



CENTER for INTERNATIONAL
ENVIRONMENTAL LAW

International Investment Law and ISDS: Overcoming Legal Barriers to Effective Climate Action under the UNFCCC and the Paris Agreement

Introduction

Investment law protections for foreign investment — particularly through Investor-State Dispute Settlement (ISDS) mechanisms — present a major legal barrier to achieving climate obligations. Many investment agreements allow foreign investors to sue governments through ISDS provisions if policy measures, such as climate regulations, negatively impact their investments. Such claims and the mere threat of them have stymied necessary measures to phase out fossil fuels — the primary driver of climate change — as governments face the prospect of having to pay polluters¹ for undertaking climate action consistent with their international duties rather than making polluters pay.

Paying Polluters Cannot Be the Price for the Implementation of Climate Obligations

In the face of a clear political and scientific consensus on the causes of climate change and its grave consequences for human rights, States have a legal duty under international law to act to prevent and mitigate further foreseeable harm. Doing so requires curbing the drivers of climate change, chief among them the production and use of fossil fuels.

However, the fossil fuel industry has been the most dominant user of ISDS,² with at least 231 known treaty-based ISDS claims involving fossil fuel investments. Faced with the reality and the threat of arbitration awards reaching hundreds of millions or even billions

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1. David R. Boyd (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*, A/78/168 (July 13, 2023), undocs.org/A/78/168.
 2. International Institute for Sustainable Development (IISD), *Investor-State Disputes in the Fossil Fuel Industry* (IISD: 2021), iii, <https://www.iisd.org/system/files/2022-01/investor%E2%80%93state-disputes-fossil-fuel-industry.pdf>.

of dollars (with the average award amounting to \$256 million between 2014 and 2023³) and high litigation costs, many governments have delayed or weakened climate policies. This “**chilling effect**” is well-documented.⁴

Several countries, including Denmark and New Zealand,⁵ have explicitly cited the existence or threat of investor suits under ISDS as the reason why they did not adopt more ambitious fossil fuel phaseout measures. Both the Intergovernmental Panel on Climate Change (IPCC)⁶ and UN Special Rapporteurs (e.g., SR on the environment;⁷ SR on climate change⁸) have highlighted the negative impact of ISDS on climate governance. Moreover, the ISDS system disproportionately affects the Global South, with the vast majority of fossil fuel and mining claims brought by investors from the Global North against these States.⁹ **This dynamic imposes severe financial burdens, particularly in countries that already face resource constraints, and reinforces patterns of extractivism and economic colonialism.**

Numerous cases have shown how investors use ISDS provisions to challenge measures that reduce emissions or transition to sustainable energy systems, such as *RWE or Uniper v. the Netherlands*, *AET v. Germany*, and *Westmoreland v. Canada* — which involved investor claims related to coal power phaseouts. Moreover, in the case of *Zeph v. Australia*, an Australian company used a Singaporean subsidiary to challenge the rejection of a mining lease based on climate impact. In *Rockhopper v. Italy*, a British exploration company was awarded damages of €184 million after the ban on offshore oil. **As a result, governments face a paradox: they are bound to fulfill their international climate obligations yet risk facing costly legal challenges for implementing the measures necessary to meet those obligations.**

3. UN Trade and Development (UNCTAD), *Compensation and Damages in Investor-State Dispute Settlement Proceedings* (UNCTAD, 2024), https://unctad.org/system/files/official-document/diaepcbinf2024d3_en.pdf.

4. Kyla Tienhaara, “Regulatory Chill and the Threat of Arbitration: A View from Political Science,” in *Evolution in Investment Treaty Law and Arbitration*, eds. Chester Brown and Kate Miles (Cambridge University Press, 2011), <https://ssrn.com/abstract=2065706>.

5. Elizabeth Meager, “COP26 Targets Pushed Back Under Threat of Being Sued,” *Capital Monitor*, January 14, 2022, <https://www.capitalmonitor.ai/analysis/cop26-ambitions-at-risk-from-energy-charter-treaty-lawsuits/>.

6. IPCC, *Climate Change 2022 Mitigation of Climate Change* (IPCC, 2022), https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf.

7. Boyd, *Paying Polluters*.

8. Special Rapporteur on the Promotion and Protection of Human Rights in the Context of Climate Change, *Promotion and Protection of Human Rights in the Context of Climate Change Mitigation, Loss and Damage and Participation*, A/77/226 (July 26, 2022), para. II.A.2(15), undocs.org/A/77/226.

9. UN Office of the United Nations High Commissioner for Human Rights (OHCHR), “Investor-State Dispute Settlements Have Catastrophic Consequences for the Environment and Human Rights: UN Expert,” press release, October 20, 2023, <https://www.ohchr.org/en/press-releases/2023/10/investor-state-dispute-settlements-have-catastrophic-consequences>.

Article 2.1(c) of the Paris Agreement: ISDS as a Fossil Fuel Subsidy and an Impediment to Aligning Finance Flows with Low GHG Pathways

Article 2.1(c) of the Paris Agreement underscores the need to align financial flows with climate objectives. This requires both public and private investments to contribute to the transition toward a low-greenhouse gas (GHG) economy and enhance resilience against climate impacts.¹⁰ However, investment treaties provide economic benefits to investments in GHG-intensive sectors, including fossil fuels.

This misalignment between investment protection frameworks, climate obligations, and finance objectives is problematic. The benefits offered by investment agreements to GHG-intensive industries hinder efforts to reduce emissions, exacerbating the challenge of meeting climate obligations and objectives. From the perspective of beneficiaries of investment treaties, investment treaty protection benefits appear as financial services, covering specific risks and offering compensation for losses. These treaties include mechanisms for binding decisions on investors' entitlement to compensation and award amounts, as well as enforcement of payments. Often compared to political risk insurance, these protections are available without cost to investors. Such mechanisms ultimately serve as a subsidy for fossil fuel industries, conflicting with the objectives of the Paris Agreement. Eliminating or reducing the “free benefits” these treaties offer to fossil fuel investors is essential to realign financial flows with climate goals.

Fragmented and Insufficient Reforms

A study conducted by the Organisation for Economic Co-Operation and Development (OECD) in 2023 revealed that 78 percent of governments surveyed recognized the importance of aligning investment treaties with the climate finance goals of Article 2.1(c). However, little has been done.¹¹

Despite the growing recognition by governments and independent experts that investment agreements, particularly the ISDS mechanism, are **a barrier to effective climate action**, reforms have been fragmented and largely insufficient. Various international efforts, including those led by the United Nations Commission on International Trade Law (UNCITRAL), have focused on procedural reforms, such as

10. United Nations Framework Convention on Climate Change (UNFCCC), UNFCCC Standing Committee on Finance: 2018 Biennial Assessment and Overview of Climate Finance Flows; Technical Report (UNFCCC, 2018), 78, <https://unfccc.int/sites/default/files/resource/2018%20BA%20Technical%20Report%20Final%20Feb%202019.pdf>.

11. OECD, Future of Investment Treaties Track 1 — Investment Treaties and Climate Change: Note on Survey of Climate Policies for Investment Treaties (OECD, 2023), 3, [https://one.oecd.org/document/DAF/INV/TR1/WD\(2023\)2/en/pdf](https://one.oecd.org/document/DAF/INV/TR1/WD(2023)2/en/pdf).

improving transparency and addressing conflicts of interest among arbitrators.¹² However, these efforts fail to address the core and structural issue: the protection of GHG-intensive investments and the financial burden on States implementing climate policies.

The Energy Charter Treaty (ECT), which protects investments in the energy sector, including fossil fuels, has been a focal point for reform. However, these reform efforts have been insufficient, as noted by the French High Council on Climate,¹³ which concluded that even a modernized ECT remains fundamentally misaligned with climate goals. While the proposed ECT reform included a fossil fuel carve-out, it failed to address the timeline according to which necessary climate action must take place, including decarbonization of the energy sector and continued protections for incumbent investors. Recognizing this inherent tension, numerous Parties have withdrawn from the ECT, including the EU and the UK, which will take effect in early 2025.

The extensive network of overlapping bilateral and multilateral treaties with ISDS provisions, including treaties like the ECT, has created a complex and fragmented investment regime, highlighting the urgent need for coordinated reform. As shown in attempts to reform the ECT, meaningful changes require significant time and resources. Addressing these issues one treaty at a time — without substantive changes or global coordination — will remain inadequate to ensure States can comply with the Paris Agreement and their other international obligations to protect human rights and the environment from climate change. **States need a coordinated response. A unified global approach is essential to create an investment framework that supports, rather than hinders, climate action.**

What Can States Do Within the UNFCCC Process and Under Their National Climate Policies to Tackle This Challenge?

Without coordinated and comprehensive reform, the chilling effect of ISDS will continue to deter States from implementing necessary climate measures, undermining the objectives of the Paris Agreement and delaying the transition to a low-GHG, fossil-free economy. Failing to address ISDS will only perpetuate the legal and financial barriers preventing the meaningful implementation of climate obligations.

12. Jane Kelsey and Kinda Mohamadieh, *Global and Regional Order: UNCITRAL Fiddles While Countries Burn* (Friedrich-Ebert-Stiftung, 2021), 1, <https://library.fes.de/pdf-files/bueros/genf/18297.pdf>.

13. French High Council on Climate, *Report on the Modernisation of the Energy Charter Treaty* (French High Council on Climate, 2022), 7, https://www.hautconseilclimat.fr/wp-content/uploads/2022/10/2022-10-19-TCE_HCC_EN.pdf.

COP29 is a pivotal opportunity for multilateral coordination.

- **A unified global response** is critical to ensure that the international investment legal frameworks are aligned with climate objectives and obligations and that States are empowered to **implement needed climate action without fear of legal repercussions**.
- To align investment frameworks with climate goals, political leaders need to **recognize ISDS as a significant barrier to effective climate policy** and make statements at the diplomatic level in multiple fora, including COP.
- Additionally, as States prepare to scale up their Nationally Determined Contributions (NDCs) and adopt more robust climate policies, **the risks posed by ISDS must be addressed in their NDCs**.
- Finally, States need to develop a plurilateral initiative to **coordinate ISDS withdrawal or carve-outs through a dedicated process** to mitigate the chilling effect of ISDS, empowering States to pursue climate commitments without the threat of having to pay polluters.

Addressing existing misalignments between climate obligations and international investment governance is critical to ensuring that investment treaties do not undermine global climate efforts.

To learn more about this topic, see CIEL's **ISDS Toolkit**.¹⁴

14. Center for International Environmental Law (CIEL), *Overcoming International Investment Agreements as a Barrier to Climate Action: A Toolkit to Safeguard Fossil Fuel Measures from Investment Treaty Claims* (CIEL, 2024), <https://www.ciel.org/wp-content/uploads/2024/02/Overcoming-International-Investment-Agreements-as-a-Barrier-to-Climate-Action.pdf>.

About CIEL

Founded in 1989, the Center for International Environmental Law (CIEL) uses the power of law to protect the environment, promote human rights, and ensure a just and sustainable society. CIEL is dedicated to advocacy in the global public interest through legal counsel, policy research, analysis, education, training, and capacity building.

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