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Conflicts between international climate law and investment arbitration: A proposed exception to the full reparation standard without moving the goalposts

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Abstract

State responsibility is a foundational aspect of public international law that ensures, *inter alia*, that States pay compensation pursuant to the full reparation standard where they breach international standards of protection owed to foreign investors. Concerns about the application of the full reparation standard include the diminishing of regulatory power of States and the advent of 'crippling' or excessive compensation awards. In this paper I argue that compensation awards may be reduced to the extent that a State policy is explicitly aimed at complying with international climate law. I argue that Article 55 of the ILC Articles allows for an exception to the full reparation standard, thereby limiting the amount of compensation payable. The Article 55 exception would allow tribunals to consider international climate law in awarding compensation, and

avoiding claims of 'moving the goalposts' by retrospectively raising climate law defences for State breaches of investment protection standards.

Keywords

Full reparation standard – international climate law – international investment law – *lex specialis* – State responsibility

1 Introduction

Combatting climate change is an international legal obligation of member States to the 1992 United Nations Framework Convention on Climate Change ('UNFCCC')[1] and the 2015 Paris Agreement.[2] One of the key ways to mitigate climate change is to carry out an effective energy transition away from non-renewable, carbon-intensive sources of energy, like fossil fuels, in favour of more climate-friendly energy sources.[3] To achieve this, States need to urgently regulate the energy sector and foster an economic environment that promotes clean energy and de-incentivises reliance on fossil fuels.[4] Trying to achieve the energy transition and at the same time uphold the rights of foreign investors in the energy sector under international

[1] United Nations Framework Convention on Climate Change ('UNFCCC') (open for signature 4 June 1992, entered into force 21 March 1994) (UNFCC) 1771 UNTS 107.
[2] Paris Agreement (open for signature 4 November 2016, entered into force 4 November 2016) UNTS 54113.
[3] International Energy Agency, 'World Energy Outlook 2023' (October 2023) <https://www.iea.org/reports/world-energy-outlook-2023> accessed 7 May 2024.
[4] Oliver Hailes and Jorge E. Viñuales, 'The Energy Transition at a Critical Juncture' (2023) 26(3) JIEL 627-648. Peter Erickson, Michael Lazarus, and Georgia Piggot, 'Limiting Fossil Fuel Production as the Next Big Step in Climate Policy' (2018) 8(12) *Nature Climate Change*, 1037.

investment treaties is a particular point of contention. Carbon-intensive industries are heavily reliant on foreign investment, and some commentators have argued that foreign investment protection is a direct barrier to achieving the much needed de-carbonisation of the energy sector.[5]

According to data from UNCTAD, between 1987-2021, 447 cases brought have been about environmental protection, fossil fuel activities or renewable energy.[6] The standards and methods for determining and awarding compensation in disputes relating to climate change and the energy transition have given rise to a number of concerns about the conflicting obligations of States under international law.[7] These concerns include that the current practices of arbitral tribunals in awarding compensation

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[5] Kyla Tienhaara, 'Regulatory Chill in a Warming World: The Threat to Climate Policy Posed by Investor-State Dispute Settlement' (2018) 7(2) Transnational Environmental Law 229; Kyla Tienhaara and others, 'Investor-state disputes threaten the global green energy transition' (2022) 376 Science 701; Kyla Tienhaara and others, 'Investor-State Dispute Settlement: Obstructing a Just Energy Transition' (2023) 23 Climate Policy 1197; UNHCR, 'Report of the Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights' (13 July 2023) UN Doc A/78/168.

[6] UNCTAD, 'IIA Issues Notes: The International Investment Treaty Regime and Climate Action' 3 (September 2022) < https://investmentpolicy.unctad.org/publications/1269/the-international-investment-treaty-regime-and-climate-action> accessed 7 August 2024.

[7] Matteo Fermeglia, 'Cashing-In on the Energy Transition? Assessing Damage Evaluation Practices in Renewable Energy Investment Disputes' (2022) 23(5–6) JWIT 982; Toni Marzal, 'Quantum (In)Justice: Rethinking the Calculation of Compensation and Damages in ISDS' (2021) 22 JWIT 249. For more general discussion on the broad issues associated with compensation and damages practices in investment arbitration see Christina L. Beharry (ed), *Contemporary and Emerging Issues on the Law of Damages and Valuation in International Investment Arbitration* (Brill Nijhoff 2018). On the conflicts between international investment law and international environmental law see Jorge E Viñuales, 'Foreign Investment and the Environment in International Law: An Ambiguous Relationship' (2009) 80(1) BYIL 244.

hinder State action on climate change,[8] result in excessive or 'crippling' damages awards,[9] and threaten fundamental international legal principles like sovereignty.[10] Under the current investment law regime there are not many internal safeguards that can prevent awards which have a negative environmental impact.[11] To understand and resolve the criticisms levelled at the conflicts between investment and climate law requires an understanding that neither operate in 'clinical isolation' from each other;[12] both fields are anchored in

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[8] Kyla Tienhaara, 'Regulatory Chill and the Threat of Arbitration: A View from Political Science' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 606-27;

[9] The three cases of *Yukos Universal Limited (Isle of Man) v. The Russian Federation (PCA Case No. 2005-04/AA227), Veteran Petroleum Limited (Cyprus) v. Russia (PCA Case No. AA 228)* and *PCA Case No. AA 226 (Hulley Enterprises Limited (Cyprus) v. The Russian Federation)* resulted in a USD 50 billion award for the parent company based in Cyprus. See Martins Paparinskis, 'Crippling Compensation in the International Law Commission and Investor–State Arbitration' (2022) 37 ICSID Review 289.

[10] Josephine Dooley, 'The Co-Existence of Mitigation and International Investment Law: A Practical Assessment of Climate Change Action Under Less 'Green-Friendly' Investment Agreements' (2022) 23(5–6) JWIT 849; Lorenzo Cotula, 'II.29 Environmental Protection' in Krista Nadakavukaren Schefer and Thomas Cottier (eds), *Elgar Encyclopedia of International Economic Law* (Edward Elgar Publishing 2017) 241; Crina Baltag, Riddhi Joshi, and Kabir Duggal, 'Recent Trends in Investment Arbitration on the Right to Regulate, Environment, Health and Corporate Social Responsibility: Too Much or Too Little?' (2023) 38 ICSID Review 381; Markus Wagner, 'Regulatory Space in International Trade Law and International Investment Law' (2014) 36 University of Pennsylvania Journal of International Law 24; See also Edward Guntrip, 'Self-Determination And Foreign Direct Investment: Reimagining Sovereignty In International Investment Law' (2016) 65 ICLQ, 829. Cf Gian Maria Farnelli, 'Investors as Environmental Guardians? On Climate Change Policy Objectives and Compliance with Investment Agreements' (2022) 23(5–6) JWIT 887 on how investors may utilise investment treaties to hold States accountable to international climate law.

[11] MacLachlan, Claire, 'Improving Environmental Protection in Investor-State Dispute Settlement (2020) 46(1) Columbia Journal of Environmental Law 179, 181-182.

[12] Steffen Hindelang and Markus Krajewski, 'Towards a more comprehensive approach in international investment law' in Steffen Hindelang and Markus Krajewski (eds), *Shifting paradigms in international investment law: more balanced, less isolated, increasingly diversified* (OUP

public international law and are impacted by general principles of law, customary international law and investment treaties.[13]

Arbitral tribunals are often tasked with striking a balance between these two complex areas of law in very specific investment disputes, which produces varying results and does not help to resolve the underlying tensions. There are ongoing efforts to harmonise these disparate duties in practice and academia, and by the mandate of Working Group III of the United Nations Commission on International Trade Law.[14]

This paper examines the cross-cutting issues between investment law and climate law, with a focus on the conflict between the full reparation standard as an aspect of State responsibility in investment arbitration on one hand, and State obligations under international climate law on the other. I explore the nature and scope of the conflict, and critically evaluate some of the proposed methods of dealing with the

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2016) 13; Daniel Bodansky, Jutta Brunnée and Lavanya Rajamani *International Climate Change Law* (OUP 2017) 35.

[13] Statute of the International Court of Justice (adopted 26 June 1945, entered into force 24 October 1945) 33 UNTS No 993 art 38(1).

[14] For more detail on the work of Working Group III see https://uncitral.un.org/en/working_groups/3/investor-state; UNGA, Seventy-second Session, Supplement No. 17 (A/72/17), paras 263-4; Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' (2023) 26 JIEL 285; Esmé Shirlow and Kabir Duggal, 'The ILC Articles on State Responsibility in Investment Treaty Arbitration' (2022) 37 ICSID Review 378; Caroline Henckels, 'Protecting regulatory autonomy through greater precision in investment treaties: the TPP, CETA, and TTIP' (2016) 19 JIEL 27; Stephan W Schill and Geraldo Vidigal 'Investment Dispute Settlement à la carte: A Proposal for the Reform of Investor–State Dispute Settlement' in Manfred Elsig and others (eds) *International Economic Dispute Settlement: Demise or Transformation?* (Cambridge University Press 2021); Emma Aisbett, Jonathan Bonnitcha, 'A Pareto-Improving Compensation Rule for Investment Treaties, (2021) 24(1) JIEL 181.

imbalance between climate law and investment law, and then propose my own novel exception to the full reparation standard under Article 55 of the ILC Articles on Responsibility of States for Internationally Wrongful Acts (ILC Articles).[15]

This paper is structured as follows. In the following section, I outline the nature of State responsibility in modern investment arbitration. I explore the connection between State responsibility in customary international law and the full reparation standard under the ILC Articles, including the codification and status of each in modern investment law. I highlight the fact that the ILC Articles are commonly applied in arbitral practice in much the same way as customary law, noting the increased integration of these concepts in investment awards over time. I demonstrate that, because investment tribunals are willing to engage with the ILC Articles and apply them as custom, a solution to the conflict between investment law and climate law which is found within the Articles is preferrable to solutions outside the Articles.

In section 3 I examine the conflicts that emerge from the application of the full reparation standard with respect to disputes related to climate change and the environment. I look at two major criticisms of the investment arbitration system, 'crippling' compensation and regulatory chill, and discuss how

[15] ILC, 'Articles on Responsibility of States for Internationally Wrongful Acts' (2001) II(2) Yearbook of the ILC (ILC Articles).

the application of the full reparation standard in climate-related cases leads to these criticised outcomes. I evaluate some of the proposed solutions to these criticisms as they pertain to the conflict between investment and climate law obligations, discussing the practical and temporal constraints that apply.

In section 4 I put forward an alternative solution which utilises the *lex specialis* exception under Article 55 of the ILC Articles to limit the application of the full reparation standard. I discuss how the exception is triggered, and highlight why an Article 55 exception is appropriate to limit compensation awards where the relevant measure is climate-related.[16] I look at the practical application of the Article 55 exception in the context of the arbitral award in *Rockhopper v Italy*,[17] an investment dispute which garnered significant attention and scrutiny on the topic of compensation and the balancing of investment protection and climate action. I find that it would have been possible for the tribunal to reduce compensation by applying the exception in slightly different circumstances and I demonstrate how the exception becomes relevant in the consideration of compensation in investment arbitration disputes.

[16] ibid.
[17] *Rockhopper Exploration Plc, Rockhopper Italia S.p.a. And Rockhopper Mediterranean Ltd V. Italian Republic*, ICSID Case No. ARB/17/14, Final Award (23 August 2022) para 153.

2 State responsibility and the full reparation standard

Investment arbitration tribunals are required to interpret the terms of investments treaties in good faith, by giving them their ordinary meaning in light of the context, including any applicable and relevant rules of international law.[18] The full reparation standard is such a relevant and applicable rule of international law in the investment arbitration context. The full reparation standard requires a responsible State to make 'full reparation' for the injury caused by a wrongful act;[19] specifically that the State '*must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed'*.[20] This requirement, originating from customary law in the *Factory at Chorzów* case (*Chorzów*),[21] has obtained the status of a near 'natural' law in investment arbitration,[22] and has been codified in the ILC Articles. The ILC Articles themselves are authoritative in the international legal sphere, through State and tribunal practice, and legal doctrine.[23]

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[18] *Vienna Convention on the Law of Treaties* (VCLT) (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 art 31. See also, James Crawford, *State Responsibility: The General Part* (CUP 2013).
[19] ILC Articles (n 15) art 31(1).
[20] *Case Concerning the Factory at Chorzów (Germany v Poland)* (Merits) PCIJ Rep Series A No 17, 47.
[21] ibid.
[22] Toni Marzal, 'Critique of Valuation in the Calculation of Damages in Investor-State Dispute Settlement: Between Law, Finance and Politics' in Isabel Feichtner and Geoff Gordon (eds), *Constitutions of Value* (Routledge 2023), 182-83.
[23] ibid, 90; Cees Verburg, 'Damages and Reparation in Energy Related Investment Treaty Arbitrations Interpreting and Applying Rules of Customary International Law Regarding State Responsibility' (2021) 23 ICLR 5.

The full reparation standard is the general starting point for determining the reparation due to an injured party for an internationally wrongful act. However, it is important to distinguish the *obligation* to make full reparation from the 'analytically distinct inquiry' as to the *form* and *standard* of such reparation.[24] According to *Chorzów*, regarding the form of reparation:

> *Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it-such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.*[25]

Where restitution in kind is not possible, compensation and damages may be awarded to achieve the same outcome as restitution and to account for loss that would otherwise not be covered by restitution. Article 36 of the ILC Articles provides instruction on the standard of compensation, stating:

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[24] Oliver Hailes, 'Unjust enrichment in investor–State arbitration: A principled limit on compensation for future income from fossil fuels' (2023) 32(2) Review of European, Comparative and International Environmental Law 358, 362.
[25] *Chorzów* above (n 20) 47; ILC Articles (n 15).

1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

Article 36 sets out the requirement for full compensation, contemplating even a loss of profits.[26] Therefore, where compensation is payable, Article 36 dictates that it must meet the standard of full reparation. This standard is applicable regardless of the nature of the injurious act, and as will be shown, is applied as a matter of standard procedure by investment tribunals.

2.1 *The integration of the full reparation standard in investment arbitration*

In 2010, Crawford noted that the International Law Commission had not anticipated the extent to which the ILC Articles were utilised in investment arbitration. In identifying six investment tribunal awards which explicitly referred to Article 31 on reparation,[27] he noted that four referred to both the ILC Articles

[26] For more discussion on the issue of compensating for loss of profits see Federica I Paddeu, 'The impact of investment arbitration in the development of state responsibility defences' in Christian Tams, Stephan Schill, and Rainer Hofmann (eds), *International Investment Law and General International Law: Radiating Effects?* (Edward Elgar Publishing 2023) 220.
[27] James Crawford, 'Investment Arbitration and the ILC Articles on State Responsibility' (2010) 25(1) ICSID Review 128, 199.

and *Chorzów* in discussing the applicable standard of compensation.[28] The tribunal in *Petrobart v Kyrgyz Republic* accepted the investor's argument that relied on both the ILC Articles and *Chorzów* in arguing that the Respondent State was obliged to compensate for all damage suffered by the investor, without further discussion.[29] In *ADC V Hungary*, the tribunal stated that in the absence of any *lex specialis* rules within the investment treaty on the standard for assessing damages, then it was required to apply the 'default standard' under customary international law.[30] The tribunal referred to the ILC Articles, stating that they 'expressly rely on and closely follow' the *Chorzów* doctrine.[31] In *LG&E Energy v Argentina*, in awarding compensation to the investor, the tribunal provided a detailed analysis on the issues of causation and certainty, and considered the investors claim for future lost profits to be too uncertain and speculative.[32] The tribunal cited the ILC Articles in stating that prospective gains are only awarded by tribunals in limited circumstances, where they have 'attained sufficient attributes to be considered legally protected interests of sufficient

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[28] *Petrobart Ltd. v. The Kyrgyz Republic*, SCC Case No 126/2003, Award (26 March 2005); *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No ARB/03/16, Award 2 October 2006; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Award (25 July 2007); *BG Group Plc v. The Republic of Argentina* Final Award (24 December 2007).
[29] ibid 77-78.
[30] *ADC V Hungary* (n 28).
[31] ibid para 494.
[32] *LG&E v Argentina* (n 28) para 90.

certainty'.[33] In the fourth case, *BG v Argentina*, the tribunal also considered the applicability and limitations of both the *Chorzów* doctrine and the ILC Articles, also noting that 'an award for damages which are speculative would equally run afoul of 'full reparation' under the ILC Draft Articles'.[34] Of these four awards, the Tribunals deliberated at varying levels over the full reparation standard, but generally these deliberations did not exceed more than a quarter of the length of the overall award/s.[35]

In 2022, Shirlow and Duggal updated Crawford's list,[36] finding that references to Article 31 of the ILC Articles in investment arbitral decisions had jumped from 6 to 53, a unanticipated jump in arbitral engagement in just over a decade. Further, of the 53 awards which explicitly referred to Article 31, 16 tribunals either explicitly cited the *Chorzów* doctrine, or otherwise used the language of the *Chorzów* doctrine.[37] This

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[33] ibid para 89.
[34] *BG v Argentina* (n 28) para 428.
[35] In *LG&E v Argentina*, the 36-page final award delivered on 25 July 2007 was entirely on damages and quantum, but this was due to the fact that the longer, 86-page decision on liability preceded the consideration of quantum matters.
[36] Shirlow and Duggal (n 14).
[37] *Ioan Micula, Viorel Micula and others v Romania (I)* ICSID Case No ARB/05/20, Award (11 December 2013) para 917; *British Caribbean Bank Limited v Belize*, PCA Case No 2010–18, Award (19 December 2014) para 299; *Gold Reserve Inc. v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/09/1, Award (22 September 2014) para 679; *Murphy Exploration v Ecuador*, PCA Case No 2012–16, Partial Final Award (6 May 2016) para 424; *Rusoro Mining Ltd. v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/12/5, Award (22 August 2016) para 640; *Flemingo v Poland*, UNCITRAL, Award (12 August 2016) para 865; *Crystallex International Corporation v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/11/2, Award (4 April 2016) para 848; *Caratube International Oil Company LLP and Devincci Salah Hourani v Republic of Kazakhstan*, ICSID Case No ARB/13/13, Award (27 September 2017) para 1083; *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v Argentine Republic*, ICSID Case No ARB/09/1, Award (21 July

shows how inextricably linked the ILC Articles and the *Chorzów* doctrine have become in investment tribunal deliberations on compensation. Therefore, in practice, the full reparation standard is essentially a default position of many arbitral tribunals in awarding compensation to foreign investors, which has an impact on the emerging issues within investment law, and has led to conflicts between the obligations of States under investment law and climate law as discussed in the following section.

3 Conflicts between the full reparation standard and international climate law

The original purpose of investment arbitration as a dispute settlement mechanism was to promote economic development and foreign investment by creating a stable investment climate,[38]

2017) para 1092; *Karkey Karadeniz Elektrik Uretim A.S. v Islamic Republic of Pakistan*, ICSID Case No ARB/13/1, Award (22 August 2017) para 663; *Infrastructure Services Luxembourg S.à.r.l. and Energia Termosolar B.V. (formerly Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V.) v Kingdom of Spain*, ICSID Case No RB/13/31, Award (15 June 2018) para 664; *UP and CD Holding Internationale v Hungary*, ICSID Case No ARB/13/35, Award (9 October 2018) para 512; *Uni´on Fenosa Gas, S.A v Arab Republic of Egypt*, ICSID Case No ARB/14/4, Award (31 August 2018) para 10.96; *Bilcon of Delaware et al v Canada*, PCA Case No 2009–04, Award on Damages (10 January 2019) para 108; *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30, Award (8 March 2019) para 208; *RWE Innogy GmbH and RWE Innogy Aersa S A U v Kingdom of Spain*, ICSID Case No ARB/14/34, Decision on Jurisdiction, Liability, Quantum (30 December 2019) para 734.

[38] See Peter Muchlinski, Federico Ortino, and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008); Rudolf Dolzer, Ursula Kriebaum, and Christoph Schreuer *Principles of International Investment Law* (3rd edn, OUP 2022); Irmgard Marboe, 'Damages in Investor-State Arbitration: Current Issues and Challenges' (2018) 2(1) International Investment Law and Arbitration 4; Borzu Sabahi, *Compensation and Restitution in Investor-State Arbitration: Principles and Practice*, (Oxford, 2011).

to protect investments that had been insufficiently protected by a host States' domestic laws and judicial system,[39] and as a way for host States to make 'credible commitments' to foreign investors.[40] The purpose of awarding compensation for breaches of investment protections was to provide foreign investors with legal certainty, and to balance their economic interests with those of host States.[41] The role of the full reparation standard in this context was to help avoid negative economic and social impacts which can result from under-compensation or overcompensation.[42]

Unfortunately, some major criticisms of investment arbitration can be linked to the application of the full reparation standard, including, *inter alia*, 'crippling' compensation awards and regulatory chill.[43] Since the start of this century, the number of arbitral awards in general have increased, along with the amount of compensation awarded,[44] with awards over USD 1

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[39] Schill and Vidigal (n 14) 223.
[40] Stephan W. Schill, 'Private Enforcement of International Investment Law: Why We Need Investor Standing in BIT Dispute Settlement' in Michael Waibel and others (eds), *The Backlash against Investment Arbitration* (Kluwer Law International 2010) 29.
[41] Herfried Wöss and Adriana San Román Rivera, 'Damages in Investment Treaty Arbitration' in *International Arbitration and EU Law* (Edward Elgar Publishing 2021).
[42] ibid 393. See also Herfried Wöss and others, *Damages in International Arbitration under Complex Long-term Contracts* (Oxford International Arbitration Series, Oxford University Press 2014), ch 2.
[43] Paparinskis (n 9); Tienhaara (n 8); Kyla Tienhaara and Lorenzo Cotula, 'Raising the cost of climate action? Investor-state dispute settlement and compensation for stranded fossil fuel assets' (2020) IIED Land, Investment and Rights series < https://www.iied.org/sites/default/files/pdfs/migrate/17660IIED.pdf> accessed 14 August 2024. See also MacLachlan (n 11) 182.
[44] Jorge E. Viñuales *Foreign Investment and the Environment in International Law* (Cambridge 2012); UNCTAD (n 6); ; Lea Di Salvatore, 'Investor–State Disputes in the Fossil Fuel Industry' (December 2021) IISD

billion becoming more common in the last decade or so, to the extent that they are now considered by some to be 'completely routine'.[45] The observable increase in damages has given rise to concerns about the compatibility of investment arbitration with other fields of international law,[46] and is described by Paparinskis as having a 'crippling' effect on States with respect to economic security, stability, and wellbeing, and disrupting the sovereignty and regulatory power of a State.[47] The most illustrative example of this crippling effect is *Tethyan Copper v Pakistan,* where the termination of the investor's mining licence led to an award of USD 5.84 billion.[48] The award came at a time when Pakistan had been approved for an IMF loan for roughly the same amount of money to support its struggling economy.[49] This lead to backlash about the 'broken' investment arbitration

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Report <www.iisd.org/publications/report/investor-state-disputes-fossil-fuel-industry> accessed 13 August 2024;

[45] Paparinskis (n 9); Jonathan Bonnitcha and Sarah Brewin, 'Compensation Under Investment Treaties' (November 2020) IISD Best Practices Series; Marzal (n 7) 251.

[46] Tienhaara (n 5); Tienhaara and others (n 5); Hindelang and Krajewski (n 12).

[47] Paparinskis (n 9) 296-7. See also Kyla Tienhaara, Lise Johnson and Michael Burger, 'Valuing Fossil Fuel Assets in an Era of Climate Disruption' (IISD analysis, 20 June 2020) < https://www.iisd.org/itn/en/2020/06/20/valuing-fossil-fuel-assets-in-an-era-of-climate-disruption/> accessed 25 April 2024.

[48] *Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan,* ICSID Case No ARB/12/1, Award (12 July 2019).

[49] International Monetary Fund, 'IMF Executive Board Approves US$6 billion 39-Month EFF Arrangement for Pakistan' (July 3 2019) <https://www.imf.org/en/News/Articles/2019/07/03/pr19264-pakistan-imf-executive-board-approves-39-month-eff-arrangement%EF%BB%BF> accessed 6 August 2024.

system,[50] and the potential for arbitration awards to cause 'irreparable social harms'.[51]

According to Tienhaara and other commentators, the increases in both the number of climate related disputes, and in the damages awarded to investors generally have caused a 'regulatory chill' which has the capacity to hinder and even prevent State regulation on climate change.[52] Examples of such claims include two cases against the Netherlands relating to regulations that would cut short the lives of each foreign investor's coal-fired power plants,[53] and two claims brought against Germany over regulations affecting a coal-fired power plant and the phase out of two nuclear power plants.[54] In the 2022 decision in *Rockhopper v Italy* the arbitral tribunal awarded an investor roughly EUR 240 million in compensation for the Italian Government's ban on offshore oil and gas exploration

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[50] Kyla Tienhaara, 'World Bank ruling against Pakistan shows global economic governance is broken' *The Conversation* (July 22 2019) <theconversation.com/world-bank-ruling-against-pakistan-shows-global-economic-governance-is-broken-120414> accessed 6 August 2024. See also Lisa Sachs and Lise Johnson, 'Investment Treaties, Investor-State Dispute Settlement, and Inequality: How International Rules and Institutions Can Exacerbate Domestic Disparities' in José Antonio Ocampo (ed), *International Rules and Inequality: Implications for Global Economic Governance* (Columbia University Press 2019) ch 5, 112.

[51] David Schneiderman, 'International Investment Law and Discipline for the Indebted' (2022) 33(1) EJIL 67.

[52] Tienhaara (n 8); Tienhaara (n 5); Tienhaara, and others (n 5); UNHCR (n 5). See also Harro van Asselt, 'Governing fossil fuel production in the age of climate disruption: Towards an international law of 'leaving it in the ground' (2021) 9 Earth System Governance.

[53] *Uniper SE, Uniper Holding BV and Uniper Benelux NV v Kingdom of the Netherlands*,
ICSID Case No ARB/21/22; *RWE AG and RWE Eemshaven Holding II BV v Kingdom of the Netherlands*, ICSID Case No ARB/21/4.

[54] *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v Federal Republic of Germany (I)* ICSID Case No ARB/09/6; *Vattenfall AB and others v Federal Republic of Germany (II)* ICSID Case No ARB/12/12.

which expropriated the investor's right to a permit.[55] This case will be discussed in more detail in section 4.

In North America examples include two claims brought against Canada, one for the revocation of permits for the exploration of petroleum and natural gas,[56] and the other for the phase-out of coal, which is currently being litigated for a third time.[57] In the United States a claim made in relation to a controversial proposal to construct a transboundary crude oil pipeline through Canada and the United States is also before an investment tribunal for a third time.[58] The longevity and repetition of these types of claims contributes to a perceived risk of litigation, exacerbating the issue of regulatory chill.

3.1 *Addressing conflicts between full reparation and international climate law*

These types of claims are symptomatic of what Viñuales identifies as a broader normative conflict between concurrent obligations stemming from investment law on one hand, and climate law on the other.[59] There are increasing calls to reform

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[55] *Rockhopper* (n 17).
[56] *Lone Pine Resources Inc. v Canada* ICSID Case No. UNCT/15/2.
[57] *Westmoreland Coal Company v Canada (I)*; *Westmoreland Mining Holdings LLC v Canada (II)* ICSID Case No. UNCT/20/3; *Westmoreland Coal Company v Canada (III)* ICSID Case No. UNCT/23/2.
[58] *TransCanada Corporation and TransCanada PipeLines Limited v United States of America (I)* ICSID Case No. ARB/16/21; *Alberta Petroleum Marketing Commission v United States of America* ICSID Case No. UNCT/23/4. See Peter Erickson and Michael Lazarus, 'Impact of the Keystone XL pipeline on global oil markets and greenhouse gas emissions' (2014) 4(9) Nature Climate Change 778 for discussion on the impacts of the proposed pipeline on global emissions.
[59] Viñuales (n 44) 28.

the investment regime to rebalance investor rights and States rights' to regulate for climate change and the environment.[60] Some of the methods designed to achieve this rebalancing are discussed below, along with the practical and temporal limits of applying each.

3.1.1 The ILC Articles and beyond

Paparinskis discusses four ways to tackle the issue of crippling compensation within the framework of the ILC Articles, noting from the outset that none of them are 'entirely satisfactory'.[61] Briefly, they are: (a) finding a 'circumstance precluding wrongfulness', which would allow for delayed payment of compensation where a current crisis or *force majeure* necessitates such a delay;[62] (b) dealing with excessive compensation at the enforcement stage in a domestic court, which is in line with the broad discretion the ILC Articles offer with respect to compensation awards;[63] (c) permitting crippling compensation, with the 'pragmatic expectation' that a tribunal will account for a respondent State's circumstances in a way that would not result in such an award; and (d) placing the issue of compensation within the broader framework of responsibility,

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[60] UNCTAD (n 6) 2; UNHCR above (n 5);
[61] Paparinskis (n 9) 303.
[62] ILC 'Third report on State responsibility, by Mr. James Crawford, Special Rapporteur' (2000) vol II pt 1 Yearbook UN Doc A/CN.4/SER.A/1995/Add.1, paras 7 and 42; James Crawford and Freya Baetens, 'The ILC Articles on State Responsibility: More than a 'Plank in a Shipwreck'?' (2022) 37(1-2) ICSID Review 13, 13-19; Martins Paparinskis, 'Circumstances Precluding Wrongfulness in International Investment Law' (2016) 31(2) ICSID Review 484;
[63] Paparinskis (n 9).

instead of the specific circumstances of each matter dealing with applicable law, causality, and valuation. In assessing the usefulness of each approach, he argues that, except for 'particularly creative paths' the ILC Articles 'as understood and applied by mainstream practice, do not provide obvious and straightforward answers for how to deal with crippling compensation claims'.[64] Instead, he advocates for a shift in customary law to recognise an exception to the full reparation standard beyond the ILC Articles which 'tweaks the general principle of full reparation away from its exclusive focus on interests of the injured (non-State) actor' to account for the interests of all actors in the arbitration space.[65] While this approach would be effective in the long-term, custom is developed over a long period of time, making it unsuitable as a short-term or immediate response to the issues. Customary norms are very influential but change is incremental and establishing that a shift in custom has occurred is difficult.[66]

3.1.2 Changes to investment treaties

Other approaches look to the wording of investment treaties to resolve existing conflicts.[67] While many current investment treaties provide 'few exceptions or safeguards' for climate change regulation, new generation investment treaties can deal

[64] Paparinskis (n 9) 306.
[65] ibid.
[66] Bodansky, Brunnée Rajamani (n 12).
[67] See Henckels (n 14).

with these issues in more proactive ways, including by introducing substantive provisions, carve-outs, exceptions, or compliance and implementation procedures.[68] It may also be possible to amend current treaties to introduce climate change carve-outs or require climate and environmental measures to be considered in investment disputes.[69] This would allow States to insert provisions into existing treaties to exempt certain regulation from investment arbitration, or to require tribunals to apply environmental law principles in evaluating certain types of regulation.[70] Broad climate carve-outs using vague language can insure against becoming obsolete as new international climate law obligations come into force in the future.[71] All of these approaches will help to safeguard future climate action taken by States in accordance with international climate law obligations, but are limited in terms of how practical amending treaties is in the immediate future, when such protections are needed to allow States to regulate. These approaches are also limited in that, while they may have a normative impact, they seek to deal with

[68] UNCTAD (n 6).
[69] Paine and Sheargold (n 14) 285–304; Joshua Paine and Elizabeth Sheargold 2024, 'Carving-out climate action from investor–State dispute settlement (ISDS): Suggested treaty language and commentary' (23 February 2024) OECD Doc DAF/INV/TR1/RD(2024)1; Andrew D Mitchell and James Munro, 'An International Law Principle of Non-Regression From Environmental Protections' (2023) 72 International & Comparative Law Quarterly 35.
[70] Paine and Sheargold (n 14); Paine and Sheargold (n 69).
[71] Joaquin Terceño, Ewa Kondracka and Tobias McKinnon, 'Investment Treaties and Environmental Protection - Treaty Provisions, Systemic Integration and State Practice' (2023) 1 TDM; Viñuales, (n 7). For more discussion on these types of reform options see Tienhaara and Cotula (n 43).

climate law issues as they apply to specific investment relationships, and do not solve the broader conflict at hand between the full reparation standard and climate law obligations.

Ideally, States could enact a binding and enforceable climate treaty with special conditions on compensation with specific derogations from the full reparation standard in the terms of that treaty. According to Article 30 of the Vienna Convention, as the treaty later in time this would serve to displace the ILC Articles to the extent that they are in conflict with the new treaty.[72] This ideal option suffers the same temporal and practical limits as the other treaty-based reform options, but nonetheless would be an effective, long-term solution to conflicts between climate obligations and any other field of international law.

3.1.3 Reform within the investment arbitration space

Other approaches seek to reconcile conflicts at the dispute stage. One such approach suggests that, in cases that implicate environmental interests, tribunals should be bound by fairness and disclosure requirements, which would require them to disclose environmental impacts of awards, as well as confirm that settlements and awards do not breach domestic or international law.[73] The difficulty with predicting the

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[72] *Vienna Convention* (n 18) art 30 para 3. See also James Crawford, *The International Law Commission's Articles On State Responsibility: Introduction, Text And Commentaries* (CUP 2002) Commentary to art 55 para 2.

[73] MacLachlan (n 11).

environmental impacts of awards/settlements is a barrier here, as is the fact that investment law is a distinct field of international law, not governed nor bound by domestic law.

Other approaches are more specific. Khachvani argues for a 'changed circumstances test' which would characterise climate change regulation by a State as an inherent aspect of business risk to be absorbed by foreign investors.[74] This approach would make climate change regulations non-compensable, unless the measures were also arbitrary, discriminatory or an abuse of due process, as in other cases of expropriation.[75] This would allow States to 'redefine the permissible scope of the exercise of property rights in light of new or newly discovered circumstances' without the risk of compensation awards.[76] In the context of the energy transition, Hailes argues for a limit on compensation for future profits with respect to fossil fuel assets by reference to the principle against unjust enrichment.[77] Boute advocates for a similarly targeted approach; for tribunals to 'reduce, and even fully neutralize, the damages due' by adopting lower forecasts for oil prices and production in calculating awards for damages in fossil fuel disputes.[78] Fermeglia suggests

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[74] David Khachvani, 'Non-Compensable Regulation versus Regulatory Expropriation: Are Climate Change Regulations Compensable?' (2020) 35 ICSID Review 154, 165-66.
[75] ibid 172.
[76] ibid.
[77] Hailes (n 24).
[78] Anatole Boute, 'Investor compensation for oil and gas phase out decisions: aligning valuation methods to decarbonization' (2023) 23(9) Climate Policy 1087, 1089.

a ‘broader, holistic approach based on proportionality and equity’ in cases dealing with renewable energy assets, which would limit compensation for a loss of profits.[79] Without assessing each option in its entirety, a key drawback that applies to each of these is the fact that in practice tribunals are very unlikely to reject the full reparation standard as it is set out in the ILC Articles. As was shown in the previous section, the standard has become common practice, and if a tribunal applies the ILC Articles, the full reparation standard is the default standard of compensation. Circumventing the ILC Articles is a significant barrier to tribunals accepting these methods of limiting compensation in investment proceedings, and an approach that would limit or deny compensation without reference to the Articles would be difficult to argue. The problem in identifying a relevant, applicable and acceptable exception to the full reparation standard to resolve conflicts with international climate law obligations lies in the unshakeable application of the ILC Articles in arbitral practice, as well as the practical and temporal constraints of seeking to change custom or amend the vast network of investment treaties.

4 Article 55 exception to the full reparation standard

This paper has thus far highlighted some of the issues associated with applying the full reparation standard and critically

[79] Fermeglia (n 7).

evaluated some approaches which might resolve the conflict between investor protections under international investment law and international climate law obligations. I now offer an alternative method for limiting the application of the full reparation standard in investment disputes over climate change regulations, which stems directly from the ILC Articles themselves. This exception would allow for States to immediately take steps to regulate with respect to climate change.

The novel exception I put forward is that there are special rules under international climate law which displace the application of the ILC Articles with respect to the *implementation* of legal consequences (the mandatory application of the full reparation standard) where an internationally wrongful act has been committed.[80] In making these claims, first, I explore the nature of the exception under Article 55, what constitutes a 'special rule', and the extent to which it is applicable to the full reparation standard. Then I outline how international climate obligations under the Paris Agreement can be characterised as *lex specialis* for the purposes of the exception. The proposed exception does not purport to derogate from the residual application of the ILC Articles in their entirety; only with respect to the full reparation standard.[81]

[80] Crawford (n 72) Commentary to art 55 para 2.
[81] ibid para 3.

Finally, I apply the exception to a recent arbitral case to demonstrate the applicability and appropriateness of this exception in resolving the conflict between the investment law and climate law with respect to the full reparation standard.

4.1 *The scope of* lex specialis *under Article 55*

It is a core aspect of sovereignty that States be able to complement international obligations with specific rules.[82] Generally, the aim of the maxim *lex specialis derogat legi generalis* is to establish cohesion between conflicting obligations, by either elaborating on the specific application of a general rule, or by modifying, overruling or setting aside a general rule.[83] Establishing the meaning of the maxim in international law is a difficult exercise, as there are different conceptions of it in various fields of public international law.[84] According to the International Law Commission, it is:

> *a generally accepted technique of interpretation and conflict resolution in international law. It suggests that whenever two or more norms deal with the same subject matter, priority should be given to the norm that is more*

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[82] Bruno Simma and Dirk Pulkowski, 'Of Planets and the Universe: Self-contained Regimes in International Law' (2006) 17 European Journal of International Law 483, 486.
[83] ibid 485; Martti Koskenniemi, 'Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law – Report of the Study Group of the International Law Commission' (2006) UN Doc A/CN.4/L.682/Add.1.
[84] Ulf Linderfalk, 'Neither Fish, Nor Fowl: A New Way to a Fuller Understanding of the *lex specialis* Principle' (2023) 25 International Community Law Review 426, 430.

> *specific. The principle may be applicable in several contexts: between provisions within a single treaty, between provisions within two of more treaties, between a treaty and a non-treaty standard, as well as between two non-treaty standards. The source of the norm (whether treaty, custom or general principle of law) is not decisive for the determination of the more specific standard. However, in practice treaties often act as lex specialis by reference to the relevant customary law and general principles.*[85]

Taking into account these various characterisations of the maxim, for the conflict at hand it is important to refer to the more precise definition of the *lex specialis* exception in the ILC Articles. Article 55 states that:

> *These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the* ***content or implementation of*** *the international responsibility of a State are governed by special rules of international law.*[86]

Under this definition, the *lex specialis* exception is two-fold; it can either replace the *conditions* for the existence of an internationally wrongful act, or the *content or implementation* of

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[85] Koskenniemi (n 83).
[86] ICL Articles art 55, emphasis added.

State responsibility once an internationally wrongful act has been found under the general rules. The former conception is known as 'strong' *lex specialis*, also referred to as a 'self-contained regime'.[87] The latter is a 'weak' form, which would only derogate from the general rule under specific conditions, and does not seek to extinguish or replace the other general law applicable under an investment treaty and customary international law.[88] This latter form is the exception I argue for; to derogate from the full reparation standard in disputes over climate change regulation. In this case, the special rule must be of at least the same legal rank as the Articles, and the effect of an exception cannot result in a breach of primary international law.[89]

The task is to recognise where and to what extent provisions of the ILC Articles are in conflict with special rules of international law, and to apply those special rules in the circumstances. Where the exception has been successfully argued in an investment dispute by a respondent State under

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[87] Crawford (n 72) Commentary art 55 para 5. There is much more discussion about the nature and scope of a 'self-contained regime' in case law and literature, all of which is beyond the scope of the present argument. See Simma, Bruno, and Dirk Pulkowski, 'Leges Speciales and Self-Contained Regimes', and Douglas, Zachary, 'Other Specific Regimes of Responsibility: Investment Treaty Arbitration and ICSID', both in James Crawford and others (eds), *The Law of International Responsibility* (OUP 2010); Jürgen Kurtz, 'The Paradoxical Treatment of the ILC Articles on State Responsibility in Investor-State Arbitration' (2010) 25(1) ICSID Review 200; Carlo de Stefano *Attribution in International Law and Arbitration* (OUP 2020).
[88] Koskenniemi (n 83) 178 para 9;
[89] Crawford (n 72) Commentary to art 55 para 2.

Article 55, as in *UPS v Canada*, the relevant 'special rules' were those contained within the applicable treaty, and not supplanted from another applicable field of law.[90] In that case, the tribunal recalled the 'residual character' of the ILC Articles in finding that provisions of the treaty effectively displaced provisions of the ILC Articles.[91] There was a high threshold for finding that the exception in Article 55 was triggered, with the tribunal finding that 'careful construction of distinctions' and the 'precise placing of limits on investor arbitration' were well established in the wording of the treaty.[92] Along with this analogous example, the Commentary to the ILC Articles gives other examples of other types of special rules that would displace the application of the ILC Articles. These include the *WTO Understanding on Rules and Procedures governing the Settlement of Disputes* with respect to compensation in a trade law context,[93] and article 41 of Protocol No. 11 to the *European Convention on Human Rights*, which allows for 'just satisfaction' instead of 'full reparation' in a human rights context.[94]

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[90] *United Parcel Service of America, Inc. (UPS) v Government of Canada* ICSID Case No UNCT/02/1 (Award, 24 May 2007). See also *Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Serbia and Montenegro)*, Judgment, 26 February 2007, para 408, ICJ Reports 2007, 43, 201 for discussion on the *lex specialis* exception in a non-investment setting. See also de Stefano (n 87) for more discussion on *lex specialis* in investment law disputes.
[91] ibid para 63.
[92] ibid para 60.
[93] *Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2* (DSU Rules) (signed 15 April 1994, entered into force 1 January 1995) 33 ILM 1226, annex 2, art 3 para 7.
[94] Protocol 11 to the European Convention for the Protection of Human Rights and Fundamental Freedoms, Restructuring the Control Machinery

However, an exception will not be found in all cases. As discussed in the Commentary to the ILC Articles, the European Court of Human Rights found in *Neumeister* that 'there must be some actual inconsistency' or 'a discernible intention that one provision is to exclude the other', and that an exception will not be found where it would be incompatible with the 'aim and object' of the applicable treaty.[95] In such cases, a special rule will not displace the general rule, but may be taken into account in applying the general rule.[96]

While these examples do not foresee the exact exception argued for in this paper, they show that it was anticipated in the Commentary to Article 55 that the *lex specialis* exception could be applied to questions of compensation. The Article 55 exception has also been successfully applied in an investment dispute, with general rules (albeit not on compensation) being displaced by special rules of a treaty. It is therefore possible that an exception to the full reparation standard pursuant to 'special rules' from another field of law that are in conflict with the standard will be accepted in an investment arbitration context. The next step then, is to identify what these 'special rules' are under international climate law, how they are in conflict with the

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Established Thereby, ETS 155, 11 May 1994, <https://www.refworld.org/legal/agreements/coe/1994/en/25780> accessed 13 May 2024, art 41.

[95] Crawford (n 72) Commentary to art 55 para 2.

[96] ibid.

full reparation standard, and the extent to which they displace the standard.

4.2 Special rules of international climate law

There is a general agreement across international law that one of the fundamental aspects of international climate law is the duty of States to prevent, reduce and control risks associated with climate change within their capabilities, which includes decisions about foreign investment activities.[97] Unfortunately, the customary law status of the full reparation standard demands that any exception should demonstrate clear intent to derogate from the standard, as dispensing with 'an important principle of customary international law' will not be done 'in the absence of any words making clear an intention to do so'.[98] In the absence of a clearly worded treaty provision as in *UPS v Canada*, special rules must be determined by reference to obligations clearly set out in international climate law. I argue that these rules are found in the Paris Agreement, supported by the underlying UNFCCC and an international consensus on specific obligations of States

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[97] Christoph Schwarte and Will Frank, 'The International Law Association's Legal Principles on Climate Change and Climate Liability Under Public International Law' (2014) 4 Climate Law 201, 205; UNESCO, 'Annex III Declaration of Ethical Principles in relation to Climate Change', *Records of the General Conference, Volume 1 Resolutions* (October 2017) 39 C/22 REV, 219; *Case Concerning the Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)* [1997] ICJ Rep 3, 41 paras 53 and 78; *Case Concerning Pulp Mills on the River Uruguay (Argentina v. Uruguay)* [2010] ICJ Rep 14, 38 para 101; UNHRSP, 'Information Note on Climate Change and the Guiding Principles on Business and Human Rights' (June 2023) < https://www.ohchr.org/sites/default/files/documents/issues/business/workinggroupbusiness/Information-Note-Climate-Change-and-UNGPs.pdf> accessed 2 May 2024;.

[98] *Elettronica Sicula SpA (ELSI) (USA v Italy)* [1989] ICJ Rep 15, 42, para 50.

to address climate change through mitigation actions, and the prevention and reduction of risk and harm caused by climate change.[99]

Firstly, it is important to recognise that international climate law is a form of *jus cogens*,[100] as the core norms of international climate law form part of general international law and are an aspect of emerging customary international law.[101] For this reason international climate law is of the same 'legal rank' as the ILC Articles, forming part of the general public international law regime, a necessary pre-condition for the application of the Article 55 exception.[102]

Another condition is that the special rule must be more specific than the general rule that it displaces.[103] This is a difficult hurdle. Thorp argues that five principles of international climate law under the UNFCCC constitute *lex specialis*: equity, solidarity, precaution, sustainability and good neighbourliness.

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[99] UNFCCC (n 1) art 4(1)(f); Teresa Thorp, 'Climate Justice: A Constitutional Approach to Unify the Lex Specialis Principles of International Climate Law (2012) 8 Utrecht Law Review 7, 16.
[100] Agnes Chong, 'The Positive Obligation to Prevent Climate Harm Under the Law of State Responsibility' (2022) 34 Georgetown Environmental Law Review 275; Roda Verheyen, *Climate Change Damage and International Law: Prevention Duties and State Responsibility* (Brill Nijhoff; 2005).
[101] European Parliament, *Normative Status of Climate Change Obligations under International Law* (June 2023) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2023)749395> accessed 2 May 2024; Medes Malaihollo, 'Due Diligence in International Environmental Law and International Human Rights Law: A Comparative Legal Study of the Nationally Determined Contributions under the Paris Agreement and Positive Obligations under the European Convention on Human Rights' (2021) 68 Netherlands International Law Review 121.
[102] Crawford (n 72) Commentary art 55 para 2.
[103] Koskenniemi (n 83).

She outlines a 'universal approach by which to reach a constitutional consensus on unifying the *lex specialis* principles of international climate law'. [104] This approach lacks the specificity required for an Article 55 exception.

At first, the specificity condition seems to be a barrier in finding special rules in the Paris Agreement, too. One of the fundamental goals and objectives of the Paris Agreement is to 'strengthen the global response to the threat of climate change'.[105] Parties to the Agreement are bound to meet the goals and objectives of the Agreement in good faith,[106] but, as the Agreement is a framework treaty, it does not specify the 'means and methods' for achieving these goals and objectives.[107] However, Article 2 of the Agreement does set out the following, non-exhaustive methods:

> *(a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;*

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[104] Thorp (n 99); Malaihollo (n 101).
[105] Paris Agreement (n 2) art 2(1).
[106] *Vienna Convention* (n 18) art 26.
[107] Rowena Cantley-Smith, 'Article 1 Scope of Obligations: Terms and Definitions' in Geert Van Calster and Leonie Reins (eds) *The Paris Agreement on Climate Change* (Edward Elgar Publishing 2021); Paris Agreement (n 2) art 2(a).

(b) Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production; and

(c) Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.[108]

Further, the Paris Agreement is the result of the culmination of protracted global negotiations, was developed for the specific purpose of combatting climate change, and 'represents the joined understanding of all nations into a common cause to undertake ambitious efforts to mitigate climate change, as well as to adapt to its effects globally'.[109] The obligations contained in the Agreement are governed by the principle of Common but Differentiated Responsibilities and Reflective Capabilities found under multiple other international climate law instruments, and include the obligation to develop Nationally Determined Contributions (NDCs).[110] I argue that

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[108] Paris Agreement (n 2) art 2(1).
[109] Geert Van Calster and Leonie Reins, 'Introduction – The Paris Agreement on Climate Change', in Geert Van Calster and Leonie Reins (eds), *The Paris Agreement on Climate Change* (Edward Elgar Publishing 2021) 2.
[110] UNFCCC (n 1) preamble, arts 3-4; Kyoto Protocol to the United Nations Framework Convention on Climate Change (adopted 11 December 1997, entered into force 16 February 2005) 2303 UNTS 162, art 10; Principle 12 of the Declaration of the United Nations Conference on the Human Environment (15 December 1972) (Stockholm Declaration) UN DOC A/RES/2994; Principles 6 and 7 of the Rio Declaration on Environment and Development (14 June 1992) UN Doc A/CONF.151/26, 31 ILM 874; Montreal Protocol on Substances that Deplete the Ozone Layer (16 September 1987) 26 ILM 1541, art 5.

when the provisions in Article 2 of the Paris Agreement (when made publicly manifest by the existence of an NDC) are reflected in the wording of a State regulation, the specificity condition is satisfied.

Critically, while NDCs themselves may not be binding, the act of making an NDC is itself a 'unilateral declaration[s]' that creates legal obligations, and failure to take steps to comply with such declarations may trigger a State's responsibility.[111] This trigger of responsibility is clarified by Mayer in the Commentary to the Paris Agreement:

> *Unilateral declarations have long been recognized as a source of international law. According to the Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations adopted by the International Law Commission in 2006, declarations can create legal obligations if they are publicly made and manifest the will to be bound. Such declarations can be formulated orally or in writing, but they must be 'stated in clear and specific terms'.*[112]

Therefore, if a State which is party to the Paris Agreement develops and publicly states its own specific targets for the direct purpose of meeting the objectives of the Paris Agreement,

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[111] Paris Agreement Commentary (n 109) Commentary to art 4; Chong (n 100).
[112] idid para 4.53.

particularly through the targeted methods set out in Article 2 of the Agreement, they can be held responsible for failing to comply with those obligations. This effectively creates an obligation and special rules under international climate law for States to follow through on unilateral declarations made pursuant to Article 2 of the Paris Agreement.

It logically follows that where a State takes an action to comply with international climate law obligations in this way, if that action also breaches an investment treaty, the special rules of climate law are in conflict with investment protection. A State was obliged to take adequate steps towards achieving the climate targets it set, while being simultaneously bound to uphold the relevant investor's rights under the investment treaty.

It is important to stress the nature of the 'weak' *lex specialis* exception here, as the special rules do not displace obligations set out in an investment treaty. Instead, the exception applies only to the question of compensation, where it can be shown that the State action was in compliance with the special rules of international climate law. Why does the exception apply to compensation? It is not only appropriate that the exception apply to compensation as was anticipated by the ILC (see the above examples in trade law and human rights), but it is also necessary to allow for investors to receive reparation for their losses without holding a State to the full reparation standard

where special rules required it to take such measures. Hailes argues that:

> *a host State's implementation of the Paris Agreement should be considered in any tribunal's interpretation of the obligation to make full reparation of financially assessable damage or otherwise to pay compensation under a treaty provision.*[113]

The exception I argue for does not just allow, but actually requires a tribunal to consider the special rules of climate law and to displace the full reparation standard to the extent that the action of the State was required by those rules.

4.3 *Applying the exception: case study* – Rockhopper v Italy

To demonstrate the added-value of the novel exception, it is necessary to show how it can be practically applied. *Rockhopper* is a good example of how a climate-friendly regulation banning offshore oil and gas production can lead to a multi-million dollar dispute between a host State and foreign investor and negative impacts for climate regulation.

4.3.1 The facts

The dispute centred around a 2015 law which banned offshore oil and gas production within a certain distance of Italian shores. The investor had intended to drill for, and then extract liquid and gas hydrocarbons from a shallow water area off the Italian coast

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[113] Hailes (n 24) 368.

called Ombrina Mare. This was a two-stage process, requiring first an exploration permit and then a production permit. The investor had exercised their rights to an exploration permit and in January 2016 Italy rejected the investor's application for a production permit. Ombrina Mare oil and gas field did not proceed to production. The tribunal held that that the Claimants the right to be granted a production concession, and that the Italian Government had unlawfully expropriated that right by enacting the ban.[114]

Significantly, the tribunal discussed the precautionary principle, arguably a core principle of international climate change law, but found that the concept did not have 'a determinative role' in the facts of the matter. The Tribunal stated:

> *Thus, a government or municipal authority, when invoking the precautionary principle must have a particular concern in mind. However, if that particular concern is then investigated and the government or authority decides that it is not as worrying as originally feared, then the action or plan stayed by the precautionary principle can go ahead. Such a government cannot, having satisfactorily investigated the matter, then decide to continue the operation of the*

[114] *Rockhopper v Italy* (n 17) paras 8 and 191.

> *precautionary principle on a new ground. This would, colloquially speaking,* ***move the goalposts****.*[115] (emphasis added)

It is significant that the relevant authorities had considered environmental concerns, but did not reject the permit on the basis of environmental or climate law. The tribunal went on award full compensation in the amount of EUR 240 million for the expropriation, pursuant to ILC Articles and *Chorzów*.[116] Despite the fact that a ban on oil and gas drilling is of a nature 'likely to be expected' in the process of domestic government responses to climate change, this did not impact on the application of the full reparation standard.[117]

4.3.2 The exception

Let us now consider an alternate approach. First, a disclaimer: it is factually relevant that the Paris Agreement was not ratified under EU law at the time of the contravening measure, but for the purposes of applying the novel exception it will be assumed that the Agreement was ratified, and that the NDCs of the EU (including Italy) were made public.

The Italian Government in these hypothetical circumstances, instead of denying the permit by enacting a ban, could have rejected the permit on grounds that approving it

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[115] ibid para 153.
[116] ibid.
[117] Alessandra Arcuri, 'On how the ECT fuels the fossil fuel economy: *Rockhopper v Italy* as a case study' (2023) 7 Europe and the World: A Law Review 3.

would breach its obligations under the ‘special rules’ pursuant Article 2 of the Paris Agreement, triggered by the public declaration in the form of the NDCs. While this would not impact the finding that the Italian Government had breached the standard of protection owed to the foreign investor, it would have required the tribunal to acknowledge that there was conflict between the investment treaty protections and the special rules. This could then displace the full reparation standard insofar as the damage caused by the rejected permit application was required by those special rules. It would fall to the Italy Government in that case to argue that, to the extent that it was taking steps to comply with the special rules, the exception in Article 55 was triggered. This would also allow a certain level of discretion for the tribunal the amount of compensation owed in the absence of the full reparation standard.

The purpose of this exception is not to take away the rights owed to foreign investors under investment treaties, nor is it to ask tribunals to balance those rights with international climate law ambitions. The purpose of the exception is to provide a mechanism for resolving conflicts faced by States that lead to negative outcomes like excessive compensation and regulatory chill in the overlap of investment law and climate law. There needs to be an appropriate way to resolve these conflicts in the immediate future while we await more comprehensive long-term reforms.

5 Conclusion

The integration of State duties with respect to foreign investment protection and climate change mitigation is complex. This paper has explored the conflicts between international investment law and international climate law in the investment arbitration context of applying the full reparation standard with respect to compensation. It is acknowledged that while the exception under Article 55 does not 'move the goalposts', it is – to borrow another colloquial phrase – a long bow to draw. However, given the way that tribunals consistently apply the full reparation standard as set out in the ILC Articles and *Chorzów*, it is particularly useful in investment arbitration. The exception can guide State regulation immediately, and may start to resolve some of the serious issues around crippling compensation and regulatory chill, as long as the criteria above are met. Application of the Article 55 exception has the capacity to address the issue of increasing compensation awards in the short term, and is not a long-term solution to the many issues identified with the investment arbitration system. It may be applied in conjunction with other approaches to limiting compensation as discussed in this paper, and has the potential to help States meet their international climate law targets by enacting climate change policy without the threat of significant compensation awards. The novel exception, being grounded in the ILC Articles, may inspire greater support and application of the exception in

practice than other methods of resolving the conflicts between investment protections and climate regulation to achieve a more harmonious application of both fields of law, which is, after all, the aim.