns the same subject matter as the primary dispute.[40] Ultimately, it falls within the sole discretion of each tribunal to determine whether a counterclaim is sufficiently connected to the primary claim, taking into account the specific circumstances of each case.[41] Regarding the second and third conditions – the parties' consent and the tribunal's jurisdiction – the specific wording of the treaty's arbitration clause is essential. Article 26(1) of the Energy Charter Treaty (ECT), for instance, includes in the Tribunal's jurisdiction only '[d]isputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, *which concern an alleged breach of an obligation of the former under Part III […]*' In other words,

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[39] See e.g. *Saluka Investments BV v Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim, 7 May 2004; *Sergei Paushok and others v The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011; *Limited Liability Company AMTO v Ukraine*, SCC Case No 080/2005, Final Award, 26 March 2008.

[40] See e.g. *Antoine Goetz and others v Republic of Burundi*, ICSID Case No ARB/01/2, Award, 21 June 2012; *Urbaser SA and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v The Argentine Republic*, ICSID Case No ARB/07/26, Award, 8 December 2016; *Burlington v Ecuador*, ICSID Case No ARB/08/5, Decision on Counterclaims, 7 February 2017. See Elise Ruggeri Abonnat, 'Counterclaims' (*Jus Mundi*, 10 September 2024).

[41] De Luca and Baltag (n 33).

the Tribunal will have jurisdiction only over disputes concerning alleged breaches of any of the provisions of Part III by the State, thereby implicitly excluding any jurisdiction over counterclaims. Conversely, where the scope of arbitrable disputes is more broadly defined to include disputes 'with respect to investment activities', there is nothing in principle standing in the way of a tribunal exercising its jurisdiction over counterclaims.[42] This said, the issue of 'consent' remains problematic in case of a treaty claim: while the entry into force of the treaty means that an offer to arbitrate is made by the host state, such an offer is only perfected when an investor files a notice to arbitrate.[43]

This last point brings me to a *second* issue, namely that these investor obligations would never be enforceable autonomously, namely in isolation from an already existing dispute between the investor and the host state. In fact, the mere possibility for a state to bring a counterclaim does not mean of course that the state can raise the breach of any of the treaty's obligations on the part of the investor simply because that breach has occurred. In other words, the right to bring counterclaims does in no way alter the asymmetric nature of ISDS: only a foreign investor can initiate a dispute against the host state. And it is only in the context of that ongoing dispute that the host state may be entitled to bring a counterclaim.

Finally, the nature and content of investor obligations are often lacking in clarity. Let us take Article 34(1)(e) of the *Investment Protocol* to the AfCFTA: 'where their business activities cause or may cause harm to the environment' they investors shall 'take steps to mitigate the harm, to restore impacted sites and ensure a clean, healthy and sustainable environment'. What is the source of this duty? Is it the domestic law of the host state? If so, how is this provision different from one requiring the investor to comply with the domestic law of the host state? Is it international law? Sometimes the reference to international law is explicit: according to Article 34(1)(a), investors shall 'respect the right to a clean, healthy and sustainable environment, as reflected in Article 24 of the African Charter of Human and Peoples' Rights, and the Resolution of the United Nations General Assembly

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[42] Ishikawa (n 34) 37.

[43] Paulsson (n 6).

A/RES/76/300'. Both Article 24 of the African Charter and UNGA Resolution 76/300 have been drafted thinking of states as subjects, not private parties. How should the corresponding standard be interpreted when applying them to a private corporation? A rich body of soft law has developed over the years – together with an equally rich literature – which could of course be relied upon by the arbitrators to give content and meaning to these obligations, once designed for states and now potentially transposed to the conduct of private corporations.[44] How investment tribunals will in the future interpret these duties and apply them to private investors remains however an open question.

These last two points bring me to a second challenge faced by existing efforts to embed investor obligations within international investment treaties, which is primarily *theoretical* in nature. While recent negotiations clearly demonstrate the interest of many states to introduce balance in their investment treaties by incorporating investor obligations, the aforementioned procedural hurdles are often not addressed concurrently, thereby undermining the overall effectiveness of these initiatives. Discussions have also taken place to address these hurdles by allowing states to bring disputes directly out of an IIA that provides for investor obligations – thereby entirely transforming the nature of investment arbitration as 'arbitration without privity' and erasing the asymmetric nature of ISDS. It follows, more broadly, that international investment law, which had been created to protect and promote foreign investments by providing foreign investors with a set of rights and imposing on the host state corresponding duties, would become a body of law that provides for both rights and duties for foreign investors. And by referencing other duties that are traditionally designed for states and applying them now also to private investors, human rights obligations and principles of international environmental law would also become instantly applicable to private corporations, and not just to states. Foreign investors would then become – although of course to a lesser extent than states – full-fledged subjects of international law.[45] It is important to

[44] See e.g. Elisa Morgera, *Corporate Environmental Accountability in International Law* (Oxford University Press 2020).

[45] On the subject, see Hersch Lauterpacht, *International Legal Personality* (Routledge 2010).

remind ourselves that this is the radical transformation that underlies any discussion on the need to introduce investor obligations in investment treaties and the corresponding procedural mechanisms that allow their enforcement. It is so much more than simply 're-balancing' international investment law.

5. Thinking Outside the Box: Another, Possibly Parallel, Direction

These obstacles are not insurmountable. Various forces are actively working to overcome them, both in the context of the negotiation of a new generation of IIAs and of the ongoing efforts to reform ISDS. Examples are not many, but there is a clear trajectory in place. And scholars have been increasingly vocal in calling for such rebalancing and for a 'rethinking' of international investment law.[46] International law, at its core, is a reflection of the international society, and, as the latter evolves, international law has to evolve with it. At the same time, these challenges might, and most likely will slow down this process: the ball is rolling but not as fast as we'd like it or as it may be desirable given the importance of meeting the sustainable development goals, decarbonizing the economy and mitigating climate change. And this is especially true if one considers the critical role that investments play in all of this: while on the one hand foreign investments can harm the environment, contribute to GHG emissions and ultimately undermine the sustainable development agenda, on the other they represent a powerful force that could help contribute to all these objectives and goals. The UN General Assembly's *2030 Agenda for Sustainable Development* underscores the important and positive role that (certain) types of foreign

[46] See e.g. Steffen Hindelang and Marjus Krajewski, *Shifting Paradigms in International Investment* Law (Oxford University Press 2016); Simon Lester, 'Rethinking the International Investment Law System' (2015) 49 Journal of World Trade 211; Timothy Meyer and Tae Jung Park, 'Renegotiating International Investment Law' (2018) 21 Journal of International Economic Law 655; Julian Arato, 'The Privater Law Critique of International Investment Law' (2019) 113 American Journal of International Law 1; Stratos Pahis, 'Rethinking International Investment Law: Form, Function & Reform' (2023) 63 Virginia Journal of International Law 447.

investment can play in achieving the sustainable development goals,[47] and the Paris Agreement refers to the importance to make finance flows (including foreign investments) 'consistent with a pathway towards low greenhouse gas emissions and climate-resilient development'.[48]

Keeping all of this in mind, this section intends to propose an alternative approach which could serve as a complement to the inclusion of investor obligations in investment treaties – without however being mutually exclusive. This alternative approach stems from two broad considerations: first, that the overarching objective is to ensure that foreign investors are 'responsible' and their conduct is line with the 'sustainability imperative'. Second, that prevention is preferable vis-à-vis reparation: this is a basic tenet in international environmental law, as most forms of environmental harms are irreversible. The same approach is adopted in the *UN Guiding Principles of Business and Human Rights* and the *OECD Guidelines for Multinational Enterprises*, which apply to corporations the notion of 'due diligence' which is of a preventive nature. With these two considerations in mind, there are other avenues that could be explored which – rather than relying on the possibility for a state to bring a claim against an investor *ex post*, once the latter has breached one of its obligations (in other words to seek reparation once the damage is done) – could contribute to change the behavior of foreign investors *ex ante*.

What this section is suggesting is to incentivize sustainable-development-aligned behavior on the part of foreign investors rather than creating a framework to punish potential breaches of direct obligations. The purpose of international investment treaties would remain unaltered – to protect and promote foreign investments – but only *certain types of investments*. In other words, the simple fact of being a foreign investor would be a necessary, yet not a sufficient condition to benefit from the protection of the applicable IIA. Conducting an environmental impact assessment, complying with the principles of prevention and precaution when conducting business

[47] UNGA 'Transforming our world: the 2030 Agenda for Sustainable Development' (Oct. 21, 2015) UN Doc A/RES/70/1, SDG 1, target 1.b; SDG 2, target 1.a; SDG 7, target 7.a; SDG 10, target 10.b.

[48] Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) 3156 UNTS 79, art 2(1)(c).

activities, respecting the right to a clean, healthy and sustainable environment, and respecting the rights and interests of local communities while exploiting natural resources could be some of the conditions *sine qua non* to benefit from the standards of treatment and protection of an IIA – or even to simply fall under its scope.

A hint in this direction can be found in the preamble of the 2012 *South African Development Community (SADC) Model BIT*, which stresses that the Parties seek to 'promote, encourage and increase investment opportunities *that enhance sustainable development* within the territories of the State Parties'.[49] Along the same lines, Article 1(3) of the *Morocco-Nigeria BIT* defines 'Investment' as

> an enterprise within the territory of one State established, acquired, expanded or operated, in good faith, by an investor of the other State in accordance with law of the Party in whose territory the investment is made taken together with the asset of the enterprise *which contribute to sustainable development* of that Party and has the characteristics of an investment involving a commitment of capital or other similar resources, pending profit, risk-taking and certain duration.

These broad formulations of course raise a number of questions. How do we define an investment that contributes to the sustainable development of a Party – or, in simpler words, how do we define a 'sustainable' investment? The literature has been grappling with these questions recently, and several taxonomies have been developed, which seek to identify those economic sectors or activities which are deemed to be environmentally, socially, or economically sustainable, and may therefore be useful to help give content and meaning to the notion of 'sustainable investment'.[50] One of the first examples is the taxonomy released in 2013 by the Climate Bonds Initiative, which contains a list of assets, activities and projects where investment would be – according to its methodology – consistent with the transition to

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[49] Emphasis added.

[50] Viñuales (n 10); Stephen S Golub et al, 'Defining and Measuring Green FDI: An Exploratory Review of Existing Work and Evidence', *OECD Working Papers on International Investment* (2011).

a low-carbon economy.[51] Another notable example, building on the work of the Climate Bonds Initiative, is the European Union's Taxonomy Regulation, enacted in 2020 as part of the broader framework established by the 2019 European Green Deal and the Action Plan on Financing Sustainable Growth.[52] Unsurprisingly, each taxonomy is different, and investment agreements could help achieve greater alignment by offering a common, actionable definition of what constitutes a 'sustainable' investment.[53]

Some IIAs have adopted a slightly different approach and have singled out specific sectors where related investments will fall *outside of* the scope of application of the treaty. This is the case of the ECT, after the modernization process which took place between 2018 and 2024 and which provided for a so-called 'fossil fuel carve-out.' The latter is an *optional* carve-out which allows the Contracting Parties to choose to exclude fossil fuel investments made after August 2023 from treaty protection, while limiting protection for existing fossil fuel investments to a maximum of ten years from the date the modernized treaty enters into force.

Similar results can be obtained by providing for more granular formulations of the different standards of treatment. Let's take the non-discrimination standard as an example. A fine-grained description of the factors that a tribunal has to take into account to determine whether two investors are 'in like circumstances' (for instance, once again, conducting an environmental impact assessment, complying with the principles of prevention and precaution, respecting the right to a clean, healthy and sustainable environment, and respecting the rights and interests of local communities) could end up depriving 'unsustainable' investments of the relevant protection. And similar, more granular, formulations could help narrow the scope of other standards of treatment and protection, thereby limiting the types of investments that can ultimately benefit from them.

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[51] CBI, 'Buildings Criteria: The Buildings Eligibility Criteria of the Climate Bonds Standard & Certification Scheme' (7 December 2023).

[52] Regulation (EU) 2020/852 of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment.

[53] Viñuales (n 10).

6. Conclusions

When Coltrane recorded his lost album in 1963, what he was trying to do was to start 'a sentence in the middle' and then go 'to the beginning and the end of it at the same time […] *both directions at once*'.[54] The reform of international investment law may still be unfolding, but it, too, is beginning to move – tentatively yet ambitiously – in both directions at once. It keeps providing foreign investors with standards of treatment and protection while, at the same time, introducing obligations that apply directly to them. It is slowly evolving into a two-way street.

And there is more. The reform of international investment law – and in particular efforts to promote more sustainable and responsible investor behavior – can also advance on two fronts, and perhaps more. On the one hand, there are growing efforts to embed direct obligations for investors in new international investment agreements. On the other, we are beginning to see a shift toward limiting protections under IIAs to those investors who act in socially and environmentally responsible ways, creating incentives for better conduct. Crucially, these two approaches are not mutually exclusive. They can – and arguably should – move forward simultaneously, along parallel tracks. In short: *both directions at once.*

[54] Michael J West, 'Delayed Trane: John Coltrane's Lost Album' (*JazzTimes*, 9 August 2018).

8

Integrating Environmental Protection into International Investment Law: Considerations on the Brazilian Cooperation and Facilitation Investment Agreements[1]

Leonardo Vieira Arruda Achtschin

1. Introduction

The international investment law regime was designed as an instrument to protect investors' interests.[2] This structure, conceived by developed

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[1] The opinions expressed by the author do not represent the official position of any entity or agency of the Brazilian government. Thus, they must be attributed solely and exclusively to the author.

[2] Miles argues that, even though the doctrine sets the 1959 Germany-Pakistan BIT as the inauguration of the international investment law system, its origin dates back to the period of the expansion of European trade and investment activity from the seventeenth to early twentieth century. Its formalization as a unique system arose during the postcolonial nationalisation process as a tool to protect investor's properties in the new independent States. See, for instance, Kate Miles, *The Origins of*

countries, was based on the belief that attracting investments would result in economic development for the host country.[3]

In recent years, however, this system has been shaken by movements that call for a revisitation of the rights and duties granted to investors through bilateral investment treaties (BITs) or free trade agreements with investment chapters (FTAs). Among these claims, the recognition of the State's right to regulate in public interest stands out. New investment treaties, such as those of the United States and Canada, have sought to adopt an approach focused on State sovereignty, promoting a balance between the State's regulatory power and investment protection.[4] In the same vein, there is Italy's new investment treaty model, which aims to balance investor rights with the exercise of State prerogatives, which also provides for corporate social responsibility.[5]

In this context, the Brazilian path in the international investment law system proved to be unique. During the 1990s, Brazil signed 14 BITs.[6] They all provided for investor treatment standards commonly adopted in investment treaties at the time, such as fair and equitable treatment (FET), indirect expropriation and Investor-State Dispute Settlement System (ISDS). However, negotiations before the National Congress brought to debate the existence

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International Investment Law: Empire, Environment and the Safeguarding of Capital (Cambridge University Press 2013) 19 and 79. In the same sense, Sornarajah states that the postcolonial period was characterized by attempts of nationalisations of foreign properties in the new independent countries, which led to discussions on the need to protect the interests of foreign investors. See Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2017) 26-36.

[3] ibid 173.

[4] ibid 208.

[5] Model BIT Italy (2022) at <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6438/download>. See Maria Chiara Malaguti, 'The New Italian Model BIT Between Current and Future Trends' (2021) 1 The Italian Review of International and Comparative Law 113.

[6] Chile (1994), Cuba (1997), Denmark (1995), France (1995), Finland (1995), Germany (1995), Italy (1995), Portugal (1994), South Korea (1995), Switzerland (1994), the Belgium-Luxembourg Economic Union (1999), the Netherlands (1998) and Venezuela (1995).

of constitutional requirements that prevented the ratification of those treaties, leading the Head of the Executive Branch to withdraw them.

As a result, Brazil remained away from the international investment law regime throughout the 1990s and the first decade of the 2000s. This isolation did not have a negative impact on the flow of investments to the country, as Brazil had gone through economic reforms in the 1990s,[7] which placed the country on a growth direction and made it attractive to foreign direct investment. Over this period, the country evolved from an importer to a net exporter of capital, which led the Brazilian government to rethink its investment policy, including protecting the interests of its companies abroad.[8]

In this context, Brazil officially entered the international investment law regime in 2015, when it signed its first Cooperation and Facilitation Investment Agreement (CFIA) with Mozambique.[9] This CFIA was followed by 13 other treaties signed to date.[10] This is a different treaty model from the

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[7] These reforms were based on the tripod inflation-targeting, flexible exchange rates and fiscal responsibility. The country adopted a new currency with the Real Plan, a new fiscal responsibility law and privatized several public services. See Alfredo Cuevas and others, 'An Eventful Two Decades of Reforms, Economic Boom, and a Historic Crisis' in Antonio Spilimbergo and Krishna Srinivasan (eds) *Brazil: Boom, Bust and the Road to Recovery* (International Monetary Fund 2019) 382.

[8] The growing importance of the country is reflected by its entry into the BRICS group, officially established in 2009. See, for instance, UNCTAD, 'BRICS Investment Report' (2023) <https://unctad.org/system/files/official-document/diae2023d1_en.pdf>. The BRICS Understanding on Investment Facilitation, made during its Summit in Russia in 2020, stated the important role played by the BRICS economies in global international investment flows, characterized for being major exporters of capital and destinations of inward foreign direct investments. See BRICS, 'BRICS Understanding on Investment Facilitation, 10th TMM Joint Communique' (2020) <https://brics2023.gov.za/wp-content/uploads/2023/07/BRICS-Understanding-on-Investment-Facilitation-2020.pdf>.

[9] Agreement for Cooperation and Investment Facilitation between the Government of the Federal Republic of Brazil and the Government of the Republic of Mozambique (2015) <https://edit.wti.org/document/show/c9fd85ab-2190-467a-a063-4ad7c3c98fbd?page=1.>.

[10] With Angola (2015), Mexico (2015), Malawi (2015), Colombia (2015), Chile (2015), Ethiopia (2015), Suriname (2018), Guyana (2018), United Arab Emirates (2019), Morocco (2019), Ecuador (2019), India (2020) and São Tome and Principe (2023).

traditional one, the most remarkable features of which are the absence of the FET clause, the lack of a provision on indirect expropriation, an institutional system of dispute prevention, the adoption of a State-State Dispute Settlement System (SSDS), the provision of a comprehensive corporate social responsibility, and the aim of preserving the State's right to regulate, focused on the protection of human rights, labour and environmental rights.

Taking into account ongoing movements that claim the modification of the long-established architecture of international investment law, the Brazilian strategy seems to have been the right one.[11] If, on one hand, this foreign policy kept the country apart from the international investment regime for more than 50 years; on the other hand, it enabled the country to develop its investment public policy based on past experiences of other nations, both related to the formulation of investment treaties and the dangers posed by the ISDS system. Arbitration tribunals against several Latin American countries revealed the potential harm that investment arbitration can pose to developing nations.[12]

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[11] This perception is even more coherent given the following facts: (i) some countries denounced the ICSID Convention, withdrawing from the investor-State system, such as Bolivia, Ecuador and Venezuela; (ii) South Africa terminated its BITs with European countries, moving away from the investor-State system; (iii) India is reviewing all its BITs, an action that gained momentum after the adoption of its model in 2015; (iv) several European countries are abandoning the Energy Charter Treaty; (v) several developed countries are adopting more balanced BIT models, such as Norway, Canada, The Netherlands, Italy; and (vi) several developed countries are reviewing their understanding of investment treaties, especially after investors bring claims against them before investment tribunals, like the *Vattenfall* case (*Vattenfall AB and others v Federal Republic of Germany*, ICSID Case No ARB/12/12).

[12] See, for example, Argentina (*Compañiá de Aguas del Aconquija SA and Vivendi Universal SA v Argentine Republic*, ICSID Case No ARB/97/3; *Enron Corporation and Ponderosa Assets, LP v Argentine Republic*, ICSID Case No ARB/01/3; *CMS Gas Transmission Company v The Republic of Argentina*, ICSID Case No ARB/01/8; *Azurix Corp v The Argentine Republic*, ICSID Case No ARB/01/12; *Mobil Exploration and Development Inc. Suc. Argentina and Mobil Argentina SA v Argentine Republic*, ICSID Case No ARB/04/16); Ecuador (*Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11; *Duke Energy Electroquil Partners & Electroquil SA v Republic of Ecuador*, ICSID Case No ARB/04/19; *Chevron Corporation and Texaco Petroleum Company v The Republic of Ecuador (I)*, PCA Case No 2007-02/AA277); Venezuela (*Fedax NV v The*

Given this context, the article investigates the movement that aims at redefining the international investment law regime from the perspective of environmental protection, based on the CFIA case study. In the first part, it is argued that the CFIA enables a procedural integration of this protection through the establishment of an original dispute prevention mechanism and a dispute resolution system based on SSDS. In the second part, it is argued that the CFIA promotes a substantial integration of environmental protection by prohibiting the reduction of established environmental standards and by providing a comprehensive corporate social responsibility. In the end, it concludes that the CFIA, although it may not be considered the leading investment treaty model, it may be an interesting alternative for promoting a system that takes into account the host State public interest while protecting investor's rights.

2. The Procedural Integration of Environmental Protection Through the Establishment of a Unique Dispute Prevention and Dispute Settlement System

The CFIA establishes its own system for resolving disputes between the investor and the host State, separating it into an instance prior to and an instance after the emergence of the controversy. It is a system based on the role of the State as a conflict resolution facilitator, which opens space for the consideration of aspects relating to environmental protection within the scope of an investment treaty. The argument presented is that, through the establishment of an authentic dispute prevention and resolution system, the CFIA enables an effective incorporation of environmental protection as a tool for the management of the investment treaty by encouraging consensual dispute resolution. In this sense, the Brazilian model establishes an institutional governance structure, focused on conflict prevention, and carried out by the Joint Committee and the Focal Point (2.1). If the dispute is

Republic of Venezuela, ICSID Case No ARB/96/3; *Mobil Corporation, Venezuela Holdings, BV and Others v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27).

not resolved institutionally, the CFIA provides for the possibility of access to a State-State dispute resolution system (2.2).

2.1 Integrating Environmental Protection Through Institutional Governance

The Brazilian investment agreements establish an institutional governance system aimed at seeking a friendly solution to the conflict between the investor and the host State. This structure, focused on an intervention prior to the emergence of the conflict, allows to bring into the institutional debate the relevance of public environmental policies adopted by the State, which may be challenged in the future by the investor through an arbitration procedure.

Traditional investment treaties usually do not provide for a preventive dispute system between the investor and the State. On the contrary, the vast majority of BITs provide to the investor, with some exceptions[13], direct access to international investment arbitration. However, some modern investment agreements have sought to establish prevention as one of the steps that precede the initiation of an arbitration procedure, as provided for in the BIT between Nigeria and Morocco.[14]

In that regard, Brazil can be considered a pioneer when it comes to adopting a preventive system for resolving investment disputes. In the case of the CFIA, this system is made possible by institutional governance, which is put into practice through the intervention of two institutions: the Joint Committee and the Focal Point (Ombudsperson). The logic behind these institutions relates to their preventive nature, seeking to promote transparency between the parties, thus avoiding the initiation of the arbitration procedure.[15]

[13] For example, exhaustion of local remedies, cooling-off period, etc.

[14] Morocco-Nigeria BIT (2016) art 4 <https://edit.wti.org/document/show/bde2bcf4-e20b-4d05-a3f1-5b9eb86d3b3b>.

[15] Nitish Monebhurrun and Leonardo Vieira Arruda Achtschin, 'Rumo à profissionalização da prevenção de controvérsias nos Acordos de Cooperação e Facilitação de Investimentos (ACFIs) do Brasil?' (2021) 18(2) Brazilian Journal of International Law 195.

The Joint Committee, a body with political and diplomatic function[16], constitutes a mandatory step that the investor must resort to before initiating a State-State arbitration procedure.[17] Failure to comply with this will lead to a denial of jurisdiction, given the absence of a report from the Committee. The Joint Committee is an institution with a quasi-jurisdictional nature, governed by specific proceedings and deadlines, whose objective is to promote transparency to put into perspective the expectations of investors in relation to the protections granted to them by the treaty.[18]

Among its duties, the Joint Committee is responsible to 'Address any issues concerning investments of investors of a Party in an amicable manner'.[19] Thus, the Committee assumes the role of dialogue coordinator, responsible for conciliating the interests of the investor and the legitimacy of the public policy adopted by the host State.

The Ombudsperson, allocated within the structure of the Chamber of Foreign Trade (CAMEX)[20], performs an administrative function in preventing conflicts, acting as an articulator between the investor and the host State

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[16] Nitish Monebhurrun and Leonardo Vieira Arruda Achtschin, 'Dispute prevention methods in the Brazilian Agreements on Cooperation and Facilitation of Investments (CFIAs)' in Nitish Monebhurrun, Carolina Olarte-Bácares and Marco A Velásquez-Ruiz (eds), *International Investment Law and Arbitration from a Latin American Perspective* (Springer 2024) 163.

[17] See Model CFIA Brazil (2015) art 23(2); Brazil-India CFIA (2020) arts 18.1 and 19.1; Brazil-United Arab Emirates CFIA (2019) arts 24(1) and 25(1); Brazil-Ecuador CFIA (2019) art 24(2); Brazil-Suriname CFIA (2018) art 15; Brazil-Mozambique CFIA (2015) art 15(2); Brazil-Angola CFIA (2015) art 15(2); Brazil-Malawi CFIA (2015) art 13(3); Brazil-Colombia CFIA (2015) art 22(2); Brazil-Chile CFIA (2015) art 24(1). See also Michelle Ratton Sanchez Badin and Fabio Morosini, 'Navigating between Resistance and Conformity with the International Investment Regime', in Fabio Morosini and Michelle Ratton Sanchez Badin (eds), *Reconceptualizing International Investment Law from the Global South* (Cambridge University Press 2017) 233.

[18] Monebhurrun and Vieira Arruda Achtschin (n 16) 163.

[19] See, for example, Brazil-United Arab Emirates CFIA (2019) art 18(4)e.

[20] The Brazilian Ombudsman (DIO) was created by the Decree No. 8.863/16. According to the Decree No 11.428/23, the DIO is part of the structure of the Brazilian Foreign Trade Chamber (CAMEX).

to reduce the risk of an arbitration procedure.[21] One of its responsibilities is related to the management of the agreement[22], providing assistance in matters related to the investor's daily life (business routine), such as granting environmental licenses to operate, reporting environmental impacts and informing about the country laws and regulations.

This management is carried out through the procedure of 'requests', aimed at clarifying general doubts regarding legislation and administrative procedures related to the investment, and the procedure of 'inquires', aimed at finding solutions for specific cases that are affecting the investor or its investment.[23]

This dispute prevention system has the merit of reconciling the need of the host country to adopt public policies with the resolution of claims originating from the investor, ensuring the legitimacy of the State's right to regulate through the institutions provided by the CFIA.[24] It is a system focused on negotiation and dialogue instead of promoting conflict[25]; it is oriented towards identifying and overcoming legal and regulatory barriers that the investor is facing in the host country.[26]

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21 Monebhurrun and Vieira Arruda Achtschin (n 16) 163.

22 See Brazil-United Arab Emirates CFIA (2019) art 19(4)(c)(d)(e).

23 Brazil, Direct Investments Ombudsman <https://oid.mdic.gov.br/en/menus/8>.

24 Ivette Susana, Esis Villarroel and Leonardo Vieira Arruda Achtschin, 'A regulação sanitária nos tratados de investimentos brasileiros' (2023) 25(135) Revista Jurídica da Presidência 101.

25 Nitish Monebhurrun, 'Novelty in international investment law: the Brazilian agreement on cooperation and facilitation of investments as a different international investment agreement model' (2017) 8(1) Journal of International Dispute Settlement 79.

26 Lise Johnson, Lisa Sachs and Nathan Lobel, 'Aligning international investment agreements with the Sustainable Development Goals' (2019) Columbia Journal of Transnational Law 58.

This reinforced structure to prevent the emergence of an arbitration dispute[27], based on the intervention of the Joint Committee and the Ombudsperson, allows Brazil to mitigate the possibility of the initiation of arbitration proceedings challenging public environmental policies adopted in line with commitments assumed by the country in international fora[28], giving it a holistic approach to its institutional governance system, as argued by some scholars.[29]

Despite its advantages, it is important to ensure that such institutions do not function exclusively in a politicised manner, but rather professionally[30], which necessarily involves counting on a team with expertise in international investment law.

2.2 Integrating Environmental Protection Through a State-State Dispute Settlement Mechanism

If the dispute is not settled amicably, the investor may, on the assumption that a violation of the treaty has occurred, request his country of nationality to establish an ad hoc arbitration. This is a State-State arbitration procedure, through which the investor does not have legal capacity to directly access the court, but only the State.

The traditional system to settle investment disputes, characterized by the direct access of the investor to arbitration (investor-State system), has been criticised, because it has been used to challenge laws and regulations, as well as public policies adopted by host States.[31] These challenges directly

[27] Fábio Morosini, Vivian Daniele Rocha Gabriel and Anastacia Costa, 'Dispute Settlement in the Investment Agreements: The Experiences of CPTPP, CETA and CFIAs' (2020) 17(1) Brazilian Journal of International Law 292.

[28] For example, Brazil adopted the United Nation's Sustainable Development Goals (SDG) in 2015 and ratified the Paris Agreement in 2016.

[29] Johnson, Sachs and Lobel (n 26).

[30] Catharine Titi, 'Non-Adjudicatory State-State Mechanisms in Investment Dispute Prevention and Dispute Settlement: Joint Interpretations, Filters and Focal Points' (2017) 14(2) Brazilian Journal of International Law 36.

[31] See Barnali Choudhury, 'Recapturing public power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit' (2008) 41

involve the right to regulate in environmental matters.[32] This scenario has fostered negotiations at the multilateral level, within the scope of the Working Group III of the United Nations Commission on International Trade Law (UNCITRAL), which have sought to reform a system perceived by many as generating friction between investor protection and the legitimate right of the State to regulate on the public interest.[33]

In the CFIA, the logic of access to arbitration is reversed, with the dispute resolution mechanism (State-State) appearing in a secondary position, that is, it can only be initiated after prior attempts at the institutional level.[34]

As a rule, the CFIA establishes that the objective of the arbitration is to verify compliance between the measure adopted by the State and the provisions of the treaty.[35] However, it also allows the court to express its opinion

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Vanderbilt Journal of Transnational Law 775; Lise Johnson, Lisa E Sachs and Jeffrey D Sachs, 'Investor-State Dispute Settlement, Public Interest and U.S. Domestic Law' (2015) Columbia Center on Sustainable Development 1.

[32] Kathryn Gordon and Joachim Pohl, 'Environmental Concerns in International Investment Agreements: A Survey' (2011) OECD Working Papers on International Investment, 2011/01. See also Kyla Tienhaara, 'Unilateral Commitments to Investment Protection: Does the Promise of Stability Restrict Environmental Policy Development?' (2008) 17 Yearbook of International Environmental Law, 139, 139-40; Thomas Waelde and Abba Kolo, 'Environmental Regulation, Investment Protection and "Regulatory Taking"' (2001) 50 International and Comparative Law Quarterly 811.

[33] See Lorenzo Cotula and Terrence Neal, 'UNCITRAL Working Group III: can reforming procedures rebalance investor rights and obligations' (2019) 15 South Centre-IIED Investment Policy Brief; Kinda Mohamadieh 'The future of investor-State dispute settlement deliberated at UNCITRAL: unveiling a dichotomy between reforming and consolidating the current regime' (2019) 16 South Centre-IIED Investment Policy Brief. For more information on the work developed by UNCITRAL Group III, see UNCITRAL, Working Group III: Investor-State Dispute Settlement Reform <https://uncitral.un.org/en/working_groups/3/investor-state>.

[34] Monebhurrun (n 25).

[35] See Model CFIA Brazil (2015) art 24(2); Brazil-United Arab Emirates CFIA (2019) art 25(2); Brazil-Ecuador CFIA (2019) art 25(2); Brazil-Guyana CFIA (2018) art 25(2); Brazil-Suriname CFIA (2018) art 25(2); Brazil-Ethiopia CFIA (2018) art 24(2); Brazil-Colombia CFIA (2015) art 23(2). The CFIA with India expressly states that the arbitral tribunal shall not award compensation (Brazil-India CFIA (2020), art 19.2), while the one with

regarding the occurrence of damages, which must be the subject of a specific arbitration agreement.[36]

The CFIA's dispute settlement model has the merit of keeping the State accused of violating the treaty as an active participant in the arbitration procedure, which does not occur in the investor-State system, where the State plays a secondary role before a tribunal that will render a decision that has the potential to affect it economically. This allows Brazil a greater margin for preserving its environmental regulatory space, shielding the country against awards disconnected from the real need to protect the environment.

In addition, this becomes more relevant given the fact that a large part of investor-State arbitrations involve the energy sector (fossil fuels) and extractive industries, forming a system largely favorable to polluting and already established industries, which leads to strong pressure from these companies to maintain the status quo.[37] Therefore, the high cost of these disputes, as well as the high amounts of compensation granted to investors by arbitration courts, makes it difficult for host States to adopt environmental policies aimed at combating climate change.[38] The results can be quite harmful to the economy of a country, as illustrated by the case *Hulley Entreprises v. Russia*, in which the tribunal awarded the investor compensation of USD 40 billion.[39] Although the *Hulley* case may be considered as

Morocco states that the Parties may assess damages and establish compensation (Brazil-Morocco CFIA (2019) art 20(2)).

[36] See Model CFIA Brazil (2015) art 24(13); Brazil-United Arab Emirates CFIA (2019) art 25(13); Brazil-Ecuador CFIA (2019) art 25(13); Brazil-Guyana CFIA (2018) art 25(13); Brazil-Suriname CFIA (2018 art 25(13); Brazil-Ethiopia CFIA (2018) art 24(11); Brazil-Colombia CFIA (2015) art 23(14).

[37] Kyla Tienhaara, 'Regulatory chill in a warming world: the threat to climate policy posed by Investor-State Dispute Settlement' (2018) 7(2) Transnational Environmental Law 229.

[38] Lea Di Salvatore, 'Investor-State Disputes in the Fossil Fuel Industry' (IISD 2021) <https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf>.

[39] *Hulley Entreprises Limited (Cyprus) v The Russian Federation*, PCA Case No 2005-03/AA226, Final Award, 18 July 2014, paras 1777-1829 and 1888(f).

an isolated case, awards in fossil fuel arbitrations have ranged from USD 1.6 to USD 8.4 billion[40], showing the scale of the damage that the ISDS system can represent for a country, especially those of low and medium incomes.[41]

In this way, the CFIA, by centralizing investment arbitration in the hands of the State, allows the country to have a greater margin for adopting public policies aimed at combating climate change, which inexorably involves the adoption of environmental regulation.

3. Substantial Integration of Environmental Protection Through the Establishment of Substantive Provisions

The CFIA is not the only investment treaty to contain provisions related to the prohibition of lowering environmental protection standards[42] and corporate social responsibility. However, the Brazilian model innovates in linking them to the dispute prevention system. Thus, the argument developed here is that the establishment of these provisions promotes a substantial integration of environmental protection within the scope of the investment treaty.

[40] See, for instance, Di Salvatore (n 38).

[41] In her research, Hallward-Driemeier empirically tested the relevance of BITs for attracting investments. She concluded that BITs do not necessarily attract foreign direct investment; on the contrary, they can cause damages to countries due to limitations imposed on policymakers. See Mary Hallward-Driemeier, 'Do bilateral Investment Treaties Attract FDI? Only a Bit and They Could Bite' (2014) World Bank Policy Research Working Paper No 312.

[42] According to Mitchell and Munro, the first agreement to mention the principle of non-regression from domestic environmental protection was the North American Free Trade Agreement (NAFTA) in 1992. See Andrew D Mitchell and James Munro, 'No Retreat: An Emerging Principle of non-regression from environmental protections in International Investment Law' (2018) 5 Georgetown Journal of International Law 625.

By this means, the Brazilian model integrates environmental protection through the prohibition of reducing environmental protection standards (3.1) and the adoption of corporate social responsibility (3.2).

3.1 Integrating Environmental Protection by Prohibiting the Lowering of Environmental Standards

The CFIA recognizes that it is inappropriate to encourage foreign investment in its territory by lowering established environmental protection standards. This is an important measure for attracting investments that comply with Brazilian environmental regulations in accordance with international environmental commitments assumed by the country, including those related to the United Nations Sustainable Development Goals (UN SDGs).

The Brazilian model, which was adopted in 2015 and whose provisions have been largely reproduced in other CFIAs[43], includes this provision in its Article 16, as transcribed below:

> 2. The Parties recognize that it is inappropriate to encourage investment by lowering the standards of their labor and environmental legislation or measures of health. Therefore, each Party guarantees it shall not amend or repeal, nor offer the amendment or repeal of such legislation to encourage the establishment, maintenance or expansion of an investment in its territory, to the extent that such amendment or repeal involves decreasing their labor, environmental or health standards. If a Party considers that another Party has offered such an encouragement, the Parties will address the issue through consultations.[44]

The Brazilian treaty prohibits the adoption of any measure that seeks to lower protective standards already established with the aim of attracting,

[43] See, for example, Brazil-India CFIA, art 22.2; Brazil-Ecuador CFIA, art 17(2); Brazil-Colombia CFIA, art 15(2); Brazil-Chile CFIA, art 17(2); Brazil-Ethiopia CFIA, art 16(2); Brazil-Suriname CFIA, art 17(2); Brazil-Guyana CFIA, art 17(2); Brazil-United Arab Emirates CFIA, art 17(2).

[44] Model CFIA Brazil, art 16(2).

maintaining or expanding investments in the territory of any of the parties to the agreement. According to the CFIA, if any Party considers that there has been a breach of this provision, it may request the initiation of a consultation procedure.[45]

Although not expressly state by the CFIA, the consultation must be addressed by the Joint Committee, the highest body of the CFIA dispute prevention system. This understanding results from the broad competence attributed to it, which is to ensure the implementation and execution of the agreement.[46]

The provision has the merit of setting a minimum standard of environmental protection already achieved by the host State and prohibiting the modification of its laws or regulations on a case-by-case basis for attracting investments. The intention is to avoid a *race to the bottom* in the pursuit of more investments to the detriment of environmental protection.

However, it should be noted that there are scholars who envisage the possibility of the use of the environmental regression prohibition clause against the host State in investment arbitration, be it ISDS or SSDS.[47] This risk would be likely to arise from political decisions taken by governments with the objective of encouraging the production of clean energy, which would require changes in environmental laws or regulations that may cause losses to other already established investors.

In cases against Spain[48] and the Czech Republic[49], countries that adopted changes to their renewable energy regulations, investors attempted to

[45] See, for example, Brazil-United Arab Emirates CFIA, art 17(2), Brazil-India CFIA, art 22.2.

[46] Model CFIA Brazil, art 17(4)(a).

[47] Mitchell and Munro (n 42).

[48] See *Charanne and Construction Investments v Spain*, SCC Case No V 062/2012, Award, 21 January 2016.

[49] See *Antaris Solar GmbH and Dr. Michael Göde v Czech Republic*, PCA Case No 2014-01, Award, 2 May 2018.

allege a violation of the fair and equitable treatment (FET) clause under the category of legitimate investor expectations.[50]

However, this does not appear to be the case with CFIA. First, Brazil does not adopt the FET clause in its investment treaties.[51] Second, any breach of the prohibition of lowering environmental protection must be alleged by the Party bound to the treaty (a sovereign State), and not directly by the investor. Third, the breach of this provision will inevitably lead to the establishment of a consultation procedure before the Joint Committee, the highest-level institution for the prevention of controversies, where the State will be able to advocate the adoption of the measure on the grounds of public interest. And fourth, the CFIA prohibits the use of this clause in State-State investment arbitration[52], which reinforces the argument in favor of its legitimacy.

Therefore, the prohibition of reducing environmental protection can offer incentives for attracting investments from renewable energies, based on non-polluting sources. A dialogical connection can also be seen between this provision and the institutional governance of the CFIA, offering at the same time legal protection on both a substantial and procedural level.

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[50] Mitchell and Munro (n 42). The FET clause is a standard for the protection of the investor, and is divided in several categories, with emphasis on legitimate expectations. The CFIA does not provide for this standard. On the FET clause, see Rudolf Dolzer, 'Fair and Equitable Treatment: Today's Contours' (2013) 12 Santa Clara Journal of International Law 7; Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford University Press 2013); Kenneth J Vandevelde, 'A unified theory of fair and equitable treatment' (2010) 43 New York University Journal of International Law and Politics 43; Christoph Schreurer, 'Fair and equitable treatment in arbitral practice' (2005) 6 The Journal of World Investment & Trade 357.

[51] On the Brazilian reluctance to accept the FET clause, see Monebhurrun (n 25); Leonardo Achtschin, 'O costume internacional como reforço da objeção brasileira à cláusula do tratamento justo e equitativo' (2020) 17(3) Brazilian Journal of International Law 24; Leonardo Achtschin, 'A aplicabilidade da cláusula do tratamento justo e equitativo ao Brasil' (2021) Lumen Juris 176.

[52] See Brazil-United Arab Emirates CFIA, art 25(3); Brazil-Ethiopia CFIA, art 24(3).

3.2 Integrating Environmental Protection Through Corporate Social Responsibility

Brazil was innovative in including a comprehensive article on corporate social responsibility (CSR) in its CFIA.[53] The provision on CSR in Brazilian treaties reflects the search for a balance in the relationship between the investor and the host State, through balancing rights and "duties".[54]

Despite including a broad list of principles to be followed by the investor, the treaty makes it clear that it is a voluntary standard.[55] In this way, CSR is a self-regulation of private companies, organisations and other entities,[56] a spontaneous conduct adopted by the company[57], like a best-efforts clause.[58]

In the Brazilian CFIA, corporate social responsibility is directly linked to the promotion of sustainable development[59]; therefore, it is in line with

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53 See Brazil-India CFIA, art 12; Brazil-Morocco CFIA, art 13; Brazil-Colombia CFIA, art 13; Brazil-Chile CFIA, art 15; Brazil-Ethiopia CFIA, art 14; Brazil-Suriname CFIA, art 15; Brazil-Guyana CFIA (n 70) art 15; Brazil-United Arab Emirates CFIA, art 15; Brazil-Ecuador CFIA, art 14; Brazil-Mexico CFIA, art 13; Brazil-Mozambique CFIA, art 10 and Annex II; Brazil-Angola CFIA, art 10 and Annex II; Brazil-Malawi CFIA, art 9.

54 Monebhurrun (n 25).

55 See Model CFIA Brazil, art. 14(1): '[i]nvestors and their investment shall strive to achieve the highest possible level of contribution to the sustainable development of the host State and the local community, through the adoption of a high degree of socially responsible practices, based on the voluntary principles and standards set out in this Article'.

56 UNEP, Corporate Social Responsibility and Regional Trade and Investment Agreements (2011) <https://wedocs.unep.org/bitstream/handle/20.500.11822/25936/csr_trade.pdf?sequence=1&isAllowed=y>.

57 Monebhurrun (n 25).

58 Nitish Monebhurrun, 'Incorporating the Social License to Operate into International Investment Law: Taking Stock from the Brazilian Experience' (2023) 24 The Journal of World Investment & Trade 744.

59 See, for example, Brazil-United Arab Emirates CFIA, art 15(1); Brazil-India CFIA, art 12.1; Brazil-Morocco CFIA, art 13(1).

Brazil's commitments under the UN SDGs. It also sets out environmental progress as its first principle, which is directly linked to the idea of sustainable development.[60]

Even though it has the status of a voluntary standard, CSR cannot be seen as an 'ineffective provision', especially due to the importance given to it by the CFIA. It is, in fact, an institution that brings functionality, principally in the CFIA's institutional governance system, as a way of balancing investors' rights and obligations to the host State.[61] Even though it is not stated in most CFIAs, it is understood that any investor conduct that does not comply with the CSR can, and should, be the subject of a final report by the Joint Committee, given the responsibility of this institution to oversee the implementation and execution of the CFIA.[62]

Thus, investor behaviour that cause damage to the environment can be analysed by the Joint Committee in light of CSR. This reasoning is confirmed by the Brazil/Morocco CFIA, which expressly states that the Joint Committee will have, as one of its duties, the competence to supervise issues relating to corporate social responsibility and the conservation of the environment.[63]

The treaty signed with Morocco, as well as other CFIAs, does not make clear how CSR will be applied by the Joint Committee, but the possibility of its use as an interpretative variable in weighing investors' claims can be

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[60] See Brazil-United Arab Emirates CFIA, art 15(2)(a); Brazil-India CFIA, art 12.2(a); Brazil-Morocco CFIA, art 13(2)(a).

[61] Susana, Villarroel and Vieira Arruda Achtschin (n 24).

[62] There is no consensus on this. While some CFIAs mention only 'implementation' (see Brazil/United Arab Emirates CFIA, other CFIAs mention 'implementation and execution' (see Brazil-India CFIA; Model CFIA Brazil).

[63] Brazil-Morocco CFIA, art 14(4)(a).

deduced.[64] This argument is supported by the status of principle accorded to CSR by the CFIA.[65]

In view of the above, CSR can play a role in integrating environmental protection within the scope of the CFIA, especially due to its link with the treaty institutional governance system, promoting the necessary balance between the rights and duties of investors.

64 Susana, Villarroel and Vieira Arruda Achtschin (n 24).

65 See Brazil-United Arab Emirates CFIA, art 15(2); Brazil-India CFIA, art 12.2; Brazil-Morocco CFIA, art 13(2); Brazil-Ethiopia CFIA, art 14(2).