DEFENDING CLIMATE ACTION IN INVESTOR-STATE DISPUTE SETTLEMENT (ISDS): AN ANALYSIS OF FAIR AND EQUITABLE TREATMENT (FET) AND THE RIGHT TO REGULATE IN THE AGE OF THE ENERGY TRANSITION.

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A. INTRODUCTION

Climate Change is the most catastrophic challenge of contemporary times. There is an abundance of scientific evidence supporting it as a significant global challenge, with human activity being the main contributing factor.[1] This phenomenon is largely caused by the emission of greenhouse gases into the atmosphere, a majority of which is a result of the use of fossil fuels for energy production, which according to Climate Watch, accounted

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[1] Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_all_final.pdf> accessed 03 May 2023, which stated that climate change is real and human activity is the main contributor. The IPCC report issued in 2022 determined that behavioural change played a crucial role in the fight against climate change. *See also*, Paul Nicklen, '26 Facts That Bring Home the Reality of Climate Change' (*National Geographic*, 5 November 2021) <https://www.nationalgeographic.co.uk/26facts>accessed 3 June 2023.

for about 73.2% in 2016 of all worldwide emissions.[2] As a result, States signed ambitious international conventions on climate change,[3] and have since then taken steps to shift from traditional fossil-fuel-based energy sources to low-carbon renewable energy sources in pursuit of an ambitious long-term goal to limit global warming below 2° Celsius.[4] This has led to what is known as the 'energy transition'. It involves a shift towards renewable energy such as wind, solar, and hydroelectric power, away from traditional sources such as oil, coal, and natural gas, among others.[5] However, this transition to renewable energy faces several obstacles, prominent is the law protecting foreign direct investments, and investor-state dispute settlement (ISDS). Most fossil-fuel-based energy companies are multinationals, and foreign investors (investors), and their investments are often protected by multiple International Investment Agreements (IIA) and Free Trade Agreements (FTA) with an investment chapter (both IIAs and FTAs are referred to as IIAs in this article). Thus, while climate change-related policies may be necessary to tackle climate change and the goals of the energy transition, they raise important legal questions,[6] impugning the standards of protection such as most-favored-nation treatment (MFN), national treatment, fair and equitable treatment **(**FET)**,** and protection against expropriation.

As a result of these contentious actions, several countries have chosen to withdraw from IIAs that protect fossil-fuel-based energy investments such as the Energy Charter Treaty (ECT). For Example, the United Kingdom announced its withdrawal in 2024,[7] Denmark announced its withdrawal in 2023,[8] Spain, Germany, and the Netherlands in 2022.[9] Consequently, for the ECT, unless it is terminated its provisions continue to apply

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[2] Hannah Ritchie and Max Roser, 'CO2 and Greenhouse Gas Emissions' (Our World in Data 2020) <https://ourworldindata.org/emissions-by-sector#energy-use-in-industry-24-2> accessed 03 May 2023

[3] UN Framework Convention on Climate Change (adopted 09 May 1992, entered into force 21 March 1994) 1771 UNTS 107 (UNFCCC); Paris Agreement (adopted 12 December 2015, entered into force 4 November 2016) U.N. Doc. FCCC/CP/2015/L.9/Rev/1.

[4] Intergovernmental Panel on Climate Change, *Climate Change 2022: Mitigation of Climate Change. Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf> accessed 3 June 2023. *See also* Sebastian Modak, '10 Countries Doing the Most to Fight Climate Change' (*Condé Nast Traveler*, 2 June 2017) <https://www.cntraveler.com/gallery/countries-doing-the-most-to-fight-climate-change> accessed 3 June 2023.

[5] UNDP, 'Energy Transition: United Nations Development Programme' (*UNDP*) <https://www.undp.org/energy/our-work-areas/energy-transition> accessed 3 June 2023.

[6] Pekka Niemelä and others, 'Risky Business: Uniper's Potential Investor-State Dispute against the Dutch Coal Ban' (*EJIL*, 19 March 2020)< https://www.ejiltalk.org/risky-business-unipers-potential-investor-state-dispute-against-the-dutch-coal-ban/ > accessed 3 June 2023.

[7] Graham Stuart, 'UK withdrawal from the Energy Charter Treaty' (UK Parliament, 22 February 2024) <https://questions-statements.parliament.uk/written-statements/detail/2024-02-22/hcws279> accessed 16 March 2024.

[8] Susannah Moody, 'Denmark Announces Plans to Exit ECT' (*Global Arbitration Review*, 14 April 2023) <https://globalarbitrationreview.com/article/denmark-announces-plans-exit-ect> accessed 6 June 2023.

[9] Toby Fisher, 'Spain Announces Withdrawal from ECT' (*Global Arbitration Review*, 13 October 2022)<https://globalarbitrationreview.com/article/spain-announces-withdrawal-ect> accessed 6 June 2023; Rachel More, 'German Cabinet Approves Exit from Energy Charter Treaty' (*Reuters*, 30 November 2022) <https://www.reuters.com/business/energy/german-cabinet-approves-exit-energy-charter-treaty-2022-11-30/> accessed 6 June 2023; Lisa Bohmer, 'Dutch Government Announces Intention to Withdraw from Energy Charter Treaty' (*Investment Arbitration Reporter*, 18 October 2022) <https://www-iareporter-

to investments made for 20 years from such date.[10] Other IIAs must also be terminated. Thus recently, due to the rights guaranteed under IIAs, several multinational companies have requested arbitrations due to the effects and expected consequences of sweeping climate change measures (climate action) implemented, ranging from indirect expropriation to a breach of FET. This article will be limited to FET.

This article argues that defending climate action in ISDS during the energy transition requires balancing FET with the Host State's (State) 'right to regulate', even without an expressed treaty carve-out. This carve-out would cover reasonable measures linked to reducing greenhouse gas emissions. Part II provides an overview of recent climate action and the challenges posed by ISDS. Then, it conducts a legal analysis of FET, highlighting the barriers to defending climate action. Part III then goes on to explore the potential solution of utilising the general principle of the 'right to regulate' as a carve-out, and through detailed examination discusses how it should be effectively employed to defend climate action in ISDS. Before concluding, Part IV concisely elucidates the complexities underlying the modernisation of IIAs, reinforcing the importance of the right to regulate.

B. A SPACE FOR DEFENDING CLIMATE ACTION IN INTERNATIONAL INVESTMENT LAW UNDER THE FET STANDARD?

The vast number of countries that are signatories to the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement illustrates the strong commitment of the international community to combat the global challenge of climate change.[11] The phasing out of fossil-fuel-based energy is considered one of the best ways to mitigate the climate crisis. This Part discusses why phasing out fossil-fuel-based energy is effective in mitigating the climate crisis, and then the legal challenge to these measures.

(1) Policy Justifications for Climate Action and the Threat Posed by ISDS

Under the UNFCCC, States committed to the stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.[12] These include policies to reduce greenhouse gas emissions, and subsidising renewable energy.[13] Further, under the Paris Agreement, States set a long-term goal to keep the global temperature increase well below 2° Celsius

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com.ezproxy.is.ed.ac.uk/articles/denmarks-government-announces-intention-to-withdraw-from-the-ect/> accessed 6 June 2023.

[10] Energy Charter Treaty (adopted 17 December 1994, entered into force 16 April 1994) 2080 UNTS 1995 (ECT), Article 17.

[11] UNFCCC, 'Parties to the United Nations Framework Convention on Climate Change' (*UN Climate Change*)<https://unfccc.int/process/parties-non-party-stakeholders/parties-convention-and-observer-states> accessed 3 June 2023, 197 signatories; UNFCCC, 'Paris Agreement - Status of Ratification' (*UN Climate Change*)<https://unfccc.int/process/the-paris-agreement/status-of-ratification> accessed 3 June 2023, 195 signatories.

[12] UNFCCC, Article 2.

[13] Bodansky Daniel and others, *International Climate Change Law* (OUP 2017), 12.

above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5° Celsius; to increase the ability to adapt to the adverse impacts of climate change and fostering climate resilience and low greenhouse emission development; and to make finance flows consistent with low greenhouse gas emissions pathway and climate-resilient development.[14] States agree to undertake ambitious efforts to the global response to climate change such as preparing and maintaining successive nationally determined contributions that it intends to achieve and pursue domestic mitigation measures to achieve the objectives, and that each successive nationally determined contribution should represent a progression and adjustments to enhance a party's level of ambition.[15] In achieving these measures, States are required to take measures that will include reducing primary energy from coal and other fossil-fuel-based sources, and shifting to low- or zero-carbon fuels.[16] This may be in the form of carbon taxes, emission trading systems, or a complete ban on fossil-fuel-based energy sources. These policies are crucial to implementing mitigation and adaptation measures, and to support the transition towards low-carbon, climate-resilient pathways. By aligning investments with the objectives of the UNFCCC and the Paris Agreement, States can effectively mitigate change.

Building upon these requirements, several States have implemented several measures to comply with their climate change obligations. Notably among them is the phasing out of fossil-fuel-based sources of energy in a move towards green energy. For Example, in 2019 Italy announced its plans to block the issuing of permits for the exploration of oil and gas as part of its plans to cut its carbon footprint.[17] Also in 2019, the Netherlands adopted the 'Law prohibiting the use of coal with the Production of Electricity'.[18] Under this law, as of 1 January 2020, inefficient coal plants with an electrical efficiency rate below 44%, that cannot produce any renewable energy through biomass, and that do not produce renewable heat, are prohibited. As of 1 January 2025, inefficient coal plants with an electrical efficiency rate below 44%, that cannot produce renewable energy through biomass, and that can produce renewable energy through biomass, and that can produce renewable heat, will be prohibited. And as of 1 January 2023, all coal plants will be prohibited. Furthermore, in 2020, Denmark brought an end to oil and gas exploration in the Danish North Sea.[19] This is part of its plan to phase-out fossil fuel extraction by 2050.[20] Additionally, in 2021, Spain passed a climate law committing to cut emissions by 30% by 2025.[21] The law banned all new gas and oil explorations and

[14] Paris Agreement, Article 2.
[15] Paris Agreement, Articles 3 & 4.
[16] UNFCCC, ' Report of the Third Session of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (Glasgow, 1–12 November 2021)' FCCC/PA/CMA/2021/2/Add.2, 4.
[17] Reuters Staff, 'Italy Ready to Block Issuance of Oil and Gas Exploration Permits' (*Reuters*, 9 January 2019) <https://www.reuters.com/article/italy-drilling-idUKS8N1YP08R> accessed 4 July 2023.
[18] Law of December 11, 2019, containing Rules for producing electricity using coal (Coal Production Act) (The Netherlands), *see also* Stan Putter, 'The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations' <https://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> accessed 3 June 2023.
[19] Climate Act, Act No. 965 of 26 June 2020 (Denmark).
[20] Julian Ambrose, 'Denmark to End New Oil and Gas Exploration in North Sea' (*The Guardian*, 4 December 2020) <https://www.theguardian.com/business/2020/dec/04/denmark-to-end-new-oil-and-gas-exploration-in-north-sea> accessed 3 June 2023.
[21] Act 7/2021 on Climate Change and Energy Transition (Spain).

production permits and subsidies with immediate effect.[22] In 2022, Germany approved a law to phase-out coal-fired power plants in the western state of North Rhine-Westphalia by 2030 instead of the previously decided 2038.[23] This also is part of the country's effort to speed up the cutting of greenhouse gas emissions.[24] In addition to phasing out fossil-fuel-based energy sources, several countries have also been introducing carbon taxes and carbon trading marketing to create financial disincentives for greenhouse gas emissions and to generate revenue to finance climate change mitigation and adaptation efforts.[25] Carbon taxes impose a fee on each ton of carbon dioxide emitted, encouraging industries and individuals to reduce their emissions to avoid the tax burden.[26] On the other hand, carbon trading establishes a market for trading emission permits allowing entities to buy and sell the right to emit greenhouse gases.[27] These mechanisms play a vital role in achieving emission reduction targets and transitioning to a low-carbon economy.

Scientific evidence shows that phasing out fossil-fuels-based sources of energy is essential in mitigating climate change.[28] Fossil fuels are the primary source of carbon dioxide (CO_2) emissions, which is the prevalent greenhouse gas responsible for global warming. According to the Intergovernmental Panel on Climate Change (IPCC), limiting warming to 1.5° Celsius requires greenhouse gas emissions to decrease by 43% by 2030 and 84% by 2050.[29] This can only be achieved with a fundamental and rapid transformation in global energy systems.[30] Estimates of future CO_2 emissions from existing fossil fuel infrastructure already exceed remaining cumulative net CO_2 emissions in pathways limiting warming to 1.5° Celsius.[31] Decommissioning and reducing utilisation of existing fossil fuel installations in the energy section as well as cancellation of new installations are required.[32] Thus, by transitioning away from fossil-fuel-based energy,

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[22] ibid, *See also* Isabelle Gerretsen, 'Spain to End Fossil Fuel Production by 2042 under New Climate Law' (*www.euractiv.com*, 17 May 2021)<https://www.euractiv.com/section/climate-environment/news/spain-to-end-fossil-fuel-production-by-2042-under-new-climate-law/> accessed 3 June 2023.

[23] Act to Reduce and End Coal-Powered energy and Amend other Laws (Coal Phase-Out Act) 2020 (Germany).

[24] ibid, *See also* Markus Wacket and Others, 'Germany's Cabinet Approves Accelerated Coal Exit by 2030 in Western State' (*Reuters*, 2 November 2022) <https://www.reuters.com/business/energy/germanys-cabinet-approves-accelerated-coal-exit-by-2030-western-state-2022-11-02/> accessed 3 June 2023.

[25] I Tiseo, 'Carbon Taxes Worldwide by Country 2022' (*Statista*, 6 February 2023) <https://www.statista.com/statistics/483590/prices-of-implemented-carbon-pricing-instruments-worldwide-by-select-country/> accessed 23 June 2023.

[26] Center for Climate and Energy Solution, 'Carbon Tax Basics' (*Center for Climate and Energy Solutions*, 21 October 2021) <https://www.c2es.org/content/carbon-tax-basics/> accessed 23 June 2023.

[27] Center for Climate and Energy Solution, 'Cap and Trade Basics' (*Center for Climate and Energy Solutions*, 6 August 2021) <https://www.c2es.org/content/cap-and-trade-basics/> accessed 23 June 2023.

[28] Intergovernmental Panel on Climate Change, *Climate Change 2023: Synthesis Report. Sixth Assessment Report of the Intergovernmental Panel on Climate Change*' <https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf > accessed 04 May 2023, which stated that global warming this century is on course to exceed an agreed 1.5 degree celsius limit without drastic and immediate cuts to greenhouse gas emissions, and the phasing out of fossil fuels.. *See also* Tim Donaghy, '8 reasons why we need to phase out the fossil fuel industry' (*Greenpeace* , 22 November 2021) <https://www.greenpeace.org/usa/research/8-reasons-why-we-need-to-phase-out-the-fossil-fuel-industry> accessed 4 June 2023.

[29] IPCC (n4) 21.

[30] ibid 97.

[31] ibid 57.

[32] ibid 16.

carbon emissions can be significantly reduced. This is critical in mitigating climate change. These measures align with the commitments made by States under the UNFCCC and the Paris Agreement to prevent dangerous interference with the climate system and promote development on a global scale. Further, these government policies have been informed by the political will of their citizens.[33] As citizens have become more aware of the threat of climate change, and the specific health and environmental threats of fossil fuel extraction in their communities, they have increasingly engaged in large-scale protests, physical blockades, and domestic litigation to challenge the power of the fossil fuel industry.[34]

However, as countries pursue the further phase-out of fossil-fuel-based energy, and devise their nationally determined contributions certain inherent risks must be considered.[35] One significant concern, according to Sarvarian, is the potential for increased investor claims arising from regulatory measures implemented to mitigate greenhouse gas emissions.[36] Indeed, this heightened risk is rooted in the pivotal role foreign investors play within the energy market. 45-50% of oil and gas projects are financed by foreign companies while 40% of power generation projects are financed through foreign direct investment.[37] Therefore, they are protected under international investment law, which can give rise to several ISDS claims arising from IIAs. These claims can be based on various grounds such as FET which is the theme of this article. Thus, States, as they exercise their right to regulate to address greenhouse gas emissions, may encounter claims stemming from actions such as revoking, delaying, or refusing permits for projects, terminating or withholding concession, imposing stricter regulations, emission reduction legislation, imposing fines or penalties for environmental regulations, cancelling agricultural projects or supply contracts based on environmental grounds, or establishing environmental reserves affecting relevant lands.[38] Additionally, there is also a risk of legal claims arising from stranded infrastructure where the transition away from

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[33] Damian Carrington and Damien Gayle , 'Climate Activists Vow to Take to Streets to Stop Fossil Fuel Extraction' (*The Guardian*, 16 January 2023) <https://www.theguardian.com/environment/2023/jan/16/climate-activists-vow-to-take-to-the-streets-to-stop-fossil-fuel-extraction> accessed 4 July 2023; See also, Australian Associated Press, 'Blockade Australia Climate Protests Cause Traffic Chaos in Brisbane and Melbourne' (*The Guardian*, 19 June 2023) <https://www.theguardian.com/environment/2023/jun/20/blockade-australia-climate-protests-cause-traffic-chaos-in-brisbane-and-melbourne> accessed 4 July 2023; See also Sandra Laville, 'Climate Protesters Gather in Parliament Square as Fossil Fuel Deadline Passes' (*The Guardian*, 24 April 2023) <https://www.theguardian.com/environment/2023/apr/24/climate-protests-london-xr-the-big-one-fossil-fuel-deadline> accessed 4 July 2023.

[34] Ibid.

[35] O Akinkugbe and A Majekolagbe, 'International Investment Law and Climate Justice: The Search for a Just Green Investment Order' [2023] 46(2) FILJ 169, 191.

[36] Arman Sarvarian, 'Invoking the Paris Agreement in Investor-State Arbitration' [2023] ICSID Review 1, 12-13.

[37] International Energy Agency, *The Oil and Gas Industry in the Energy Transition: Insights from the IEA Analysis*. *World Energy Outlook Special Report 2020* <https://iea.blob.core.windows.net/assets/4315f4ed-5cb2-4264-b0ee-2054fd34c118/The_Oil_and_Gas_Industry_in_Energy_Transitions.pdf> accessed 03 May 2023, 6, 19, 26.

[38] Sarvarian (n35) 13-14.

fossil-fuel-based energy renders existing infrastructure, such as power plants, refineries, and pipelines, economically obsolete, leading to financial losses for investors.[39]

The year 2022 witnessed notable developments that underscore these potential challenges. The IPCC acknowledged that ISDS cases could lead to States refraining from, or delaying, measures to phase-out fossil fuels.[40] During the same year, significant procedural developments occurred in two ISDS cases against the Netherlands arising from its decision to phase-out coal-fired power by 2030,[41] and against the United States for the US President's cancellation of the Keystone XL Pipeline.[42] Additionally, the decision in *Rockhopper v Italy* was issued, wherein Italy was found to have violated the ECT by imposing a legislative ban on offshore oil and gas exploitation activities concerning an existing project, and was ordered to pay over €190 million in compensation.[43] Although the Tribunal found it unnecessary to determine a breach of the FET standard, the decision underscores the ongoing tension between investors' rights and States' right to regulate, especially when it comes to environmental concerns. A few years prior, Germany had been sued twice by the Swedish energy company Vattenfall. The first instance pertained to environmental regulations imposed on a coal power station,[44] while the second centred on Germany's decision to phase-out nuclear energy following the Fukushima disaster.[45] On both occasions, the government settled the case after making concessions to the company. These cases are predicted to be the first of many, as to achieve the goal of the Paris Agreement of limiting the rise in global average temperatures to 1.5° Celsius, States need to prevent the exploitation of many known fossil fuel reserves.[46]

Indeed, some countries have offered compensation to these companies, as compensation to aggrieved investors.[47] However, there is no rational reason why fossil fuel companies should be entitled to compensation from States for climate action.[48] As this article will show, States have a right to regulate. Providing compensation does not only increase the cost of the energy transition for States but, it perversely shifts resources away from States that are already facing costs associated with climate adaptation and

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[39] Firdaus Nur and Mori Akihisa, 'Stranded assets and sustainable energy transition: A systematic and critical review of incumbents' response ' [2023] 73 ESD 76, 81.

[40] IPCC (n4) 81.

[41] *RWE AG v the Netherlands*, ICSID Case No. ARB/21/4; *Uniper SE v the Netherlands*, ICSID Case No. ARB/21/22.

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

[43] *Rockhopper Italia S.p.A.* v *Italy*, ICSID Case No. ARB/17/14, Award 23 August 2022.

[44] *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany,* ICSID Case No. ARB/09/6.

[45] *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12.

[46] Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' [2023] 26 JIEL 285, 286.

[47] Flues Fabian , 'Billions paid out to coal companies show how investment rules are obstructing the green transition' (Business & Human Rights Centre, 23rd May) <https://www.business-humanrights.org/en/blog/billions-paid-out-to-coal-companies-show-how-investment-rules-are-obstructing-the-green-transition/> accessed 5 August 2023.

[48] Julia Dehm, OECD Public Consultation on Investment Treaties and Climate Change. in Investment Division, Directorate for Financial and Enterprise Affairs, Organisation for Economic Co-operation and Development Paris, France, Investment Treaties and Climate Change OECD Public Consultation | January - March 2022 Compilation of Submissions (OECD 2022), 86.

climate loss and damage. This transfers resources to fossil fuel corporations that are some of the entities most responsible for causing climate change and that have already reaped substantial profits from activities that have caused climate change.[49] Thus, these legal considerations further complicate the process of transitioning away from fossil-fuel-based energy and require careful legal analysis to mitigate potential legal liabilities while ensuring a fair and balanced approach to the energy transition.

(2) Climate Action and FET: What is the Scope of Investor Protection?

Part II thus far relayed that phasing out fossil-fuel-based energy is a desirable policy instrument that can mitigate climate change, and the threat posed by the investment regime. However, if these policies are to succeed, sufficient policy space needs to be provided under international investment law for a legal justification. This section of Part II seeks to outline the standard of protection and the legal limits to defending climate action under IIAs.

IIAs create obligations that require States to protect private investors. One of the most contentious aspects in this regard is FET, which according to Lim, has garnered considerable attention due to its flexibility, seemingly broad scope, and growing popularity.[50] In typical IIAs:

> 'Each Contracting Party shall, at all times accord to the Investments of investors of other Contracting Parties fair and equitable treatment.'[51]

As Schreuer explains, FET is an open-textured guarantee designed to 'allow for independent and objective third-party determination of [a respondent's] behaviour on the basis of a flexible standard'.[52] In the context of the energy transition, the criteria against which tribunals may evaluate a State's conduct in applying FET include:

(a) whether the State breached the investor's reasonable and legitimate expectations when the investment was made;
(b) whether the State acted unjust or arbitrarily; and
(c) whether the State acted transparently.

Recent cases involving companies such as RWE AG and Uniper SE, Vattenfall AB, and TC Energy Corp amplify these. They alleged that climate action measures were adopted against their legitimate expectations. Additionally, they assert that the actions of the respective governments were unjust, arbitrary, and were not transparent. According to them, these measures are predicted to result in a reduction in demand for their products, ultimately leading to a decline in profits, and rendering their investment valueless.[53]

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[49] ibid.
[50] CL Lim and others, *International Investment Law and Arbitration* (2nd edn, CUP 2021), 332.
[51] Energy Charter Treaty (ECT) (1991) 2080 UNTS, Article 10, Agreement between the United States of America, the United Mexican States, and Canada (adopted 30 November 2018, entered into force 01 July 2020) (USMC), Article 14.6.
[52] Christoph Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 JWIT 357, 365.
[53] Stan Putter, 'The Netherlands Coal Phase-Out and the Resulting (RWE and Uniper) ICSID Arbitrations' <https://arbitrationblog.kluwerarbitration.com/2021/08/24/the-netherlands-coal-phase-out-and-the-resulting-rwe-and-uniper-icsid-arbitrations/> accessed 3 June 2023; Daniela Páez-Salgado, 'A Battle on

This Part now examines the relevance of these three important facets of FET in the energy transition. Although some of these disputes have been discontinued,[54] one remains ongoing,[55] and as previously predicted more claims will arise. Thus, it is timely and appropriate to analyse how climate action may be treated under FET to determine whether there is space for defending them.

Legitimate expectations

Several arbitral tribunals have interpreted FET extensively to include the obligation on the part of the State to protect an investor's legitimate expectations and provide a stable legal environment.[56] The Tribunal in *Tecmed v Mexico* ruled that:

> 'the foreign investor expects the Host State to act in a consistent manner, free from ambiguity and totally transparent in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investments and comply with such regulations.'[57]

Advances in scientific knowledge around climate change require a constant adaption of a State's environmental laws which makes interpretation of legitimate expectation crucial.[58] Investors' legitimate expectations are based on the State's legal framework and any undertakings and representations made explicitly or impliedly by the State.[59] The regulatory framework on which the investor is entitled to rely consists of legislation,[60] treaties[61] and assurances contained in decrees, licences, and executive statements.[62] A pertinent example unfolds with the discontinued case of *RWE and Uniper v The Netherlands* where RWE and Uniper argued that they had a legitimate expectation that they would be allowed to operate Eemshaven, a coal-fired power plant based on

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Two Fronts: Vattenfall v. Federal Republic of Germany' <https://arbitrationblog.kluwerarbitration.com/2021/02/18/a-battle-on-two-fronts-vattenfall-v-federal-republic-of-germany/> accessed 4 June 2023; Rithika Krishna, 'TC Energy Seeks NAFTA Damages over Canceled Keystone XL Project' (*Reuters*, 23 November 2021) <https://www.reuters.com/legal/litigation/tc-energy-seeks-nafta-damages-over-canceled-keystone-xl-project-2021-11-23/> accessed 4 June 2023.

[54] Oberlandesgericht Köln, 19 SchH 14/21; Oberlandesgericht Köln, 19 SchH 15/21.

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

[56] *Thunderbird v Mexico*, UNCITRAL, Award, 26 January 2006. para 147; *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para 302; *Novenergia II v Spain*, Final Award, 15 February 2018, para 648.

[57] *Tecnicas Medioambientales Tecmed SA v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, paras 152-156.

[58] Camille Martini, 'Balancing Investors' Rights with Environmental Protection in International Investment Arbitration: An Assessment of Recent Trends in Investment Treaty Drafting (2017) 50 (3) IL 529, 538.

[59] Rudolf Dolzer and others, *Principles of International Investment Law* (3rd edn, OUP 2022) 208.

[60] *Novenergia II v Spain*, SCC Case No. 2015/063, Final Award, 15 February 2018, paras 662-667, 681, 697.

[61] *Antin v Spain*, Award, ICSID Case No.ARB/13/31, Award, 15 June 2018, para 532.

[62] Dolzer (n58) 209.

irrevocable permits.[63] Under the Environmental Permit, Eemshaven was allowed to fire coal to generate electricity. It argued that that expectation was legitimate and that it is entitled to expect that the State will honour the irrevocable lawful permits, and not withdraw or invalidate them for reasons lying outside the applicable law to the permits themselves. While it may be argued that concerns about climate change and fossil fuels contributing to climate change existed when the ECT and most IIAs were signed in 1995, and the UNFCCC being signed months before, numerous explicit representations given by the Respondent in public statements created an expectation on the part of the claimant, which cannot be ignored. These include statements in Energy Reports, where the Respondent openly advocated for the construction of new coal-fired plants, arguing for the need until 2050.[64] Further, it promised not to ban certain technology such as coal, and in 2017 it concluded that a coal ban was unnecessary to meet its climate goals.[65] In light of these arguments, it appears that RWE and Uniper may have a valid claim to legitimate expectations. The State's numerous representations and indications through legislation and licenses, expressing the necessity of coal until 2050 and the absence of plans to phase it out until recently contribute to a compelling case for legitimate expectations. Similarly, in *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, the Claimant asserts that they were invited by the Respondent to apply for a Presidential permit, and was issued the permit twice on the condition that they commence construction of the cross-border segment of the KXL Pipeline within five years after the permit was issued, then revoked the permit.[66] These factors place an impediment to the phasing-out of fossil-fuel-based energy. The *Tecmed* interpretation places an expansive burden on States to safeguard investors' legitimate expectations and ensure a dependable legal framework. This can inadvertently clash with environmental measures. When States have previously extended assurances and commitments that align with fossil-fuel-based investments, these assurances become ingrained in investors' legitimate expectations. As a result, transitioning away from such investment, even in the face of pressing climate change concerns, can trigger a breach of legitimate expectations. Investors may argue that such an abrupt shift in policies or regulations undermines the stability and transparency they were initially assured. Thus, this broad interpretation of legitimate expectations presents a significant obstacle in defending climate action in ISDS.

Transparency

Transparency means that the legal framework for the investors' operations is readily apparent and that any decision affecting investors can be traced to that legal framework.[67] Transparency would also include the obligation to be informed of intended significant

[63] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 529-534; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 447.
[64] ibid.
[65] ibid.
[66] *TC Energy Corporation and TransCanada Pipelines Limited v. United States of America*, ICSID Case No. ARB/21/63, Request for Arbitration, 2 November 2021, para 96.
[67] *Frontier Petroleum v Czech Republic*, UNCITRAL, Final Award, 12 November 2010, para 285; *Micula v Romania I*, ICSID Case No. ARB/05/20, Award, 11 December 2013, para 520.

policy or regulatory changes, to allow Investors to plan 'adequately' and 'engage' in any necessary 'dialogue about protecting its legitimate expectations'.[68]

Although transparency was not argued in *RWE and Uniper* it is still relevant in the age of the energy translation. This is so for several reasons. First, investments in the energy sector often involve long payback periods. Transparent information about policy shifts, regulations, and market trends allows investors to plan for the long term and make strategic decisions that align with evolving energy goals. Second, the energy transition brings about risks and uncertainties, including shifts in market demand, technological advancements, and changing consumer preferences. Transparent disclosure of policy and regulatory changes allows investors to provide input, express concerns, and collaborate with policymakers to shape effective and balanced regulations that align with their interests and contribute to sustainable energy development. This may lead to a just energy transition. However, considering the scale and number of investors involved in fossil-fuel-based energy industries and the urgency of climate action, it may be impractical and burdensome for States to individually approach and consult every investor regarding significant policy changes. However, this is expected by FET. Thus, this may yet present another obstacle to defending climate action in ISDS.

Unjust and arbitrary treatment

Freedom from unjust and arbitrary treatment is also inherent in FET.[69] This includes an obligation not to purposefully inflict damage upon an investment.[70] This can include unreasonable measures. In *Mondev v United States*, it was held that unjust and arbitrary treatment is "a wilful disrgard of due process of law".[71] Another tribunal ruled that these measures include those not founded in reason or fact but on caprice, prejudice, or personal preference.[72]

In *RWE and Uniper*, the Claimants argued that the decision to phase-out fossil-fuel-based energy was not reviewed to determine whether the period for transition was adequate, whether a biomass conversion was feasible, and what steps the companies were taking to mitigate CO_2 emissions, in breach of the prohibition of unjust and arbitrary treatment.[73] Similarly in *TC Energy Corporation and TransCanada Pipelines Limited*, the Claimants argued that the revocation of the presidential permit for climate change concerns, was in breach of the prohibition of unjust and arbitrary treatment. While these arguments raise valid concerns regarding whether the measures adopted by the State were justified, it must be recognised that climate change is not a recent phenoman. States have been aware of climate change for years, yet they continued to encourage foreign direct investment in the energy sector which contributed to greenhouse gas emissions. It can be argued, that for years they have reaped the benefits of these types of investments.

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[68] *Electrabel S.A. v Hungary,* ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, para 7.79.
[69] *S.D. Myers v Canada,* UNCITRAL, Award on Liability 13 November 2000, para 263.
[70] *Vivendi v Argentina*, ICSID Case No.ARB/97/3, Resubmitted Case: Award, 20 August 2007, para 7.4.39.
[71] *Mondev International Ltd v United States of America*, Award, 11 October 2002, para 127
[72] *Plama Consortium Ltd. v Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, para 184.
[73] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 432; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 462.

Therefore, it is imperative for the State to take measures that would achieve a just transition. This includes consultation with affected stakeholders, robust assessments of the environment impact of proposed policies, and proactive efforts to mitigate adverse effects on existing investments. While States have limited resources and cannot conduct individual assessments for every investment, it is only through these concerted efforts that a State can address both the interest of investors and the imperative to combat climate change. Where the State fails to adequately evaluate these factors, the State can be seen to have disregarded the legitimate interests and concerns of affected investors. The lack of comprehensive review could be seen as indicative of a decision being made without proper consideration of the potential impacts on existing investments or a failure to take reasonable steps to minimise the adverse effects on investors. These issues can present yet an obstacle to defending climate action in ISDS.

(3) Bringing It Together: A Safe Harbour for Defending Climate Action or a 'Regulatory Chill' Effect?

This Part has explored the policy justifications for climate action, the looming threat posed by ISDS, the relevant facets of FET, and the potential for defending climate action. However, as we have observed, there are obstacles to defending climate action within the FET standard. FET places a heavy burden on States to defend their climate action, as investors go through a laundry list of all that the State should have done but failed to do. This may result in a 'regulatory chill', which emerges when the government, cognisant of potential ISDS claims, is hesitant to enact or enforce regulatory measures for fear of investor claims.[74] For Example, in 2022, New Zealand's climate change minister indicated that his government had slowed the pace of phasing-out fossil fuels to reduce the likelihood of ISDS claims arising from existing projects.[75] This chilling effect can impede the timely implementation of climate action measures, potentially hindering the pursuit of vital climate action, although adopted in good faith. The urgency of mitigating climate change's profound impacts is set in a precarious balance against the potential legal ramifications, resulting in a delicate dance between environmental concerns and legal prudence. Thus, in light of these formidable challenges, in the next Part, I introduce the 'right to regulate' of States as providing a safe harbour for defending climate action.

C. CREATING A SAFE HARBOUR FOR DEFENDING CLIMATE ACTION: THE RIGHT TO REGULATE

While there may be differing opinions on the suitability of the current system of the IIAs for facilitating the energy transition, I firmly believe that with the appropriate utilisation of the applicable law, defending climate action does not have to be an insurmountable challenge within the existing framework of IIAs. The State has the 'right to regulate' (some

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[74] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' [2018] 7(2) TEL 229, 235.

[75] Elizabeth Meager, 'Cop26 Targets Pushed Back Under Threat of Being Sued', *Capital Monitor*, 14 January 2022, <https://capitalmonitor.ai/institution/government/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/> accessed 5 August 2023.

authors refer to it as a 'margin of appreciation' or 'regulatory space') and can change the existing regulatory framework for the energy transition and phase-out fossil-fuel-based energy to reduce greenhouse gas emissions and mitigate the effects of climate change. Such a decision would be consistent with IIAs and would not necessarily violate treaty provisions on the protection of foreign investments.

The requirement of FET is not a rule in international law requiring a State to freeze its regulatory regime,[76] or limit its powers to alter the regulatory framework applicable to investments that would undermine investors' investments. Thus, in this Part, I discuss the 'right to regulate' as a potential carve-out to FET and a safe harbour to defend climate action. I begin by defining the right to regulate. Subsequently, I delve into its status as a general principle of international law, and its recognition within IIAs. I then explore the potential application of the right to regulate in establishing a safe harbour that can be utilised to defend climate action in ISDS.

(1) Definition of the Right to Regulate

States are simply required to treat investments fairly, and that requirement by no means deprives the State of the right to exercise its regulatory powers.[77] States are sovereign and they are seized with powers to make laws for peace, order, good governance, and the protection of their citizens and the environment. This is known as the right to regulate. It is defined by Titi as 'the legal right exceptionally permitting the State to regulate in derogation of international commitments undertaken by means of an investment agreement without incurring a duty to compensate'.[78] As a result of the negative environmental impacts of the burning of fossil fuels to produce energy, governments around the world have increasingly committed to reducing emissions from fossil-fuel-based energy generation. Therefore, arbitral tribunals must acknowledge and respect this 'right to regulate' as a carve-out when investors allege a breach of the FET standard.

(2) The Status of the Right to Regulate in International Law

The right to regulate derives from two sources: (1) general international law, and (2) IIAs. For the first category, States incorporate the right to regulate in IIAs, through the inclusion of preambles, 'general provisions', or specific exemptions. The second refers to the right to regulate as a general rule whose content is general and abstract.[79]

(3) The Right to Regulate as a General Principle of International Law

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[76] Diego Zannoni, 'The legitimate expectation of regulatory stability under the Energy Charter Treaty' (2020) 33 LJIL 451, 455.
[77] Vaughan Lowe, 'Regulation or Expropriation?' (2002) 55 (1) CLP 447, 450.
[78] Aikaterini Titi, *The Right to Regulate in International Investment Law* (Nomos 2014), 33.
[79] Marcelo Kohen and Bérénice Schramm, (2019) *General principles of law*, *General Principles of Law*. Available at: <https://www.oxfordbibliographies.com/display/document/obo-9780199796953/obo-9780199796953-0063.xml> accessed 05 June 2023.

It is important to recognise that international investment law is not an isolated system but is rooted in general international law, with its specific characteristics. It operates within a broader juridical framework where rules from various sources can be integrated.[80] In this context, Arbitrators guided by the Vienna Convention on Law of Treaties (VCLT), can take into account other international norms when interpreting IIAs.[81] However, for this to apply to ISDS, there must be a foundation in law. I am of the view that the right to regulate is a general principle of international law, recognised under Article 38(1) of the ICJ Statute.[82] Hence, the legitimate basis for its utilisation in ISDS.

General principles of international law are logical inferences that can be found in any legal system or are related to international law.[83] The identification of general principles of law derived from national legal systems is generally considered to consist of a two-step analysis: first, determining the existence of a principle common to the principal legal systems of the world; second, ascertaining the transposition of that principle to the international legal system.[84]

Is it a common principle to the principal legal systems of the world?

The starting point for the present analysis is Article 38, paragraph 1 (c), of the Statute of the International Court of Justice, which in itself provides some guidance.[85] The provision requires that a general principle of law be recognised by the community of nations, which suggests that, for a general principle of law to exist, it must be generally recognised by the members of the community of nations.[86] It cannot be disputed that the right to regulate exists as a general principle of law. This is because the principle refers to the State's sovereign authority to regulate and govern within its territory in pursuit of public interest objectives. The principle is inherent in the functioning of any legal system and is crucial for maintaining order, protecting public welfare, and advancing national interests. In the domestic context, the right to regulate reflects the principle of State autonomy and acknowledges that States possess the authority and discretion to regulate matters within their unique social, cultural, economic, and political context. This right is reflected in the constitution of all States. For example, in the Commonwealth Caribbean, the Constitution recognises the right of the legislature of the State to make laws for peace, order, and good governance.[87] A similar provision is found in the Constitutions of Canada and the United States of America.[88] Therefore, States should have the space to maneuver in adopting measures that may have an impact on their international obligations.

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[80] *Asian Agricultural Products Ltd v Sri Lanka* ICSID Case No.ARB/87/3, Award, 27 June 1990, para 21.
[81] Vienna Convention on the Law of Treaties (VCLT) (1969) 1155 UNTS 33, Article 31(3)(c).
[82] Statute of the International Court of Justice (1945) 59 STAT 1055, Article 38(1).
[83] Kohen and Schramm (n77).
[84] International Law Commission, 'Report of the International Law Commission on the Work of its 62nd Session' (1 April–5 June and 6 July-7 August 2020) Second report on general principles of law, UN Doc A/CN.4/741, 6.
[85] ibid 7.
[86] ibid.
[87] Antigua & Barbuda s46; Barbados s48; Belize s68; Grenada s38; Jamaica s46; St. Lucia s40; St. Kitts Nevis s37; St. Vincent & the Grenadines s37.
[88] Constitution Acts, 1876 to 1982 (Canada), Section 91; Constitution of the United States of America, Article 1.

Can it be transposed to the international legal system?

The second step is ascertaining whether the principle common to the principal legal systems of the world is transposed to the international legal system. Transposition, therefore, does not occur automatically. State practice and jurisprudence show that, for a principle common to the principal legal systems of the world to be elevated to a general principle of law, that principle must be compatible with the fundamental principles of international law.[89] This compatibility test serves to ensure that a legal principle is not only recognised by the community of nations as just but also as capable of existing within the broader framework of international law.[90] Another requirement for the transposition of a principle common to the principal legal systems of the world is that the conditions exist to allow the adequate application of the principle in the international legal system.[91] This serves to ensure that the principle can properly serve its purpose in international law, avoiding distortions or possible abuses.[92] The right to regulate is recognised in IIAs (as discussed in the following section) and has been applied by international courts and tribunals (although not acknowledging it as a general principle). For example, the European Court of Human Rights has repeatedly referred to the 'margin of appreciation' in its jurisprudence.[93] The Court recognises 'a State is entitled to a certain 'space to maneuver', within which its conduct is exempted from full-fledged review'.'[94] This is also now being recognised in the investment context. For Example, the Tribunal in *Phillip Morris v Uruguay* held, in the context of public health-related regulations, that:

> 'the 'margin of appreciation' is not limited to the context of the ECHR but 'applies equally to claims arising under BITs,' at least in contexts such as public health. The responsibility for public health measures rests with the government and investment tribunals should pay great deference to governmental judgments of national needs in matters such as the protection of public health.'[95]

Thus, it appears that there will be no obstacle in transposing the right to regulate that exists within the domestic context into the international legal system. This will provide an avenue for defending climate action. It offers a framework for reconciling a State's regulatory authority with its international commitments, especially in the context of addressing environmental concerns like climate change. However, it is difficult to ascertain the acceptable margin of change in the exercise of the State's normal regulatory power in pursuance of public interest. The *Hydro* Tribunal has explained that 'the State is

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[89] ILC (n82) 22.
[90] ibid.
[91] ibid 23.
[92] ibid 27.
[93] *Greece v UK*, App No 176/56, 1958-I D&R 181, para 318; *Denmark v Greece*, App No 3321/67, 12 YB Eur Conv HR (1969) 1, para 114; *Lawless v Ireland*, App No 332/57, 1 Eur Ct HR (ser B), at 56 (1960–61), para 90 For discuss on the ECHR's approach to the Margin of Appreciation: See Yucal Shany 'All Roads Lead to Strasbourg?: The Application of the Margin of Appreciation Doctrine by the European Court of Human Rights and the UN Human Rights Committee [2018] 9 JIDS 180.
[94] ibid.
[95] *Phillip Morris v Uruguay* ICSID Case NoARB/10/7, Award, 8 July 2016, para 339.

entitled to a high measure of deference' [96] but this does not give arbitrators enough direction.

(4) The Right to Regulate as a Provision In IIAs

The new generation of IIAs are not revolutionary but rather makes explicit the regulatory power of States under general international law that had already been inferred by investment tribunals operating under the first generation of treaties.[97] Only a small proportion of bilateral investment treaties (estimated at 3,300 today) contain a general exemption modelled on Article XX of the General Agreement on Tariffs and Trade or a more limited compliance-measures clause.[98] In the US-Argentina BIT (1991) for example, there is such a specific carve-out. It states:

> 'This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interest.'[99]

Similar provisions have been seen in recent IIAs such as Burkina Faso–Türkiye BIT (2019):

> '1. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or applying non-discriminatory legal measures:
> (a) designed and applied for the protection of human, animal or plant life or health, or the environment;
> (b) related to the conservation of living or non-living exhaustible natural resources.
> […]
> 4. This Agreement shall not imply in any way an obligation for the Contracting Parties to relax their laws and regulations regarding health, safety or environment in order to encourage investment. Neither Contracting Party is under any obligation to waive or otherwise derogate, or to offer to waive or otherwise derogate from such measures for the purpose of encouraging the establishment, acquisition, expansion or the maintenance of an investment in its territory by an investor of the other Contracting Party.'[100]

The use of these clauses has never been clear-cut. Tribunals applying the US-Argentina BIT 1991 have imposed a significant burden on the State, similar to the necessity requirement explained under the Commentary to Article 25 of the ILC Articles on State

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[96] *Hydro Energy I v Spain* ICSID Case NoARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum, 9 March 2020, para 676(8).
[97] Freya Baetens, 'Protecting Foreign Investment and Public Health Through Arbitral Balancing and Treaty Design' [2022] 71(1) ICLQ 139, 172.
[98] Sarvarian (n35) 14.
[99] US-Argentina BIT (1991), Article XI.
[100] Burkina Faso–Türkiye BIT (2019), Article 5.

Responsibility for Internationally Wrongful Acts (ARSIWA).[101] Tribunals have also restricted the scope of what falls under these carve-out clauses. They have ruled that there must exist an impairment of an essential interest of the State or those of the international community as a whole.[102] Furthermore, they have recognised that this is a self-judging clause, where the State is the sole arbiter of the scope and application of the rule. Thus, if the legitimacy of such measures is challenged, it is for an international tribunal to determine whether the plea of necessity can exclude the wrongfulness of the action.[103] As seen in the decisions, this substantive review is conducted according to customary international law as reflected in Article 25 of the ARSIWA.[104] However, one Annulment Committee has submitted that Article XI and Article 25 are substantively different. The first covers measures necessary for the maintenance of public order or the protection of each Party's essential security interests, without qualifying such measures.[105] The second subordinates the State of necessity to four conditions.[106] It requires for instance that the action taken 'does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole', a condition which is foreign to Article XI.[107] Thus, a Tribunal which treats these the same may make a manifest error of law. The challenge to defending climate action under these specific carve-out clauses lies in the interpretation and application of the provision. While the clause allows parties to take measures necessary for the maintenance of public order, the fulfillment of international obligations regarding peace or security, or the protection of essential security interests (which deals with measures necessary to deal with certain situations such as climate change and protects the regulatory powers of the State), its application has been subjected to inconsistency. Where a tribunal takes the approach that these carve-out clauses are to be interpreted similarly to Article 25, the State must demonstrate a compelling justification for the phasing-out of fossil-fuel-based energy, showing that the climate crisis is an impairment of an essential interest of the State or the international community as a whole. While previous sections of this article have discussed the legitimate policy objective of climate actions, the concept of necessity is subject to a high threshold. It requires a situation

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[101] International Law Commission, Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA), 56th Sess., A/RES/56/83 (2002), Article 25 provides:- '1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.' *see usage* in *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Award, 13 May 2005, paras 353-378; *Enron Corporation v Argentina* ICSID Case No. ARB/01/3, Award, 22 May 2007, paras 322-342; See also *Sempra Energy International v Argentina* ICSID Case No. ARB/02/16, Award, 28 September 2007, para 375 where the tribunal rules that the clause is not self-judging but proceeded to review under the rules of necessity similar to previous tribunals.

[102] ibid.

[103] *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Award, 13 May 2005, para 373; *Enron Corporation v Argentina* ICSID Case No. ARB/01/3, Award, 22 May 2007, paras 334; *Sempra Energy International v Argentina* ICSID Case No. ARB/02/16, Award, 28 September 2007, para 388.

[104] ibid.

[105] *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Decision on Annulment, 25 September 2007, para 130.

[106] ibid.

[107] ibid.

requiring a grave and imminent peril. Climate change is a phenomenon that unfolds over decades or even centuries, making it distinct from more immediate threats typically associated with the concept of 'grave and imminent peril'. Further, climate change predictions are based on scientific models and projections, which can involve uncertainties and varying degrees of confidence. This also undermines the claim that climate change constitutes a 'grave and imminent peril'. While Article 3 of the UNFCCC calls for precautionary measures to anticipate and prevent climate change, and the lack of full scientific certainty should not hinder action to prevent serious or irreversible damage,[108] the UNFCCC has no direct application in ISDS, and tribunals have no jurisdiction to arbitrate claims concerning the treaty. To apply in an international investment dispute, there must be a basis in an investment treaty, contract, or law.

Recently, in *Eco Oro v Colombia*[109], the Tribunal construed Article 2201(3) of the Columbia-Canada FTA (which is *pari materia* to Burkina Faso–Türkiye BIT) as being permissive, ensuring a Party is not prohibited from adopting or enforcing a measure to protect human, animal, or plant life and health, provided that such measures are not arbitrary or unjustifiable discriminatory between investment or between investors or a disguised restriction on international trade or investment. However, according to the Tribunal, there is no provision in Article 2201(3) permitting such action to be taken without the payment of compensation.[110] A similar approach was taken by the Tribunal in *Infinito Gold v Costa Rica.*[111] The approach by these two tribunals undermines the existence of the clause and the principle of the right to regulate. The clause exists as a carve-out for measures taken by the State for the reasons listed. If compensation is still required despite the allowance of protective measures, it questions the practical value and purpose of Article 2201(3) itself. In defending climate action this interpretation causes a financial burden to States, especially developing countries or those with limited resources. These funds could be allocated to other pressing priorities. Moreover, this deters policy implementation, as the fear of potential legal challenges and financial liabilities may lead governments to be more cautious and hesitant in enacting measures that could impact investors, as discussed earlier. This can also lead to inequality and the perception of investor privilege, as the requirement for the government to pay substantial compensation can reinforce the perception that the law favours the interest of large multinationals over local companies and the public interest. Thus, these provisions may not provide a safe harbour for defending climate action without more words such as 'will not give rise to compensation'. Such language would clarify that compensation is not required for measures taken to protect the environment, allowing governments to pursue climate action without undue financial burden or concerns about investor backlash. Interestingly, both *Eco Oro* and *Infinito Gold* stand in contrast to the earlier decision of *David Aven v Costa Rica* where the Tribunal held that the rights of investors are subordinate to the rights of the State to ensure that investments are carried out in a manner sensitive to environmental concerns, according to the carve-out provision contained in Article 10.11

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[108] UNFCCC, Article 3.

[109] *Eco Oro Minerals Corp. v Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum, September 8, 2021, para. 829.

[110] Ibid.

[111] *Infinito Gold Ltd v. Republic of Costa Rica*, ICSID Case No. ARB/14/5, Award, 2 June 2021.

of Chapter Seventeen of the Central America-Dominican Republic-United States Free Trade Agreement.[112]

On the other hand, recent IIAs make explicit recognition of the right to regulate in their IIAs. They have included the States' regulatory powers within a 'general provisions' clause which appears to be written in preambular language. For Example, the 2018 EU–Singapore BIT uses the following language:

> '1.The Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment or public morals, social or consumer protection, privacy and data protection and the promotion and protection of cultural diversity.'[113]

Some IIAs have also included this explicit recognition with similar wording in their preambles, for example, the Comprehensive and Economic Trade Agreement (CETA).[114] Moreover, the Trans-Pacific Partnership Agreement (TPP) in its preamble also recognises the 'inherent right of the parties to regulate and resolve to preserve the flexibility of the Parties to set legislation and regulatory priorities, safeguard public welfare, and protect legitimate public welfare objectives such as public health, the environment, the conservation of living or non-living exhaustible natural resources, the integrity and stability of the financial system and public morals'.[115] Further, the Myanmar–Singapore BIT (2019), Preamble:

> 'REAFFIRMING the Parties' right to regulate and to introduce new measures, such as health, safety, and environmental measures relating to investments in their territories in order to meet legitimate public policy objectives.'[116]

Additionally, the EU–United Kingdom Trade and Cooperation Agreement (2020), Preamble:

> 'RECOGNISING the Parties' respective autonomy and rights to regulate within their territories in order to achieve legitimate public policy objectives such as the protection and promotion of public health, social services, public education, safety, the environment including climate change, public morals, social or consumer protection, animal welfare, privacy and data protection and the promotion and protection of cultural diversity, while striving to improve their respective high levels of protection, […]'[117]

In the Colombia–Spain BIT (2021), Preamble:

> 'Convinced that investment has the potential to contribute to sustainable development and increase prosperity in both countries. Reaffirming the right of each Contracting Party to regulate the Investments made in its Territory

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[112] *David Aven v Republic of Costa Rica*, UNCITRAL Case No. UNCT/15/3, Award 18 September 2018. para 412.

[113] EU-Singapore nvestment Protection Agreement (2018) (not yet entered into force), Article 2.2.

[114] Comprehensive and Economic Trade Agreement (CETA) (2016) in the preamble 'RECOGNISING that the provisions of this Agreement preserve the right of the Parties to regulate within their territories and the Parties' flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity'. Repeated again in Article 8.9.

[115] Trans-Pacific Partnership Agreement (TPP) (2016) UNCTAD/WEB/DITC/2016/3.

[116] Myanmar–Singapore BIT (2019), Preamble.

[117] EU–United Kingdom Trade and Cooperation Agreement (2020), Preamble.

> to meet objectives legitimate public welfare concerns, which can be achieved without lowering your standards of health, public order and safety, labor and environmental rights of general application.'[118]

According to Baltga, the purpose of such clauses is to rectify that the mere exercise of a State's regulatory powers does not amount to a breach of investors' rights, provided it was done to achieve legitimate public policy objectives.[119] Indeed, these clauses are located in the preamble or preambular. However, although the preamble is non-binding, the language may be consequential.[120] They do not attempt to establish clear hierarchies of norms but instead affirm that investment and other norms coexist harmoniously.[121] According to the VCLT, a tribunal should consider the context of the terms used and the treaty's object and purpose. Article 31(2) of the VCLT expressly provides that the preamble is part of the context for the interpretation of a treaty.[122] The provision establishes a positive right, specifying that the mere fact of changing a law, adversely affecting the parties' expectations (of profits) does not amount to a breach of an investment protection obligation.[123] According to Van Harten, these provisions give ISDS adjudicators, an interpretive source to weigh investors' rights against the good faith choices of legislatures, governments, and courts.[124] While these clauses have not yet been the subject of interpretation by an ISDS tribunal, *prima facie* it appears that arbitrators should appreciate the purpose of the provision is to strike a balance between protecting investors' rights and allowing States to regulate in the public interest. A tribunal should analyse whether the challenged measure is a legitimate policy objective such as the protection of public health, social services, public education, safety, environment or public morals, social or consumer protection, privacy, and data protection, and the promotion and protection of cultural diversity. These clauses may present an opportunity to defend climate action because they explicitly recognises the protection of the environment as a legitimate policy objective. Climate action such as the phasing out of fossil-fuel-based energy, and transitioning to renewable energy sources, contributes to the protection and preservation of the environment. Moreover, Climate change poses a significant risk to public health and safety, including increased frequency and intensity of natural disasters, heatwaves, and the spread of diseases. By regulating and implementing climate action policies, parties can mitigate these risks, safeguard public health, and ensure the safety of their citizens. These clauses recognise the importance of protecting public health and safety as legitimate policy objectives, thereby providing a basis for defending climate action. Indeed, these preambular clauses may provide a safe

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[118] Colombia–Spain BIT (2021), Preamble.

[119] Crina Baltag and others, 'Recent Trends in Investment Arbitration on the Right to Regulate, Environment, Health and Corporate Social Responsibility: Too Much or Too Little?' [2023] ICSID Review 1, 7.

[120] Noam Zamir & Paul Barker, 'The Trans-Pacific Partnership Agreement and States' Right to Regulate under International Investment Law' (2017) 45(2) DJILP 205, 215.

[121] MH Hulme, 'Preambles in Treaty Interpretation' (2016) 164 UPLR 1281, 1323.

[122] VCLT, Article 31.

[123] European Parliament, 'Outcome of the special European Council (Article 50) of 29 April 2017 Meeting' (*European Parliament*, February 2017) <https://www.europarl.europa.eu/RegData/etudes/ATAG/2017/603226/EPRS_ATA%282017%29603226_EN.pdf> accessed 27 June 2023.

[124] Gus Van Harten, 'ISDS in the Revised CETA: Positive Steps, But Is It a "Gold Standard"?' (Centre for International Governance Innovation , 20th May) <https://www.cigionline.org/publications/isds-revised-ceta-positive-steps-it-gold-standard/> accessed 27 June 2023.

harbour for defending climate action. However, for the avoidance of doubt, they too may need more qualifying words such as 'will not give rise to compensation', thereby clarifying that such a measure does not trigger a requirement for compensation. Such clarification would alleviate concerns and provide a stronger basis for defending climate action within the framework of IIAs.

In light of the foregoing discussion, the right to regulate is crucial to defending climate action. It upholds State autonomy and acknowledges its unique circumstances, allows the State to prioritise public interest objectives such as climate change, and it strikes a balance between investors' rights and public interest objectives. Indeed, most investment treaties do not include reference to environmental concerns or include carve-out related to climate change, however, this does not mean that environmental concerns have no relevance in ISDS.[125] It is a general principle of international law that must be considered as an applicable law. Further, it is becoming increasingly important in the face of evolving global challenges like climate change. Indeed, tribunals have recognised the right to regulate, but they have done so in an abstract manner without sufficient guidance, resulting in inconsistency. The energy transition, with its aim of reducing emissions from fossil-fuel-based energy, presents new complexities and necessitates a reevaluation of the right to regulate. Thus, not only must tribunals continue to take into account the right to regulate when assessing potential breaches of FET but must recognise the origin, which will highlight the limits to applying the doctrine. In the next section of this Part, I will discuss how the right to regulate should be used by arbitrators to create a safe harbour for defending climate action.

(5) Using the Right to Regulate to Defend Climate Action

In defending climate action in ISDS, the effective utilisation of the right to regulate is crucial. It serves as a tool for maintaining a harmonious equilibrium between safeguarding the public interest and protecting the rights of investors, and arbitrators are faced with the task of striking a delicate balance between these two competing interests. Thus, in this section to this Part, I answer the critical question for arbitrators: How should the right to regulate be used?

Wide margin, only drastic change?

Some tribunals in determining what constitutes an acceptable margin of change have granted a 'high measure of deference which international law generally extends to the right of national authorities to regulate matters within their own borders'.[126] As a result, 'only a radical change to a regulatory regime satisfies this high threshold'.[127] This is based on the 'perceived need to expand judicial deference in investor-state arbitration where

[125] Valentina Vadi, 'Beyond Known Worlds: Climate Change Governance by Arbitral Tribunals?' [2015] 48(5) VJTL 1285, 1343.
[126] *Antaris v Czech Republic* PCA Case No.2014-01, Award, 2 May 2018, para 360; *Eskosol S.p.A v Italy* ICSID Case NoARB/15/50, Award, 4 September 2020, para 433.
[127] Jack Biggs, 'The Scope of Investors' Legitimate Expectation under the FET Standard in the European Renewable Energy Cases' [2021] 36(1) ICSID Review 1, 113.

tribunals are faced with disputes that implicate the public interest, including, for example, disputes over the effects of fundamental State regulatory policy in areas like the environment, health, or public morals, as well as State action in the context of emergencies'.[128] Further, supporters of the margin in the ISDS context question whether non-national arbitrators ought to pass judgment on the State's domestic regulatory policy.[129] While this approach respects national sovereignty, *prima facie* it lacks clarity as to when defence should be given. It lacks a precise criterion on what constitutes a radical change which may lead to inconsistent outcomes and legal uncertainty. Further, this wide margin may also favour the State's interest over those of investors, leading to a potential imbalance that can arise in investment proceedings. This potential imbalance, while it can defend climate action, can be subject to abuse by the State which may discourage future investment. Therefore, another approach must be considered.

Flexibility to arbitrators?

Burke-White and von Staden stress that the right to regulate envisions different degrees of deference in different contexts.[130] Therefore, where an investment dispute has a public character, the margin of appreciation allows the arbitrator the flexibility to determine whether a wide or limited degree of deference would be appropriate.[131] This perspective introduces a nuanced approach to the right to regulate. Similarly, this approach introduces ambiguity and subjectivity into the decision-making process of tribunals due to the lack of clear criteria and guidelines. The discretionary nature of this approach raises the potential for abuse and bias in decision-making. Arbitrators may favour certain parties or interests, which undermines the balance between investor-rights and the State's regulatory powers. These concerns may lead to potential inconsistent outcomes which compromises the fairness and integrity of the ISDS system.

Necessity?

Titi argues that the right to regulate under general international law is a reflection of customary international law and is reflected in the ARSIWA.[132] As discussed earlier, the Tribunals *CMS*, *Enron*, and *Sempra* imported the customary law requirements of necessity into their analysis and required Argentina to show that the actions it took were the only ones available to the government to respond to the crisis.[133] Admittedly, this standard derives from a source in international law – the necessity defence in customary law.[134] The necessity defence is a narrow carve-out of general customary law rules of state responsibility. It is extraordinarily narrowly defined and almost impossible to

[128] Julian Arato, 'The Margin of Appreciation in International Investment Law' [2014] 54(3) VJIL 545, 557.
[129] ibid.
[130] William W Burke-White and Andreas von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations' [2009] 35(283) YJIL 283, 305-306.
[131] ibid.
[132] Titi (n76), 66-72.
[133] See *CMS Gas Transmission Company v Argentina* ICSID Case No. ARB/01/8, Decision on Annulment, 25 September 2007, para 130.
[134] ARSIWA, Article 25.

satisfy.[135] Moreover, the right to regulate is a primary rule and should not be underpinned by secondary obligations such as those found under the ARSIWA. The right to regulate refers to the State's inherent authority to adopt and enforce regulations within its territory in pursuit of public interest objectives. It is not necessarily an exception from a previous breach. Instead, it represents a State's sovereign power to govern and make decisions within its legal framework. Therefore, caution should be exercised in relying on the necessity defence in the right to regulate to defend climate action.

Good faith and proportionality?

Arato argues that the right to regulate entails no particular standard of review.[136] However, considering that this principle is a general principle of law existing in domestic legal systems, its operation in the domestic context must also be adopted. In domestic legal systems, when laws passed by their legislatures are challenged, domestic courts generally look at whether the law is reasonably required and reasonably justifiable.[137] There must be 'clear and compelling evidence that the State erred or acted improperly'.[138] In the absence of such, Tribunals should consider themselves bound to accept the justification given by States.[139] Thus, the principle reflects the principle of good faith and proportionality. Von Staden supports this view.[140] He argues that recognising, in principle, the appropriateness of deferential standards of review does not imply the necessity, much less the suitability, of a general, one-size-fits-all standard that would need to be added to the treaty as a whole.[141] According to him, what it requires, though, is that tribunals carefully scrutinise the provisions invoked in a given dispute and inquire whether they include substantive terms or concepts that point toward the legitimate role of regulatory action by the respondent State.[142] It is not for the tribunal to replace the State's assessment of what public purposes should be pursued with its own,[143] as long as the stated purpose is not a mere pretense.[144] This scrutiny can better be understood in the international context through the analysis conducted by the WTO's Appellate Body on 2.2 of the Technical Barriers to Trade (TBT) Agreement. This Agreement deals with technical regulations and conformity assessment procedures which have the potential to create barriers to international trade.[145] The Appellate Body in *US – Tuna II (Mexico)* provided

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[135] ibid.
[136] Arato (n126) 558.
[137] Antigua & Barbuda CAP II; Barbados CAP III; Belize CAP II; Grenada CAP I; Jamaica s13; St. Lucia CAP I; St. Kitts Nevis CAP II; St. Vincent & the Grenadines CAP I; Constitution Acts 1982 (Canadian Charter of Rights and Freedoms) (Canada).
[138] *Saluka v Czech Republic,* UNCITRAL, Partial Award, 17 March 2006, para 272.
[139] ibid.
[140] Andreas von Staden, 'Deference or No Deference, That is the Question: Legitimacy and Standards of Review in Investor-State Arbitration' (Investment Treaty News, 19 July) <https://www.iisd.org/itn/en/2012/07/19/deference-or-no-deference-that-is-the-question-legitimacy-and-standards-of-review-in-investor-state-arbitration/> accessed 6 June 2023.
[141] ibid.
[142] ibid.
[143] *ADC Affiliate Ltd. & ADC & ADMC Management Ltd. v. Republic of Hungary* ICSID Case No. ARB/03/16, Award of Oct. 2, 2006, paras. 429-433.
[144] ibid.
[145] Agreement on Technical Barriers to Trade (1995) 1868 UNTS 120.

the following guidance to panels adjudicating claims under Article 2.2 of the TBT Agreement:

> 'a panel must assess what a Member seeks to achieve by means of a technical regulation. In doing so, it may take into account the texts of statutes, legislative history, and other evidence regarding the structure and operation of the measure…Subsequently, the analysis must turn to the question of whether a particular objective is legitimate, pursuant to the parameters set out above…Further, the word 'objective' describes a 'thing aimed at or sought; a target, a goal, an aim'. The word 'legitimate', in turn, is defined as 'lawful; justifiable; proper'. Taken together, this suggests that a 'legitimate objective' is an aim or target that is lawful, justifiable, or proper.'[146]

The Appellate Body further explained in the context of Article 2.2:

> 'the assessment of 'necessity' involves a relational analysis of the trade-restrictiveness of the technical regulation, the degree of contribution that it makes to the achievement of a legitimate objective, and the risks non-fulfilment would create'.[147]

The articulation of such standards of review domestically can range from highly deferential judicial review at one end of the scale under a residual 'good faith' standard to a much more demanding and intrusive review of the merits of a decision under a strict scrutiny standard.[148] Good faith review, for example, merely inquires whether there was honest and fair dealing on the part of the respondent party and whether there had been at least a prima facie rational basis for its action.[149] Further, good faith is an extremely lenient standard.[150] It allows States to balance conflicting rights and interests and defers to the State's resolution of that balancing, as long as the State's determination was made in good faith and was reasonable. It requires States to internalise the balancing process and offer a rational basis for their ultimate determinations.[151] By contrast, under a strict scrutiny standard of review, the court's inquiry is much more detailed and seeks to determine whether the governmental measure at issue 'is narrowly tailored to achieve a compelling governmental purpose' and is the 'least restrictive or least discriminatory alternative'.[152] This is known as the proportionality review. As the legitimacy of the Investor-State Dispute Settlement system continues to face concerns some argue that privileging majority voting among a small number of unelected and unaccountable judges, disenfranchises ordinary citizens and brushes aside cherished principles of representation, and such resolution should be entrusted to the representatives and

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[146] Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, adopted 13 June 2012, DSR 2012:IV, para. 314.
[147] ibid 322.
[148] Andreas von Staden, 'The democratic legitimacy of judicial review beyond the state: Normative subsidiarity and judicial standards of review' [2012] 10(4) IJCL 1, 17.
[149] ibid.
[150] William W Burke-White (n128) 312.
[151] ibid.
[152] ibid.

electronically accountable legislatures.[153] Thus, international investment arbitration tribunals should adopt an approach similar to that which exists in the domestic context and is reflected in the practice of the WTO.

International Arbitration Tribunals need to accept that this is the appropriate standard to approach State regulations, especially climate action. This approach balances the rights of investors and the right to regulate in that it ensures that the State's decision-making is respected and upheld, as long as it is proportionate and in good faith. In the context of the energy transition and the phasing out of fossil-fuel-based energy, Tribunals should in light of evidence determine whether the measures taken were reasonably required and reasonably justifiable. First, there must be a showing that the measures taken by a State contributed to a legitimate aim, and, second, the tribunal must determine whether there were 'reasonably available alternatives' more compliant with the State's international obligations 'while providing an equivalent contribution to the achievement of the objective pursued'. Indeed, the legitimate aim for phasing out fossil-fuel-based energy is to mitigate climate change. This can be inferred by the fact that they are based on scientific evidence as recognised by several international law instruments ratified by the overwhelming majority of States.[154] Further, the lack of visible alternatives to the phasing-out of fossil-fuel-based energy sources provides a compelling justification for considering it as a reasonable and proportionate decision by the State. This approach allows Tribunals to weigh the right to regulate of the State and by extension the international community as a whole, against the infringement on investors' rights. By taking this approach to the right to regulate, States will be able to defend climate action and in doing so, the legitimacy of international arbitration tribunals can be preserved.

No ICSID tribunal has seriously engaged with the right to regulate and the appropriate standard of review to apply in cases that raise public interest issues. This good faith and proportionality analysis would lead to a more consistent and coherent approach to reviewing public regulation, especially relating to climate change. As the ECtHR observed in *Broniowski*, 'tribunals will respect the legislature's judgment as to what is 'in the public interest' unless that action is manifestly without reasonable foundation'.[155] Thus, it would be wise for international tribunals to embrace the good faith and proportionality analysis, this will defend climate action in the age of the energy transition. As discussed above RWE and Uniper have argued that it had a legitimate expectation that they would be allowed to operate Eemshaven, a coal-fired power plant based on irrevocable permits,[156] they were entitled to a stable legal environment as the ban on fossil fuels is a departure from previous positions taken when the IIAs were signed, and the decision to phase-out fossil-fuel-based energy was not reviewed to determine whether the period for transition was adequate, whether biomass conversion was

[153] Jeremy Waldron, 'The Core of the Case against Judicial Review' [2006] 115 YLJ 1346, 1353. *See also* Yuval Shany, 'Towards a General Margin of Appreciation Doctrine in International Law' [2006] 16(5) EJIL 907, 920.

[154] Vadi (n123) 1328.

[155] *Broniowski v Poland*, Application no. 31443/96 (2005), para 54.

[156] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 529-534; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 447.

feasible, and steps the companies were taking to mitigate CO_2 emissions.[157] While these are valid points, they must be outweighed by the pressing need to address climate change and transition to more sustainable energy sources. Ultimately, the application of good faith and proportionality analysis by international arbitration tribunals can help to strike this balance between investors' rights and the State's right to regulate. This approach takes into account the gravity of the climate crisis and the urgent need for action. This approach will create a safe harbour for defending climate action.

D. WHY NOT MODERNISE THE IIAS?

As discussed earlier, fossil fuel investors have increasingly used the IIAs to challenge climate action. Thus, in an age characterised by the pressing need to address climate change and transition to more sustainable energy practices, the call for reevaluating and updating IIA provisions has grown louder. In June 2022, the Contracting Parties to the ECT finalised discussions on the modernisation of the ECT, and an agreement in principle was reached to be adopted by the Energy Charter Conference in November 2022. However, the European Union was been unable to adopt a common position in favour of the modernised ECT, leading to two postponements of the final vote. At the time of writing, no new date for the vote has been fixed.

The agreed modernised ECT continues to protect both existing and new investments in fossil fuels. However, Contracting Parties can exclude investment protection for fossil fuels in their territories.[158] The modernised ECT also extends investment protection to new energy activities and fuels, such as carbon capture, utilisation and storage, hydrogen, anhydrous ammonia, biomass, biogas, and synthetic fuels.[159] Further, the modernised text also seeks to clarify some of the substantive standards on investment protection,[160] notably 'fair and equitable treatment' now provides for a list that designates certain measures that would constitute a violation of this standard, including the frustration of investors' legitimate expectations.[161] Additionally, a new article reaffirms the Contracting Parties' right to regulate to achieve such legitimate policy objectives.[162]

While some writers view these changes positively,[163] there are issues associated with the modernisation of the ECT. First, obtaining a unanimous agreement for its

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[157] *RWE AG and RWE Eemshaven Holdings II BV v The Netherlands*, ICSID Case No ARB/21/4, Claimant's Memorial, 18 December 2021, para 432; *Uniper SE, Uniper Benelux Holding B.V., and Uniper Benelux N.V. v The Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial, 20 May 2022, para 462.
[158] ECT Agreement in Principle, Annex NI, Section B, Article 1.
[159] ibid Article 1(5); Annex EM I; Annex NI, Section B.
[160] ibid Article 10.
[161] ibid.
[162] ibid New Article: Right to Regulate.
[163] Maria José Alarcon, 'ECT Modernisation Perspectives: Revamping International Investment Law: A Comparative Look at Substantive ISDS Reform in the ECT and Beyond' (Kluwer Arbitration Blog, 10th May) <https://arbitrationblog.kluwerarbitration.com/2023/05/10/ect-modernisation-perspectives-revamping-international-investment-law-a-comparative-look-at-substantive-isds-reform-in-the-ect-and-beyond/> accessed 13 August 2023; Simon Maynard and Mikhail Kalinin, 'ECT Modernisation Perspectives: Unpacking the Impact of the Revised ECT Text on Dispute Resolution' (Kluwer Arbitration Blog, 6th November)< https://arbitrationblog.kluwerarbitration.com/2022/11/06/ect-modernisation-

adoption may prove challenging, given the opposition of Switzerland, the United Kingdom, Japan, and Kazakhstan. Second, for the revised ECT to become effective, it requires ratification by three-fourths of the Contracting Parties,[164] a process that might span several years as it requires approval from national parliaments. Third, the rationale for modernisation remains unclear. As this article has demonstrated, the right to regulate already exists as a general principle of international law that can be used to defend climate action, negating the immediate need for modernisation. Verbeek asserts that the turn of events concerning the ECT also has implications for the other IIAs currently in force because many of these treaties still contain old-style provisions on investment protection, which are incompatible with climate change objectives.[165] Again, as discussed, the right to regulate can be used to defend climate action.

E. CONCLUSION

In the face of a climate change disaster, it is argued that ISDS presently stands as a barrier to effective climate change mitigation. While the imperative to address climate change may urge a reevaluation of IIAs, the process of modernization is not easy. This article has highlighted the potential risks and challenges faced by States when attempting to balance the interest of investors and realising their climate change objectives. The complexities of climate action, as well as the potential for retroactive changes to the regulatory framework in the energy transition, can create uncertainty and increase the risk of ISDS. Thus, it is imperative for tribunals not to interpret the FET standard in isolation but to acknowledge and embrace the right to regulate as a carve-out. The interpretation of the right to regulate should be guided by principles of good faith and proportionality. By conducting this thorough analysis, tribunals ensure that regulatory measures adopted in response to climate change are reasonable, and do not unduly encroach upon the rights of investors. This approach preserves the sovereignty of States envisaged by international law and will provide a safe harbour for defending climate action in ISDS.

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perspectives-unpacking-the-impact-of-the-revised-ect-text-on-dispute-resolution/> accessed 13 August 2023.

[164] ECT, Article 42.

[165] Bart-Jaap Verbeek, 'The Modernization of the Energy Charter Treaty: Fulfilled or Broken Promises?' [2023] 8 BHRJ 97, 102.